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# Exploring the Boundaries of Compensation for Misleading Conduct: The Role of Restitution under the Australian Consumer Law

Elise Bant\* and Jeannie Marie Paterson†

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## Abstract

The *Australian Consumer Law* ('ACL') provides a comprehensive suite of remedial orders available in response to conduct contravening the statutory prohibitions on misleading conduct. However, the potential remedial awards are constrained by the language of the statute, which appears to have an overriding compensatory focus. This limitation presents a significant challenge to courts seeking to make meaningful reparation to victims of significant or intentionally misleading conduct in cases where their 'loss or damage', as commonly conceptualised, is either difficult to assess or wholly absent. This article explores compensatory and other orders for contraventions of the prohibition on misleading conduct in light of these boundaries. In particular, the analysis considers the broader characterisation taken by courts to the concept of 'loss or damage' under s 237 of the *ACL*, which has underpinned the award of orders akin to rescission and restitution. The article also examines the nature of and justifications for remedies awarded on a 'user principle' for misleading conduct.

## I Introduction

The variety of orders that may be made under the *Australian Consumer Law* ('ACL')<sup>1</sup> in favour of victims of misleading conduct in contravention of s 18 and its

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<sup>1</sup> *Competition and Consumer Act 2010* (Cth) sch 2 ('ACL'). Section 18 of the *ACL* replaced *Trade Practices Act 1974* (Cth) s 52 ('TPA').

analogues,<sup>2</sup> has seen the regime likened to a remedial ‘smorgasbord’,<sup>3</sup> offering courts a range of options that go well beyond what is commonly on offer at general law.<sup>4</sup> However, a constraining feature is the scope of the permitted orders, which must be designed to ‘compensate’,<sup>5</sup> ‘redress’,<sup>6</sup> or ‘prevent or reduce’<sup>7</sup> the plaintiff’s ‘loss or damage’<sup>8</sup> arising ‘because of’<sup>9</sup> the defendant’s misleading conduct.<sup>10</sup> This requirement to compensate, redress, or prevent or reduce loss presents a significant challenge to courts seeking to make meaningful reparation to victims of significant or intentionally misleading conduct in cases where their ‘loss or damage’, as commonly conceptualised, is either difficult to assess or wholly absent. Nor are these cases purely hypothetical or overwhelmingly rare: to the contrary, looking across the spectrum of doctrines responding to misleading conduct at common law, equity and under statute, the authorities are replete with examples.

For present purposes, two scenarios may suffice to illustrate the gaps exposed by the statutory remedial regime. In Scenario One, a plaintiff purchases a perfectly serviceable and cost-effective washing machine in reliance on the defendant’s false representation that it is made in Australia. The evidence is clear that the plaintiff needed a washing machine and, had he wanted to purchase an alternative that was genuinely made in Australia, it would have been more expensive. Although the plaintiff has not received what he wanted from the transaction, there is no direct pecuniary loss to be made good — the washing machine is worth what the plaintiff paid for it. There is also no opportunity cost — the alternative transactions closed off by the decision to purchase the washing machine in question were in fact more costly. In Scenario Two, a celebrity’s image is used to promote the defendant’s products without her consent, with the deliberate aim of creating the false impression that she has endorsed the goods.<sup>11</sup> The evidence is clear that the celebrity never

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<sup>2</sup> For examples of analogous provisions, see *Corporations Act 2001* (Cth) s 1041H; *Australian Securities and Investments Commission Act 2001* (Cth) s 12DA. The ACL remedial orders are also available for contraventions of the more specific prohibitions contained in ACL ss 29–37. For the purposes of the analysis in this article, we focus on the remedial provisions in the ACL ss 236 and 237/243. These provisions replace *TPA* ss 82 and 87 respectively. For all relevant purposes the provisions are equivalent and hence, unless the context requires otherwise, reference is only made to the ACL.

<sup>3</sup> *Akron Securities Ltd v Iliffe* (1997) 41 NSWLR 353, 366 (Mason P) (‘Akron’).

<sup>4</sup> These include the options of rewriting the contract, considered heretical at common law: see, eg, *Myddleton v Lord Kenyon* (1794) 30 ER 689, 698–9. But see *Vadasz v Pioneer Concrete (SA) Pty Ltd* for an example of the gravitational influence of the statutory options on the decision to order ‘partial rescission’ in equity of a contract induced by fraudulent misrepresentation: (1995) 184 CLR 102.

<sup>5</sup> ACL ss 237(2)(a), 238(2)(a).

<sup>6</sup> Ibid s 239(3)(a).

<sup>7</sup> Ibid ss 237(2)(b), 238(2)(b), 239(3)(b).

<sup>8</sup> Ibid ss 236–9.

<sup>9</sup> Ibid ss 237(2)(a), 237(1)(a), 238(2)(a). Note the different language in s 239(1)(b) (‘caused’) and s 239(3) (‘in relation to’).

<sup>10</sup> Discussed below in Part III.

<sup>11</sup> See, eg, *Wickham v Associated Pool Builders Pty Ltd* (1988) 12 IPR 567 (‘Tracey Wickham Case’); *10th Cantanae Pty Ltd v Shoshana Pty Ltd* (1987) 79 ALR 299, 319–23. See also Jeannie Paterson, Elise Bant and Gavin Rees, ‘They’re Using My Face: What Cosmetic Bloggers and the Cambridge Analytica Saga Tell Us about Protection from Misleading Conduct’ on The University of Melbourne, *Pursuit* (6 May 2018) <<https://pursuit.unimelb.edu.au/articles/they-re-using-my-face>>. Misleading conduct here often runs alongside claims of passing off. For a case of similar ‘false celebrity endorsement’ involving unauthorised use of music in breach of copyright in conjunction with a

would have agreed to license the use of her image to the defendant and she was not in the habit of making money from endorsements, but also that neither her reputation nor marketable ‘brand’ have been tainted by the misleading association. Again, although the celebrity is unhappy, there is no immediately apparent pecuniary loss. Her earning power has not been tarnished by the episode.

In both cases, we will see below that traditional analyses struggle to identify the nature and measure of any loss that may then become the subject of compensatory orders under the *ACL*. As we will also see, the plaintiffs might have success under the general law, but the disjuncture between statutory and general law claims undermines the role of the *ACL* in providing a relatively straightforward and comprehensive basis for relief in response to the prohibited conduct. Yet it seems clear that, unless appropriate orders are made, defendants will be able to employ with impunity patterns of misleading conduct as part of their business model, thereby confounding the twin purposes of the *ACL* to promote ‘fair trading and the provision of consumer protection’.<sup>12</sup> Although the regulator, the Australian Competition and Consumer Commission and the state and territory fair trading agencies, may seek pecuniary penalties against such defendants, its capacity to police and prosecute contravention of the prohibition is necessarily limited by its available resources.<sup>13</sup> An effective enforcement strategy needs to utilise the resources of both the regulator and private litigants.

It is against this background that this article seeks to explore the boundaries of compensatory and other orders for contraventions of the prohibition on misleading conduct under s 18 of the *ACL*. Contraventions of the prohibition may be addressed by private claims for damages under s 236 or wide-ranging ‘compensation orders’ under ss 237–9,<sup>14</sup> all of which respond to loss or damage suffered because of the defendant’s misleading conduct. As we will see, commonly the awards will address pecuniary loss, such as where the plaintiff paid too much for a product, or lost profits as a result of the defendant’s contravention. However, gain-based relief that is restitutionary in nature or effect has also long been available to redress loss or damage suffered because of misleading conduct, in particular pursuant to the suite of remedies listed in s 243 of the *ACL*.<sup>15</sup> This is so despite the apparent compensatory focus of the remedial regime.

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political campaign, see *Eight Mile Style LLC v New Zealand National Party* [2017] NZHC 2603 (25 October 2017) (‘*Eight Mile Style*’).

<sup>12</sup> *Competition and Consumer Act 2010* (Cth) s 2.

<sup>13</sup> See Commonwealth of Australia, *Resources and Guides* (2019), Australian Consumer Law <<http://consumerlaw.gov.au/business-and-the-acl/>>.

<sup>14</sup> Illustrations of the kinds of orders that courts may make under these powers are set out in *ACL* s 243, previously found in the *TPA* s 87(2).

<sup>15</sup> For present purposes, restitutionary orders may be distinguished from disgorgement awards. Restitution denotes an order requiring the defendant to ‘give back’ the objective or market value of some benefit obtained from the plaintiff. Disgorgement awards require a defendant to ‘give up’ a profit obtained as a result of the contravention, but which benefit has not necessarily come from the plaintiff’s assets or labour: see *Anderson v McPherson* (No 2) (2012) 8 ASTLR 321 (Edelman J); Justice James Edelman, James Varuhas and Simon Colton, *McGregor on Damages* (Sweet & Maxwell, 20<sup>th</sup> ed, 2018) ch 14. On whether disgorgement awards can or should be ordered under the *ACL*, see Elise Bant and Jeannie Marie Paterson, ‘Should Specifically Deterrent or Punitive Damages Be Made Available to Victims of Misleading Conduct under the *Australian Consumer Law*’ (2019) 25(2) *Torts Law Journal* 99.

Restitutionary remedies that have been awarded under the *ACL* include orders akin to equitable rescission<sup>16</sup> and orders for the refund of money or return of property. These enable courts to reverse transactions brought about as a result of the defendant's misleading conduct, even in cases (such as Scenario One) where the transaction is not financially disadvantageous to the plaintiff. A more contentious category of case involves the award of damages assessed by reference to the reasonable fee or royalty payable for the defendant's misleading use of the plaintiff's property without her consent. Damages assessed by reference to this so-called 'user principle' are commonly employed at common law, in equity and on occasion under the *ACL* in cases akin to Scenario Two. This article explores the boundaries in theory and in practice of a solely compensatory understanding of the statutory remedies, in light of the range of such orders made by courts in pursuit of the legislative direction to compensate, prevent or reduce loss or damage arising from misleading conduct.

Part II of the article outlines the approach preferred by most courts, and advocated here, to interpreting the ambit of the remedial provisions of the *ACL*. This Part briefly considers the differing conceptions of 'loss or damage' articulated in s 236, providing a right to compensatory damages for contraventions of s 18, in response to misleading conduct, as opposed to that found in s 259 responding to the consumer guarantee provisions. This analysis illustrates the ways in which the interpretive method employed by the courts operates to distinguish and restrict the two different remedial regimes. Ultimately, it favours a relatively confined meaning of loss or damage for the purposes of s 236 awards that focuses on 'actual' (rather than normative or theoretical) loss.

Parts III and IV consider the broader characterisation taken by courts to the concept of 'loss or damage' under s 237, which has underpinned the ready award of orders akin to rescission and restitution granted under the 'remedial smorgasbord'<sup>17</sup> offered by s 243. This sets the scene for the consideration, in Part V of the article, of the nature of and justifications for remedies awarded on a 'user principle' for misleading conduct. The article suggests that these orders are strongly restitutionary in nature, aligning most closely with the orders to rescind and refund. From this perspective, however, they occupy the outer fringes of even the most generous boundaries of compensation or other redress for 'loss or damage' recognised under s 237. In that context, the article concludes by reflecting briefly on the merits of statutory reform for two purposes: first, to provide express authority for courts' efforts to promote the instrumental aims of the *ACL* through restitutionary awards, including, for example, damages assessed by reference to a user principle; and second, to support coherence in the broader treatment of misleading conduct at common law, in equity and under statute.

In addressing these issues, the article draws on insights from cognate general law doctrines to the extent that they operate in a manner consistent with and supportive of the language and purpose of the *ACL*. For this purpose, the article seeks to locate the statutory remedies within their relevant legal context, which extends well beyond the familiar common law analogues of deceit and negligent

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<sup>16</sup> On the restitutionary nature of rescission, see below Part III.

<sup>17</sup> *Akron* (1997) 41 NSWLR 353, 366 (Mason P).

misstatement. As will be shown, equitable doctrines, the torts of passing off, defamation and injurious falsehood, as well as other statutory schemes concerned to, or apt to regulate misleading conduct, all offer useful guidance on the outer limits of compensatory and other relief responding to contraventions of the statutory prohibitions on misleading conduct in the *ACL*.

## II     The Interpretive Method: Damages for Misleading Conduct and under the Consumer Guarantees Regime Compared

In examining the conditions and justifications for the award of restitutionary relief under the *ACL*, this article proceeds on two bases. The first is that in interpreting the statutory remedies responding to misleading conduct under the *ACL*, general law '[a]nalogy ... is a servant not a master'.<sup>18</sup> Primacy must be given to the words and purpose of the statute. The second basis also accepts, however, that while general law analogies 'are not controlling ... they represent an accumulation of valuable insight and experience which may be useful in applying the Act'.<sup>19</sup> From these foundations, the starting point in applying the remedial regime must be the words and structure of the statute, interpreted in light of its purpose. Common law and equitable principles and doctrines may then properly be drawn upon where those principles and doctrines reflect and promote the aims of the statutory orders and are consistent with the statutory scheme as a whole. That is, while the Act must not be viewed as a mere codification of the general law, there may be a selective and tailored use of general law concepts, circumscribed to the extent that they reflect and promote the statutory language (including its arrangement or structure) and legislative purpose. The practical import of this approach can be readily illustrated through brief consideration of key remedial provisions of the *ACL* concerned with, respectively, misleading conduct (s 236) and the new consumer guarantee regime (s 259).

### A     *Damages under ACL s 236 for Contravention of the s 18 Prohibition on Misleading Conduct*

In entitling a plaintiff, as of right,<sup>20</sup> to monetary compensation for loss caused by misleading conduct, s 236 provides a central source of relief for plaintiffs seeking pecuniary orders under the *ACL*:

<sup>18</sup> *Marks v GIO Australia Holdings Ltd* (1998) 196 CLR 494, 529 [103] (Gummow J) ('Marks').

<sup>19</sup> *Henville v Walker* (2001) 206 CLR 459, 470 [18] (Gleeson CJ) ('Henville').

<sup>20</sup> Remedies (including compensation) that may be available at the discretion of the court under *ACL* ss 237, 243 and the different conceptions of 'loss or damage' (the subject of those sections) are addressed from Part III of this article onwards.

### 236 Actions for damages

(1) If:

- (a) a person (the *claimant*) suffers loss or damage because of the conduct of another person; and
- (b) the conduct contravened a provision of Chapter 2 or 3;

the claimant may recover the amount of the loss or damage by action against that other person, or against any person involved in the contravention.

The meaning of ‘loss or damage’ under s 236 is undefined in the *ACL*. This has presented courts with an immediate interpretative challenge in determining the scope and application of the phrase. In that context, the common law and equity offer rich sources of insight into the potential meanings of those statutory terms. Further, by utilising such general and familiar terminology, and by failing to provide a particularised definition, it may be presumed that Parliament intended courts to draw on relevant general law concepts for guidance.<sup>21</sup> However, the task is not an open-ended one, in which courts may pick at random from general law conceptions of loss or damage. Rather, ‘[t]he task is to select a measure of damages which conforms to the remedial purpose of the statute and to the justice and equity of the case.’<sup>22</sup> Notwithstanding general acceptance of this starting point, courts have at times vacillated over the relevant analogical source.<sup>23</sup> The following analysis demonstrates the value of adopting an interpretive method that draws on general law concepts only to the extent that that are consistent with and promote the particular statutory language and purpose.<sup>24</sup>

When thinking about potential forms of loss or damage, the laws of contract and tort provide alternative (albeit not exhaustive)<sup>25</sup> paradigms for the law’s response to misleading conduct. Both commonly provide remedies for misleading conduct: in contract where the misrepresentation is incorporated into the agreement, and in tort through a raft of claims including deceit, negligent misstatement, defamation, passing off and injurious falsehood. The task is to determine which of these general law doctrines best aligns with and promotes the statutory language and purpose of the remedial provisions of the *ACL*.

<sup>21</sup> *Wardley Australia Ltd v Western Australia* (1992) 175 CLR 514, 525 (Mason CJ, Dawson, Gaudron and McHugh JJ).

<sup>22</sup> *Henville* (2001) 206 CLR 459, 470 [18] (Gleeson CJ).

<sup>23</sup> See *Marks*, where the Court adopted a reliance-based measure, analogous to tort: (1998) 196 CLR 494. Cf *Murphy v Overton Investments Pty Ltd*, where the award for damages was akin to expectation measure, analogous to contract: (2004) 216 CLR 388.

<sup>24</sup> See also Elise Bant and Jeannie Paterson, ‘Statutory Interpretation and the Critical Role of Soft Law Guidelines in Developing a Coherent Law of Remedies in Australia’ in Ron Levy et al (eds), *New Directions for Law in Australia: Essays in Contemporary Law Reform* (ANU Press, 2017) 301.

<sup>25</sup> As Gummow J has observed, it is an error to think that ‘tort and contract compris[e] the universe of analogues offered by the general law in [TPA] s 52 cases’: *Elna Australia Pty Ltd v International Computers (Aust) Pty Ltd (No 2)* (1987) 16 FCR 410, 420–1. See also *GIO Australia Holdings Ltd v Marks* (1996) 70 FCR 559, 582–3 (Foster J). On the gain-based remedial analogues beyond rescission and restitution for misleading conduct, see Bant and Paterson, ‘Should Specifically Deterrent or Punitive Damages Be Made Available’, above n 15.



It is well understood in the law of contract that expectation damages are a form of normative, not factual, loss.<sup>26</sup> Expectation damages make sense in a context where the legal order demands that contracts must be performed.<sup>27</sup> Where a misleading contractual warranty (for example, as to profit) has been breached, a plaintiff's dashed expectation of gain caused by the proscribed conduct constitutes 'loss' because the plaintiff not only *expected* the profit, but was *entitled* to it.

By contrast, the language of s 18 of the *ACL* does not go so far. Section 18(1) requires that defendants should not engage in misleading or deceptive conduct, not that they should perform their promises or make true their representations. Without loss of profit to which the plaintiff was *entitled*, the only loss suffered in cases of misleading or deceptive conduct relating to profitability is distress or disappointment.<sup>28</sup>

## **B     *Damages under ACL s 259 for Failure to Comply with the Consumer Guarantees***

This response to the damages provision in s 236 can be contrasted with the remedial scheme under s 259<sup>29</sup> for failures to comply with the consumer guarantee provisions of the *ACL*.<sup>30</sup> The *ACL* follows the *TPA* in including a regime of minimum, non-excludable standards of quality that must be met by goods and services supplied to consumers. Unlike the *TPA*, however, the standards under the *ACL* apply as statutory rights, or 'consumer guarantees', rather than being embedded as implied terms in consumer contracts.<sup>31</sup> This shift in statutory design means that consumers cannot rely on the law of contract to provide a remedy in the event that goods or services supplied to them failed to comply with the consumer guarantees.<sup>32</sup> Accordingly, the *ACL* contains a remedial regime under s 259 that is specific to the consumer guarantees and different from that found in s 236.

Section 259 provides a primary right for consumers to seek a remedy for goods that fail to comply with the consumer guarantee regime, including

<sup>26</sup> L L Fuller and William R Perdue Jr, 'The Reliance Interest in Contract Damages: 1' (1936) 46(1) *Yale Law Journal* 52, 53.

<sup>27</sup> Justice Hayne discussed the nature of expectation damages in contract in *Clark v Macourt* (2013) 253 CLR 1, 7 [11]. See also *Marks* (1998) 196 CLR 494, 503 [16] (Gaudron J):

[O]nce it is appreciated that, for the purposes of the law of contract 'expectation' loss signifies the loss of a valuable right, namely, the contractual promise, it is irrelevant and quite misleading to ask whether, in the case of misleading and deceptive conduct under s 52 of the [*TPA*], ss 82 and 87 allow for 'expectation' loss or 'consequential' loss. It is irrelevant, because, if the misrepresentation is not contractual, there can be no loss of a contractual promise.

<sup>28</sup> On the limits on damages for personal injury, which has been interpreted to include disappointment and distress, see *ACL* pt 2-1.

<sup>29</sup> See Jeannie Marie Paterson, 'The Consumer Guarantee Remedial Regime: Some Uncertainties and the Role of Common Law Analogy' (2016) 33(3) *Journal of Contract Law* 210.

<sup>30</sup> *ACL* pt 3-2 div 1. See generally Jeannie Paterson and Kate Tokeley, 'Consumer Guarantees' in Justin Malbon and Luke Nottage (eds), *Consumer Law and Policy in Australia and New Zealand* (Federation Press, 2013) 97.

<sup>31</sup> Cf *Cameron v Ozy Tyres Pty Ltd* [2015] NSWCATCD 68 (30 June 2015) [31], where the consumer guarantees were characterised as statutory implied terms.

<sup>32</sup> Jeannie Marie Paterson, 'The New Consumer Guarantee Law and the Reasons for Replacing the Regime of Statutory Implied Terms in Consumer Transactions' (2011) 35(1) *Melbourne University Law Review* 252.

requirements for the supplier to replace, repair or refund defective goods. Of particular interest for current purposes, however, is s 259(4), which provides for consequential loss arising from a failure to comply with a consumer guarantee:

The consumer may, by action against the supplier, recover damages for any loss or damage suffered by the consumer because of the failure to comply with the guarantee if it was reasonably foreseeable that the consumer would suffer such loss or damage as a result of such a failure.

As for s 236, the language of ‘loss or damage’ is undefined. However, in this context it is clearly more appropriate to draw upon contractual analogy to give content to the protection arising from the statutory guarantees.<sup>33</sup> In contrast to the award of damages under s 236 for misleading conduct, the consumer guarantee provisions establish that the consumer is not merely protected from the consequences of misleading conduct, but, affirmatively, is entitled to goods that meet the mandatory standards of quality set out in the legislation. The primary remedies of replacement and repair are geared to fulfilling the consumer’s legitimate expectation of performance.<sup>34</sup> This echoes the contractual measure of relief. The trigger for the complementary award to damages is where goods *fail* to meet the mandated standard of quality. On this understanding, the remedial regime reflects that the consumer is entitled to the guaranteed quality of goods: the normative loss under the consumer guarantee provisions is the disappointed expectation. Consistently with this analysis, in *Barton v Transmissions and Diesels Ltd*<sup>35</sup> the District Court in Auckland (New Zealand) held that the general principle under remedial provisions of the *Consumer Guarantees Act 1993* (NZ), on which the consumer guarantee regime in the *ACL* was based,<sup>36</sup> is that the plaintiff should be placed, so far as money can do it, in the same position as if there had been compliance with the terms of the guarantee.

On this basis, it should be possible under s 259(4) to claim profits lost due to the deficient goods, provided that the loss was ‘reasonably foreseeable’.<sup>37</sup> Similarly, s 259(4) extends to damages to cover the costs of remedying a failure to comply with the consumer guarantees, a measure reminiscent of rectification damages that may be awarded in contract for the breach of an undertaking to repair or build. In both cases, as in contract, the provision protects consumers’ expectation interest, allowing them to obtain the outcome contracted for, or its closest equivalent in money, rather than merely an amount representing their actual, economic loss.<sup>38</sup>

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<sup>33</sup> Ibid.

<sup>34</sup> *ACL* ss 259(2), 261.

<sup>35</sup> [2001] DCR 412, 415 [7].

<sup>36</sup> See Explanatory Memorandum, Trade Practices Amendment (Australian Consumer Law) Bill (No 2) 2010 (Cth) [7.09].

<sup>37</sup> On this point, and notwithstanding the close analogy that the law of contract otherwise presents to the consumer guarantee remedial regime, the law of tort provides surer guidance on the statutory test: see Paterson, ‘The Consumer Guarantee Remedial Regime’, above n 29.

<sup>38</sup> *Tabcorp Holdings Ltd v Bowen Investments Pty Ltd* (2009) 236 CLR 272, 289 [18].

## C     *Conclusion on Measuring ACL s 236 Damages*

Consistent with the foregoing analysis, for the measure of loss or damage for misleading conduct under s 236, courts have generally refused to apply an expectation measure of damage by analogy with contract. Rather, the statutory measure is the extent to which a plaintiff is left ‘worse off’ by reference to the ‘actual’ loss suffered as a result of misleading conduct.<sup>39</sup> This sum is usually calculated in terms of ‘reliance loss’, by analogy with the tort of deceit<sup>40</sup> and negligent misstatement.<sup>41</sup> This tort-like measure is further supported by the language and structure of s 236, which directs courts to consider loss suffered *because of* (caused by) misleading or deceptive conduct.<sup>42</sup> This generally, but not always,<sup>43</sup> requires the examination of changes to the plaintiff’s position made *in reliance on* that conduct.<sup>44</sup> Reliance signifies causation in most contexts. Identifying loss flowing from, or caused by, acts of reliance is therefore a logical starting point for the statutory enquiry and generally will make the law of deceit and negligent misstatements more apt analogical sources than the law of contract.

This is not to say that a measure of damages equivalent to what would have been awarded for breach of contract cannot be awarded for contravention of the prohibition on misleading conduct. As Gaudron J explained in *Marks*, it may be that but for the misleading or deceptive conduct, a plaintiff would have entered into a contract that would have yielded the very benefit that was represented.<sup>45</sup> In this case, damages will be the same as if the representation had been contractual.<sup>46</sup>

If we return to the plaintiff in our opening Scenario One, who has purchased goods that do not meet the represented standard (in this case being made in Australia), under the Australian consumer protection regime he will have a choice of claim pathways. If the representation proves false, then the purchaser may pursue damages for misleading conduct. The normal measure of compensating reliance loss would suggest no loss, as there is no suggestion that the washing machine was overpriced. Alternatively, the consumer guarantee regime in the *ACL* renders a

<sup>39</sup> See *Gates v City Mutual Life Assurance Society Ltd* (1986) 160 CLR 1, 12 (Mason, Wilson and Dawson JJ); *Marks* (1998) 196 CLR 494, [54]–[56] 515–6 (McHugh, Hayne and Callinan JJ).

<sup>40</sup> See *Kizbeau Pty Ltd v W G & B Pty Ltd* (1995) 184 CLR 281, 291 (Brennan, Deane, Dawson, Gaudron and McHugh JJ); *Kenny & Good Pty Ltd v MGICA (1992) Ltd* (1999) 199 CLR 413, 460–1 [129] (Kirby and Callinan JJ).

<sup>41</sup> *Gates v City Mutual Life Assurance Society Ltd* (1986) 160 CLR 1, 11 (Mason, Wilson and Dawson JJ). The law of negligent misstatement has perhaps been under-utilised by courts to date: see Elise Bant and Jeannie Paterson, ‘Limitations on Defendant Liability for Misleading or Deceptive Conduct under Statute: Some Insights from Negligent Misstatement’ in Kit Barker, Ross Grantham and Warren Swain (eds), *The Law of Misstatements: 50 Years on from Hedley Byrne v Heller* (Hart Publishing, 2015) 159.

<sup>42</sup> *Brown v Jam Factory Pty Ltd* (1981) 35 ALR 79; *Henville* (2001) 206 CLR 459.

<sup>43</sup> On the issue of non-reliance damages, see *Janssen-Cilag Pty Ltd v Pfizer Pty Ltd* (1992) 37 FCR 526; *Caason Investments Pty Ltd v Cao* (2015) 236 FCR 322, 352 [155]; Elise Bant and Jeannie Marie Paterson, ‘Statutory Causation in Cases of Misleading Conduct: Lessons from and for the Common Law’ (2017) 24(1) *Torts Law Journal* 1.

<sup>44</sup> *Caffey v Leatt-Hayter (No 3)* [2013] WASC 348 (20 September 2013) [466]–[476] (Beech J).

<sup>45</sup> (1998) 196 CLR 494, 504.

<sup>46</sup> *Collings Construction Co Pty Ltd v Australian Competition and Consumer Commission* (1998) 43 NSWLR 13.

supplier liable for ‘express warranties’,<sup>47</sup> which include representations made to induce a plaintiff to purchase the goods. Here, the purchaser might claim damages for a failure to comply with the consumer guarantees under s 259(4), which we have seen includes a forward-looking expectation measure. This may lead to a claim for the additional cost of purchasing a washing machine that does meet the represented standard (in this case being made in Australia).

### III Rescission and the Remedial Smorgasbord: *ACL* ss 237–9

Turning to ss 237–9 of the *ACL*, these provisions arm courts with the discretion to make a wide range of creative orders to remedy misleading conduct.<sup>48</sup> Section 243 of the *ACL*, which replicates the earlier provision under s 87 of the *TPA*, provides a non-exhaustive list of the kinds of orders that may be made:

#### 243 Kinds of orders that may be made

Without limiting section 237(1), 238(1) or 239(1), the orders that a court may make under any of those sections against a person (the respondent) include all or any of the following:

- (a) an order declaring the whole or any part of a contract made between the respondent and a person (the injured person) who suffered, or is likely to suffer, the loss or damage referred to in that section, or of a collateral arrangement relating to such a contract:
  - (i) to be void; and
  - (ii) if the court thinks fit—to have been void ab initio or void at all times on and after such date as is specified in the order (which may be a date that is before the date on which the order is made);
- (b) an order:
  - (i) varying such a contract or arrangement in such manner as is specified in the order; and
  - (ii) if the court thinks fit—declaring the contract or arrangement to have had effect as so varied on and after such date as is specified in the order (which may be a date that is before the date on which the order is made);
- (c) an order refusing to enforce any or all of the provisions of such a contract or arrangement;
- (d) an order directing the respondent to refund money or return property to the injured person;
- (e) except if the order is to be made under section 239(1)—an order directing the respondent to pay the injured person the amount of the loss or damage;
- (f) an order directing the respondent, at his or her own expense, to repair, or provide parts for, goods that had been supplied by the respondent to the injured person;

<sup>47</sup> *ACL* s 59.

<sup>48</sup> *ACL* s 237 allows for claims by injured persons and the regulator on behalf of such persons. Section 238 allows for compensation orders arising out of other proceedings. Section 239 covers orders for non-party consumers.

- (g) an order directing the respondent, at his or her own expense, to supply specified services to the injured person;
- (h) an order, in relation to an instrument creating or transferring an interest in land, directing the respondent to execute an instrument that:
  - (i) varies, or has the effect of varying, the first mentioned instrument; or
  - (ii) terminates or otherwise affects, or has the effect of terminating or otherwise affecting, the operation or effect of the first mentioned instrument.

Section 237(2) of the *ACL* ('Compensation orders etc on application by an injured person or the regulator') provides that any order made under s 243 'must be an order that the court considers will: (a) compensate the injured person, or any such injured persons, in whole or in part for the loss or damage; or (b) prevent or reduce the loss or damage suffered, or likely to be suffered'.<sup>49</sup> The repetition of 'loss or damage' in both subsections might be taken to mean that the primary aim of the orders is compensatory, responding to pecuniary loss arising from misleading conduct. But this may be an unduly narrow understanding of loss or damage in the context of the legislation and hence the potential remedial compass of the provision. Indeed, on its face, and in light of the section heading, the very juxtaposition (through 'or') under s 237(2) of orders that '(a) compensate ... or (b) prevent or reduce' loss or damage, taken together with the extension of preventative remedies under s 237(2)(b) to loss or damage 'likely' to be suffered, suggests that the section as a whole is not restricted to orders with a solely compensatory effect. This reading of s 237(2) is further supported by the range of illustrative orders listed in s 243. Finally, if those orders are intended to ensure that meaningful redress is afforded to victims of misleading conduct, it is highly unlikely that the remedial purpose of s 237 can be restricted solely to compensatory awards.<sup>50</sup>

It is striking that from early days, the statute has been employed to grant rescission-like remedies, in particular pursuant to a combination of *ACL* ss 243(a), (c) and (d). This is so notwithstanding that equitable rescission operates to effect restitution and counter-restitution of benefits conferred pursuant to the impugned transaction. That is, the aim is to require the parties to give back (make restitution of)<sup>51</sup> benefits received from the other, rather than provide compensation as that concept is understood in the law of torts. The equitable orders consequent on rescission commonly include orders for restitution of the use-value of all benefits

<sup>49</sup> *ACL* ss 238–9 are to similar effect.

<sup>50</sup> See, eg, *Tenji v Henneberry & Associates Pty Ltd* (2000) 98 FCR 324, 333–4 [20] (French J) ('*Tenji*'): Rescission in equity transcends compensation. Avoidance under [*TPA*] s 87 must serve a compensatory purpose but may serve other purposes in doing justice between the parties. There are cases in which a party who enters a contract as a result of misleading or deceptive conduct may be compensated in a pecuniary sense by an award of monetary damages but is left nonetheless with a continuing burden of unforeseen risk, a transaction soured by the events that surrounded it and a property, once the repository of hope for the future that is now an albatross around its neck.

<sup>51</sup> Restitution in this sense is distinguished from disgorgement damages or the order following an account of profits, which require a defendant to give up defined benefits to the plaintiff, whether or not they were transferred from the plaintiff: see Edelman, Varuhas and Colton, above n 15. See also further discussion below in Part VA.

received by the parties under the impugned transaction, usually in the form of interest on the purchase price and a rate of reasonable market hire or rent for any transferred asset.<sup>52</sup> These orders cannot be regarded as compensatory in nature. This is demonstrated by the fact that, at general law, compensation cannot be sought cumulative upon rescission unless the plaintiff pleads and proves the independent tort that supports compensation as a remedy.<sup>53</sup> Further, it will be noted that none of the orders listed in s 243 adopt the language of rescission. Nor do they refer to other related concepts such as election, affirmation, counter-restitution or the requirement of *restitutio in integrum*.

Notwithstanding, the equitable remedy of rescission has long been considered to constitute a powerful, albeit not binding, guide to the relevant considerations that should inform the making of analogous orders under the provision. Thus in the seminal decision of *Henjo Investments Pty Ltd v Collins Marrickville Pty Ltd (No 1)*, Lockhart J noted that '[i]n granting a remedy under [ACL ss 237/243], the court is not restricted by the limitations under the general law of a party's right to rescind for breach of contract or misrepresentation'.<sup>54</sup> Nonetheless, it was appropriate and indeed necessary to consider in that case whether *restitutio in integrum* was possible in exercising the statutory discretion, as required for rescission at general law, given the plaintiff's long delay in pursuing relief and the irretrievably altered circumstances surrounding the transaction.<sup>55</sup> That same year, the Full Court of the Federal Court in *Munchies Management Pty Ltd v Belperio* drew on the leading High Court authority on equitable rescission, *Alati v Kruger*,<sup>56</sup> to explain why, on the facts of that case, considerations of *restitutio in integrum* constituted no bar to equivalent statutory relief stating 'equitable principles concerning rescission give safe, if not necessarily exclusive, guidance'.<sup>57</sup> To similar effect is Gummow J's observation in *Marks* that the provisions created 'new remedies which have an affinity to the equitable remedies of rescission and rectification',<sup>58</sup> however '[t]he principles regulating the administration of equitable remedies afford guidance for, but do not dictate, the exercise of the statutory discretion conferred by s 87 [ss 237/243]'.<sup>59</sup>

Courts have reconciled the restitutionary nature of orders of rescission made under ACL ss 237/243 with the statutory scheme through close analysis of the terms of those provisions, the structure of the remedial scheme and the protective purpose of the statute.<sup>60</sup> Courts have recognised that it would be possible to embrace an

<sup>52</sup> See, eg, *Brown v Smitt* (1924) 34 CLR 160; *Alati v Kruger* (1955) 94 CLR 216.

<sup>53</sup> *Sibley v Grosvenor* (1916) 21 CLR 469, 475 (Griffith CJ); *Redgrave v Hurd* (1881) 20 Ch D 1, 12 (Jessel MR), 26 (Lush LJ), discussed in Elise Bant, 'Rescission, Restitution and Compensation' in Simone Degeling and Jason N E Varuhas (eds), *Equitable Compensation and Disgorgement of Profit* (Hart Publishing, 2017) 277.

<sup>54</sup> *Henjo Investments Pty Ltd v Collins Marrickville Pty Ltd (No 1)* (1988) 39 FCR 546, 564.

<sup>55</sup> *Ibid.*

<sup>56</sup> (1955) 94 CLR 216.

<sup>57</sup> *Munchies Management Pty v Ltd v Belperio* (1988) 58 FCR 274, 288 ('*Munchies*').

<sup>58</sup> *Marks* (1998) 196 CLR 494, 535 [116]. See also *Tenji* (2000) 98 FCR 324, 329–30 [12] (French J).

<sup>59</sup> *Marks* (1998) 196 CLR 494, 535 [116] (Gummow J) (citations omitted).

<sup>60</sup> The chain of development is addressed in Elise Bant and Jeannie Marie Paterson, 'Misleading Conduct before the Federal Court: Achievements and Challenges' in Pauline Ridge and James Stellios (eds), *The Federal Court's Contribution to Australian Law: Past, Present and Future* (Federation Press, 2018) 165.

expansive approach to *ACL* s 236, ‘giving “recover” the sense of *regaining through restitution a position lost* by the conduct complained of’.<sup>61</sup> However, given the established approach to s 236 damages, which are awarded as of right, the better solution (and one accommodated by the language and structure of the remedial scheme) is to adopt this more expansive approach under ss 237 and 243. There, the courts’ remedial discretion clearly embraces orders akin to rescission, regaining through restitution a position lost and thereby ‘reducing’ the loss or damage suffered because of misleading conduct.<sup>62</sup>

The leading case on the broad meaning of loss or damage under *ACL* ss 237/243 is *Demagogue*.<sup>63</sup> Chief Justice Black there explained that the language and structure of the statute, taken as a whole, demonstrated that ‘the loss or damage contemplated by [s 237] is not limited to loss or damage in the [*ACL* s 236] sense but was intended to include the detriment suffered by being bound to a contract unconscionably induced’.<sup>64</sup> Justice Gummow separately agreed,<sup>65</sup> adding:

It may well be that in a given case the contract is not financially disadvantageous to the complainant. But, at least in Australia, if a contract is rescinded in equity for some vitiating factor in its formation, it is not sufficient for the defendant to show that the transaction to which the complainant was improperly induced to assent, after all, contained terms which, viewed objectively, were not manifestly disadvantageous so that, the complainant should freely have accepted them. ... It would be an odd result if s 87 and s 4K were to be read in a contrary sense by giving too narrow a meaning to the phrase ‘loss or damage’.<sup>66</sup>

Justice Cooper likewise considered that “‘loss or damage” in *ACL* s 237 means no more than the disadvantage which is suffered by a person as the result of the act or default of another in the circumstances provided for in the section’.<sup>67</sup> Orders designed to prevent or redress loss or damage must be viewed in light of the purpose of the provisions:

That object mirrors the approach of equity in the case of equitable fraud or unconscionability. The granting of equitable relief in those circumstances is not ‘to extend sympathetic benevolence to a victim of undeserved misfortune’ but ‘one which denies to those who have acted unconscientiously the fruits of their wrongdoing’.<sup>68</sup>

The orders made by courts effecting statutory rescission under s 243 of the *ACL* reflect this broad, policy-driven conception of ‘loss or damage’ under s 237 of the *ACL*. This generous characterisation of detriment permits courts to consider, as relevant factors in crafting orders for relief, whether the plaintiff would suffer harm

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<sup>61</sup> *Munchies* (1988) 58 FCR 274, 287 (emphasis added), cited with approval in *Demagogue Pty Ltd v Ramensky* (1992) 39 FCR 31, 45 (Gummow J) (‘*Demagogue*’); *Metz Holdings Pty Ltd v Simmac Pty Ltd (No 2)* (2011) 216 IR 116, 257 [865] (Barker J). See also *Karmot Auto Spares Pty Ltd v Dominelli Ford (Hurstville) Pty Ltd* (1992) 35 FCR 560, 573 (Heerey J).

<sup>62</sup> *Ibid.*

<sup>63</sup> (1992) 39 FCR 31.

<sup>64</sup> *Ibid* 33.

<sup>65</sup> *Ibid* 43.

<sup>66</sup> *Ibid* 43–4.

<sup>67</sup> *Ibid* 47 (citations omitted).

<sup>68</sup> *Ibid* 48 (citations omitted).

in the absence of, or indeed as a result of, the award.<sup>69</sup> The particular focus of the enquiry, as for equitable rescission, seems to be whether it is possible to return the parties to their former positions, so preventing or reducing loss or damage. To that end, for example, courts routinely apply change of position-style considerations to protect rescinding plaintiffs from being placed without justification (such as plaintiff fault or risk-taking once they become aware that the defendant's conduct was misleading) in a worse position than they occupied prior to the impugned transaction.<sup>70</sup>

This reasoning would suggest that our erstwhile plaintiff in Scenario One, the unhappy recipient of a functional washing machine that was not made in Australia, might be afforded redress by being released from the bargain and left free to pursue another.<sup>71</sup>

#### IV Restitution under *ACL* s 243: Refunds and Orders to Return

The discussion so far has explored how tailored consideration of appropriate general law doctrines regulating misleading conduct can provide useful guidance on the statutory measures of loss or damage under the *ACL*. Part III of this article introduced the award of restitutionary relief by tracing how courts have married the restitutionary nature of statutory orders akin to rescission with the remedial purpose of ss 237 and 243 orders. This section considers further orders found under s 243 that may be regarded as restitutionary in nature, before turning to consider, in Part V, the nature and role of user-damages under the *ACL*.

Consistent with the earlier discussion of rescission, the language of restitution is used in this Part to mark an award that reverses a transfer of benefit from plaintiff to defendant. An order of restitution requires the defendant to 'give back' the objective or market value of a benefit obtained from the plaintiff.<sup>72</sup>

On this definition, s 243 of the *ACL* contemplates what, at face value, appear to be restitutionary awards: thus, s 243(d) cites 'an order directing the respondent to refund money or return property to the injured person'. Further, following the broad characterisation of loss or damage embraced in the cases discussed previously concerning statutory rescission, it is possible to conceptualise such awards as involving compensation as 'recovery ... [in] the sense of regaining through restitution a position lost'.<sup>73</sup> The orders 'prevent or reduce' loss or damage to the plaintiff by returning her or him vis-à-vis the contravener to the position she or he occupied prior to the misleading conduct.

On this analysis, the relevant end-point of orders to refund and return may be different to the tortious and more expansive compensatory measure generally

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<sup>69</sup> See, eg, *Munchies* (1988) 58 FCR 274, 287–9; *Akron* (1997) 41 NSWLR 353, in particular the judgment of Mason P.

<sup>70</sup> The same change-of-position considerations are also at work in equitable rescission: see, eg, *Coastal Estates Pty Ltd v Melevende* [1965] VR 433, 440–1 (Sholl J); Bant, 'Rescission, Restitution and Compensation', above n 53, 287–90, 298.

<sup>71</sup> Cf the similar result reached through the consumer guarantees regime, discussed above Part II(B).

<sup>72</sup> See also below n 86 and accompanying text.

<sup>73</sup> *Munchies* (1988) 58 FCR 274, 287–8.



applicable under s 236, which seeks to place the plaintiff in the position she or he would have held had the misleading conduct not occurred at all. That section's tort-like enquiry is hypothetical and wide-ranging, potentially capturing a variety of consequential losses; by contrast, the restitutionary approach underpinning s 243 orders of refund and return may be limited to a more historical and restrictive enquiry, restricted to reversing the impugned transaction to restore the parties to their former position.<sup>74</sup> In some cases, however, it may be possible that orders enabling recovery of the plaintiff's former position and compensation in a more strict, tortious sense will equate. For example, a payment made as a result of a misleading representation may leave a consumer out of pocket in an equivalent amount.<sup>75</sup> In that scenario, any order for refund or return will effect both restitution and compensation.

Two early cases give a flavour of the circumstances that may attract these awards. In *Haydon v Jackson*,<sup>76</sup> the plaintiffs purchased a motel business as a result of the defendants' misleading conduct relating to the takings of the motel and as to its occupancy rate. The complex arrangements agreed by the parties at base resulted in the plaintiff making overpayments for rent and the goodwill of the business. The trial judge made orders relieving the purchasers from the obligation to make further payments relating to goodwill and ordered the defendants to repay the value of the overpayments.<sup>77</sup> On appeal, Fisher J (Lockhart J concurring) considered that TPA s 87(2) (now s 243(4) of the ACL) justified the orders to repay, together with interest on the amount of the repayment. However, the Court varied the trial judge's orders, suggesting that orders should be directed to the particular defendant who had received the overpayments (a party 'involved in' the contravention) rather than the parties who had directly engaged in the misleading conduct.<sup>78</sup> In making the variation, Fisher J observed that '[a]lthough on the face of it there is a discretion in the provision as to who is to be ordered to refund, there is little doubt that that person should be the person who has received the money which is ordered to be refunded'.<sup>79</sup>

This analysis is wholly consistent with a defendant being required to 'give back' a benefit — including the benefit of the use of the money (interest) on the initial amounts of the overpayments — received from the plaintiff. It is also consistent with the monetary adjustments consequent on rescission discussed earlier, which reflect an award for the use-value of money or other primary benefits transferred under the impugned transaction.<sup>80</sup>

<sup>74</sup> Bant, 'Rescission, Restitution and Compensation', above n 53, 282.

<sup>75</sup> *Fenech v Sterling* (1985) 61 ALR 465, 469 (Beaumont J), approved in *Haydon v Jackson* [1988] ATPR ¶40-845, 49, 101 (Fisher J). See also *Sanrod Pty Ltd v Dainford Ltd* (1984) 54 ALR 179, 191 (Fitzgerald J) ('*Sanrod*').

<sup>76</sup> [1988] ATPR ¶40-845.

<sup>77</sup> *Ibid* [49095], [49099].

<sup>78</sup> *Ibid* [49101].

<sup>79</sup> *Ibid*.

<sup>80</sup> Given this longstanding practice, the United Kingdom ('UK') Supreme Court's recent re-characterisation of interest awards on principal sums that are the subject of orders of restitution as compensatory in nature must be open to serious doubt: see *Prudential Assurance Co Ltd v Revenue and Customs Commissioners* [2018] 3 WLR 652. For the former and, it is submitted, correct position, see *Sempra Metals Ltd v Inland Revenue Commissioners* [2008] 1 AC 561; *Littlewoods Retail Ltd v HM Revenue & Customs* [2014] EWHC 868 (Ch) (28 March 2014) [372] (Henderson J). The restitutionary nature of interest in this context is the subject of detailed consideration in *Heydon v NRMA Ltd (No 2)* (2001) 53 NSWLR 600, 603–10 [12]–[36] (Mason P); *Lahoud v Lahoud* [2010]

In determining that interest should also be included in the award, Fisher J approved the 1984 case of *Sanrod*, where Fitzgerald J had stated:

I can myself perceive no difficulty in accepting that, when money is paid in consequence of misleading conduct, the loss suffered by that conduct includes not only the money paid but also the cost of borrowing that money or the loss from its investment, as the case may be ... Interest awarded as a component of damages in such circumstances is not for loss of the use of the money awarded as damages, but for loss of the use of the money paid over in consequence of the misleading conduct and is directly related to the misleading conduct.<sup>81</sup>

While the discussion is framed in terms of compensation and loss, in the following paragraph, Fitzgerald J had further observed:

The absurdity of any other conclusion is well indicated by the present case. The guilty respondent in fact had the use of the deposit monies and received interest on them to the date of termination of the contract totalling \$6320.38. It will scarcely advance the object of the Act to provide a corporation which engages in misleading conduct with a narrow construction of ss. 82 and 87 upon which it can rely to retain the fruit of any monies which it acquires by its contravention while denying an innocent party who has done no more than make payments the right to recover anything more than has actually been paid over.<sup>82</sup>

Thus, although framed in terms of compensation for loss, both cases also sought to ensure the return of the benefit (the ‘fruit’) received by the defendant from the plaintiff. Recognition of the awards as restitutionary in nature would help to explain why courts have not generally been concerned to enquire whether the transfer of benefit was matched with a corresponding financial loss — an enquiry that we have seen earlier would normally be required for compensatory awards. It is enough to satisfy the broad conceptualisation of ‘loss’ under s 237 that the award is required to reverse the impugned transaction, preventing loss to the plaintiff (and thus providing redress to the plaintiff) by taking steps to restore the parties, vis-à-vis each other, to their former positions. The ultimate award granted by Fitzgerald J is also consistent with this generous and not overly technical approach.<sup>83</sup> The amount of the deposits that had been received by the defendant in the case was some \$42 000. The interest actually earned by the defendant recipient was (as stated above) some \$6 300. The final order was in the sum of \$50 000. No evidence was brought by the plaintiff as to the actual value of the ‘loss of the use of the money to the plaintiff paid over in consequence of the misleading conduct’.<sup>84</sup> In that light, it appears that the ultimate award reflected neither the defendant’s subjective gain, nor the plaintiff’s subjective loss. Rather, the Court ordered restitution of a sum that reflected the fair or objective value of the use of the plaintiff’s money by the defendant.

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NSWSC 1297 (10 November 2010) [117]–[149] (Ward J), followed in *Copuss Pty Ltd v Nix* [2012] NSWSC 671 (20 June 2012). See also *ACN 005 057 349 Pty Ltd v Commissioner of State Revenue* [2015] VSC 76 (6 March 2015) [220]–[246] (Sloss J).

<sup>81</sup> (1984) 54 ALR 179, 191 (Fitzgerald J).

<sup>82</sup> *Ibid.*

<sup>83</sup> *Ibid.*

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

## V     Damages Calculated by Reference to a ‘User Principle’: Compensation, Restitution or Both?

Parts III–IV of this article mapped the award of restitutionary remedies under the *ACL*. The remaining Parts press that analysis further, to explore the boundaries and nature of user damages and their award under the *ACL*. In Part V, we return to the type of conundrum raised by the Scenario Two in our introduction, the case in which the defendant has wrongfully benefited from her conduct in using the plaintiff’s image without permission, but without causing any pecuniary loss to the plaintiff.<sup>85</sup>

In examining the nature and forms of these orders, the article again seeks guidance from the surrounding law regulating misleading conduct, but casts its net beyond solely rescission, deceit and negligent misstatement to encompass torts such as injurious falsehood, defamation and passing off, as well as other statutory schemes that address misleading conduct. Throughout, the aim is to determine the extent to which these forms of relief are consistent with and support the statutory language and purpose of the *ACL*.

### A     *User Damages: A Brief Overview*

In Part IV of this article, we saw that orders to refund made under s 243(d) in response to misleading conduct appear restitutionary in nature, in that they require the defendant to ‘give back’ the objective value of benefits received by the defendant. An implication of this measure of restitutionary orders is that they are to be distinguished from orders for disgorgement of the *actual or subjective* benefit obtained by a defendant from using the received benefit. Disgorgement orders may be more than market value and so the subject of an account of profits that may, in turn, be subject to allowances with respect to defendant’s particular time, skill and effort expended in generating the profit.<sup>86</sup> The defendant’s subjective gain may also be less than market value. Nonetheless, in this case, if restitution is sought by way of remedy, the measure of gain remains objective<sup>87</sup> and the question becomes whether the defendant is entitled to any defence such as change of position.<sup>88</sup> Restitution operates to return or restore the parties to their former position by unwinding the transfer of benefit to the defendant. Understood in this way,

<sup>85</sup> See also the discussion of Gummow J in *Elna Australia Pty Ltd v International Computers (Aust) Pty Ltd (No 2)* identifying analogous forms of equitable relief by way of restitution in comparable circumstances of misleading conduct: (1987) 16 FCR 410, 420–1.

<sup>86</sup> *Anderson v McPherson (No 2)* (2012) 8 ASTLR 321, 353 [226] (Edelman J); *Warman International Ltd v Dwyer* (1995) 182 CLR 544. The possibility of disgorgement damages under the statute is the subject of Bant and Paterson, ‘Should Specifically Deterrent or Punitive Damages be Made Available’, above n 15.

<sup>87</sup> For this reason, the ‘user principle’ authorities discussed below have often emphasised that the market value may well exceed the benefit actually received by a defendant from wrongful use of the plaintiff’s property: see, eg, the cases and principles discussed in *Winnebago Industries Inc v Knott Investments Pty Ltd (No 4)* (2015) 241 FCR 271, 285–92 [38]–[63] (‘*Winnebago (No 4)*’). In the context of the tort of trespass, see, eg, *Inverugie Investments Ltd v Hackett* [1995] 3 All ER 841.

<sup>88</sup> Elise Bant, *The Change of Position Defence* (Hart Publishing, 2009) 171, 210. For an example of a scenario where change-of-position considerations affected the usual user award in a case of equitable rescission, see *Coastal Estates Pty Ltd v Melevende* [1965] VR 433, 440–1 (Sholl J); Bant, ‘Rescission, Restitution and Compensation’, above n 53, 287–90, 298.

restitutionary orders may be seen as consistent with the aim of orders under s 237 to 'prevent or reduce' loss suffered because of misleading conduct, by restoring the plaintiff in substance to her position prior to the misleading conduct.

This Part considers cases where the defendant is ordered to pay the plaintiff a reasonable fee, licence or royalty for the wrongful use of the plaintiff's assets in association with misleading conduct.<sup>89</sup> This kind of award is very common at general law. It is found in a range of variously-named common law awards such as 'wayleave' damages, mesne profits, reasonable royalties, reasonable licence fees and damages on a 'user principle', all of which appear to respond equally to wrongful use of land, goods or intellectual property.<sup>90</sup> From a certain perspective, this class of order shares the same sort of restitutionary pattern as found in cases of statutory rescission and refund discussed earlier in Part IV: the defendant is required to give back to the plaintiff the market value of the benefit received from wrongful use of the plaintiff's property.<sup>91</sup> As with orders of restitution for unjust enrichment, the measure does not focus on the defendant's actual profit obtained from the use:<sup>92</sup> however spectacularly successful, or indeed inept or marginal the use has been, the defendant must pay the reasonable (usually market) price or rate of hire for the privilege of using the plaintiff's property. This is consistent with the established practice in cases of equitable rescission, discussed earlier. Any plea by the defendant that this award should be discounted to reflect detriment she or he has suffered as a result of her or his actual use of the benefit, for example by placing the money under her or his bed or donating it to charity, raises difficult change-of-position considerations that must be assessed in light of the nature of the wrong, the culpability of the defendant and overriding issues of stultification and coherence in the law.<sup>93</sup> The otherwise strict and objective primary measure of restitution closely matches the form of award commonly made in cases of 'user damages'.

That having been said, it is important to note from the outset that, at least in some cases, user damages will be squarely compensatory. This will be so where the plaintiff can demonstrate a lost opportunity arising from the wrong, for example that it would have licensed the use of the property to the defendant, or gave up the opportunity to license the property to a third party, as a result of the defendant's misleading conduct.<sup>94</sup> By contrast, in other scenarios where these awards traditionally have been routinely ordered, it is not easy to accommodate a compensatory analysis. The evidence may be clear that the defendant never would

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<sup>89</sup> The factual circumstances in which these awards may be relevant vary widely, from misleading 'celebrity endorsement' cases, such as the *Tracey Wickham Case* (1988) 12 IPR 567, to: cases involving counterfeit goods or trade mark infringement, as in the *Winnebago* litigation discussed below; misleading representations of business association cases, as in *Harcourts WA Pty Ltd v Roy Weston Nominees Pty Ltd (No 5)* (2016) 119 IPR 449 ('*Harcourts (No 5)*'); and the more removed scenario found in the *Larrikin Music* litigation, discussed below in Part V(A).

<sup>90</sup> For a detailed examination, see Edelman, Varuhas and Colton, above n 15, chs 14, 47.

<sup>91</sup> See above Part III.

<sup>92</sup> This measure would be the focus of an account of profits or 'disgorgement damages'.

<sup>93</sup> The main authorities and analyses are considered in *Cavenagh Investment Pte Ltd v Kaushik Rajiv*, which ultimately adopted the analysis in Bant, *The Change of Position Defence*, above n 88: [2013] 2 SLR 543, 568–71 [60]–[64] (Chan Seng Onn J) (High Court).

<sup>94</sup> The second category of damages identified in *General Tire & Rubber Co v Firestone Tyre & Rubber Co Ltd* [1975] 1 WLR 819, 824–6 (Lord Wilberforce) ('*General Tire*').

have paid to use the property,<sup>95</sup> or the plaintiff never would have agreed to license its use by the defendant, as in Scenario Two regarding celebrity product endorsement. This latter scenario arose in *Aristocrat Technologies Australia Pty Ltd v DAP Services (Kempsey) Pty Ltd (in liq)*.<sup>96</sup> The plaintiff had elected ‘damages’ over an account of profits as its remedy for breach of copyright under s 115(2) of the *Copyright Act 1968* (Cth). Emphasising the compensatory aims of damages under the statutory provision, but without further discussion of the point, the Full Federal Court of Australia held that ‘a royalty does not provide the appropriate measure of damages where the copyright owner would not have granted a licence’.<sup>97</sup>

As we will see, this restrictive approach to compensatory relief taken under the *Copyright Act 1968* (Cth) in cases where the plaintiff would not have licensed the use of its intellectual property has not been adopted in the context of the *ACL*. The aim of Part VB of this article is to explore the nature and propriety of user damages awarded for misleading conduct where actual financial loss on the part of the plaintiff cannot be established,<sup>98</sup> to determine whether such damages are appropriate and justified in light of the overarching compensatory and protective purposes of the *ACL* remedies. To this end, the analysis will take guidance from the operation of user damages in the surrounding and relevant general law and statutory context. A good example of a case in which user damages were awarded for breach of s 52 of the *TPA* (*ACL* s 18) arose from the *Larrikin Music* litigation.<sup>99</sup> The litigation over issues of copyright infringement was prolonged and contentious.<sup>100</sup> However, the ultimate award of user damages under s 82 of the *TPA* was neither contested nor challenged on appeal. The decision on damages has since been cited with approval by courts in Australia<sup>101</sup> and overseas<sup>102</sup> that have awarded user damages in cognate fields, in the absence of proof of financial loss on the part of the plaintiff.

<sup>95</sup> See, eg, *Irvine v Talksport Ltd* [2003] 2 All ER 881, a case of passing off where the Court of Appeal overturned the trial judge’s award measured by reference to what the defendant would have been prepared to pay and substituted a reasonable fee calculated by reference to the value of earlier endorsements agreed by the plaintiff.

<sup>96</sup> (2007) 157 FCR 564 (*‘Aristocrat’*).

<sup>97</sup> *Ibid* 569 [27].

<sup>98</sup> Cf the position where actual loss has occurred but cannot be measured, where restitutionary relief has also been found to be appropriate under *ACL* ss 237, 243 and equivalent provisions: *Donald Financial Enterprises Pty Ltd v APIR Systems Ltd* (2008) 67 ACSR 219, 289–93 [177]–[192] (Edmonds J), upheld on appeal in *APIR Systems Ltd v Donald Financial Enterprises Pty Ltd* [2009] FCAFC 45 (9 April 2009) [54]–[57]; *Clifford v Vegas Enterprises Pty Ltd (No 5)* (2010) 272 ALR 198, 273–9 [423]–[455] (Barker J); *Rapid Roofing Pty Ltd v Natalise Pty Ltd* (2007) 2 Qd R 335, 360–1 [80]–[83] (Keane JA); *Stumer Investments Pty Ltd v Azzura Holdings Pty Ltd* [2010] QSC 352 (20 September 2010) [40] (McMurdo J); *Grande Enterprises Ltd v Pramoko* [2014] WASC 294 (22 August 2014) [89]–[91] (Le Miere J).

<sup>99</sup> *Larrikin Music Publishing Pty Ltd v EMI Songs Australia Pty Ltd* (2009) 179 FCR 169; *Larrikin Music Publishing Pty Ltd v EMI Songs Australia Pty Ltd* (2010) 263 ALR 155; *Larrikin Music Publishing Pty Ltd v EMI Songs Australia Pty Ltd (No 2)* (2010) 188 FCR 321 (*‘Larrikin Music (No 2)’*).

<sup>100</sup> See, eg, Australian Law Reform Commission, *Copyright and the Digital Economy*, Report No 122 (2013); Matthew Rimmer, ‘An Elegy for Greg Ham: Copyright Law, the Kookaburra Case, and Remix Culture’ (2012) 17(2) *Deakin Law Review* 385.

<sup>101</sup> *Winnebago (No 4)* (2015) 241 FCR 271 (passing off).

<sup>102</sup> *Eight Mile Style* [2017] NZHC 2603 (25 October 2017) (breach of copyright).

Relevantly for present purposes, the plaintiff alleged that the misleading conduct of the defendant composers and recording companies caused third parties not to pay certain royalties to the plaintiff, to which the plaintiff claimed it was otherwise entitled.<sup>103</sup> The foundation of the plaintiff's claim of misleading conduct lay in earlier copyright infringement. The trial judge controversially found that the defendants had infringed the plaintiff's copyright in the iconic song 'Kookaburra Sits in the Old Gum Tree' through incorporating a brief flute riff inspired by Kookaburra into the equally iconic Men at Work song entitled 'Down Under'.<sup>104</sup> The misleading conduct, by contrast, arose from later statements made to third party associations, which collected performance royalties on behalf of association members and distributed back payments to the relevant association members. As a condition of entering into such an arrangement for 'Down Under', the defendants had warranted to the third party associations that the defendants had 100% copyright in the material and that the material did not infringe copyright held by any other person.<sup>105</sup> Although the defendants fiercely denied the allegations of breach of copyright and misrepresentation, they conceded that if established, the plaintiffs had suffered loss or damage because of the misrepresentations.<sup>106</sup> By consensus between the parties, Jacobson J assessed damages under s 82 of the *TPA* (s 236 of the *ACL*) based on a hypothetical bargain that would have been struck between a willing licensor and licensee of the copyright in Kookaburra.<sup>107</sup> In so doing, his Honour noted that this was 'in accordance with the principles commonly applied in assessing damages for the infringement of the rights of the owner of an item of intellectual property'.<sup>108</sup> Given the very modest amount of infringing material, his Honour assessed the fee at five per cent of the total royalty income.<sup>109</sup>

As Jacobson J noted,<sup>110</sup> this approach to the measure of damages for wrongful use of intellectual property is well-established. However, notwithstanding this longstanding acceptance and widespread application across the full spectrum of property and property-like interests, the nature and bounds of user damages remain disputed. This inevitably affects the extent to which they can be understood to be consistent with the language and purpose of s 236 and/or ss 237 and 243 awards. It is not possible to answer these issues definitively in this article, but, fortunately for our purposes, it is only necessary to sketch the spectrum of the debate. It will then be possible to determine the extent to which the awards, as characterised and ordered by courts, conform with and promote the remedial purposes of ss 236 and 237 awards.

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<sup>103</sup> *Larrikin Music Publishing Pty Ltd v EMI Songs Australia Pty Ltd* (2010) 263 ALR 155, 183 [263] (Jacobson J).

<sup>104</sup> *Ibid* 159 [27]–[28], 191 [337] (Jacobson J).

<sup>105</sup> *Ibid* 184 [274] (Jacobson J).

<sup>106</sup> *Larrikin Music (No 2)* (2010) 188 FCR 321, 323 [7] (Jacobson J).

<sup>107</sup> *Ibid* 323 [8].

<sup>108</sup> *Ibid*.

<sup>109</sup> *Ibid* 343 [220]–[222].

<sup>110</sup> *Ibid* 325 [24].

## B     *User Damages as Compensation?*

Some have argued that user damages compensate the loss of an opportunity to bargain to licence the use of the property.<sup>111</sup> As discussed earlier, where it is shown that the plaintiff was deprived of an opportunity that the plaintiff would have taken to licence use of the property to the defendant or a third party, then this analysis is entirely plausible. The problem is that there is difficulty accommodating all such awards in this manner. In many cases, it is clear that the defendant would never have agreed a price for the user: this was, for example, the clear tenor of evidence in the *Larrikin Music* litigation.<sup>112</sup> Further, many courts have awarded user damages while explicitly rejecting that the plaintiff suffered any actual loss through the wrongful use, because the plaintiff never would or could have licensed the use of the property. Whether the property concerns a chair,<sup>113</sup> horse,<sup>114</sup> accommodation,<sup>115</sup> underground passageways,<sup>116</sup> patent,<sup>117</sup> ‘goodwill’,<sup>118</sup> or trademark,<sup>119</sup> the principle appears to be the same: notwithstanding that there is no financial loss nor injury to the property concerned, the plaintiff is entitled to recover the reasonable value of the benefit enjoyed by the defendant as a result of the breach. Given the lack of actual financial loss in such cases, it is difficult to see how user damages in such cases align with compensation for ‘loss or damage’ in the sense required by s 236 of the *ACL*, in particular.

An alternative, broader compensatory analysis, is that the plaintiff loses his ‘right of dominium’ over the asset, in the sense of his right to control access to and use of the property and that it is this loss that is the subject of compensation by reference to user damages.<sup>120</sup> A related approach is to view the award as addressing a correlative, but *normative* (rather than material or ‘actual’), loss and gain: by breaching the plaintiff’s right to exclusive use of the subject matter of the property right, the defendant has violated and gained from the (corresponding) loss of the plaintiff’s right.<sup>121</sup> As we will see, these rights-based analyses find some support in the case law.<sup>122</sup> A recent example is the UK Supreme Court case of *One Step*

<sup>111</sup> Robert J Sharpe and S M Waddams, ‘Damages for Lost Opportunity to Bargain’ (1982) 2(2) *Oxford Journal of Legal Studies* 290.

<sup>112</sup> *Larrikin Music (No 2)* (2010) 188 FCR 321, 333 [98].

<sup>113</sup> *The Owners of the Steamship ‘Mediana’ v The Owners, Master and Crew of the Lightship ‘Comet’* [1900] AC 113, 117 (Lord Halsbury) (*‘The Mediana’*).

<sup>114</sup> *Watson, Laidlaw & Co Ltd v Pott, Cassels, and Williamson* (1914) 31 RPC 104, 119 (Lord Shaw).

<sup>115</sup> *Inverurie Investments Ltd v Hackett* [1995] 3 All ER 841; *Swordheath Properties Ltd v Tabet* [1979] 1 WLR 285.

<sup>116</sup> *Martin v Porter* (1839) 5 M & W 351; 151 ER 149.

<sup>117</sup> *General Tire* [1975] 1 WLR 819, 826; *Watson, Laidlaw & Co Ltd v Pott, Cassels, and Williamson* (1914) 31 RPC 104, 120 (Lord Shaw).

<sup>118</sup> *Winnebago (No 4)* (2015) 241 FCR 271.

<sup>119</sup> *32Red Plc v WHG (International) Ltd* [2013] EWHC 815 (Ch) (12 April 2013) [22]–[42] (Newey J). See also the discussion in *Winnebago (No 4)* (2015) 241 FCR 271, 289–92 [50]–[62].

<sup>120</sup> Mitchell McInnes, ‘Gain, Loss and the User Principle’ (2006) 14 *Restitution Law Review* 76, 85.

<sup>121</sup> David J Brennan, ‘The Beautiful Restitutionary Heresy of a Larrikin’ (2011) 33(2) *Sydney Law Review* 209, 219–25.

<sup>122</sup> See, eg, *Bunnings Group Ltd v CHEP Australia Ltd* (2011) 82 NSWLR 420 (*‘Bunnings v CHEP’*); *Macquarie International Health Clinic Pty Ltd v Sydney Local Health District (No 10)* [2016] NSWSC 1587 (10 November 2016) [124] (*‘Macquarie Health (No 10)’*).

(*Support Ltd v Morris-Garner* in which Lord Reed (with whom Lady Hale, Lord Wilson and Lord Carnwath agreed) characterised user damages as

providing compensation for loss, albeit not loss of a conventional kind. Where property is damaged, the loss suffered can be measured in terms of the cost of repair or the diminution in value, and damages can be assessed accordingly. Where on the other hand an unlawful use is made of property, and the *right to control such use is a valuable asset*, the owner suffers a loss of a different kind, which calls for a different method of assessing damages. In such circumstances, the person who makes wrongful use of the property *prevents the owner from exercising his right to obtain the economic value of the use in question, and should therefore compensate him for the consequent loss*. Put shortly, he takes something for nothing, for which the owner was entitled to require payment.<sup>123</sup>

Lord Reed subsequently concluded that

[t]he claimant has in substance been deprived of a valuable asset, and his loss can therefore be measured by determining the economic value of the asset in question. The defendant has taken something for nothing, for which the claimant was entitled to payment.<sup>124</sup>

However, there are problems with these right-based analyses. It is difficult to see how a plaintiff's right to possession, or right to control the use of the property, for example, can be regarded as having been harmed or lost through its infringement: its past breach yields a remedy (even if only nominal) and future breaches may be the subject of an injunction. The right itself sails on unharmed. If, by contrast, all that is required is a corresponding normative loss and gain through the infringement of the plaintiff's rights, it is unclear why gain-based relief is not available in every case where a plaintiff's right is infringed, no matter of what kind. Yet, as *Morris-Garner* itself makes clear, it is clear that not all rights infractions attract this kind of relief.<sup>125</sup>

Barker has presented a more nuanced approach connecting rights theory with a compensatory approach to user damages.<sup>126</sup> He argues that, in the most problematic cases, what is lost by the defendant's infringement may be the plaintiff's *legal power* to seek an injunction *ex ante* to prevent that breach:

Either A loses his own power to stop the infringement, or a power to see that someone else (the court) stops it. A reasonable permission fee for the use of A's property then provides an approximation of the factual value of A's lost legal power to stop the infringement occurring. Indeed, such a permission fee provides a natural index of A's lost entitlement to 'insist' on his permission

<sup>123</sup> [2018] 2 WLR 1353, 1365 [30] (emphasis added) ('*Morris-Garner*'). Cf *Turf Club Auto Emporium Pte Ltd v Yeo Boong Hua*, in which the Singapore Court of Appeal adopted a related but distinct analysis, characterising user damages as compensatory in nature, albeit calculated by reference to a restitutionary measure, and directed to the loss of rights, rather than actual loss: [2018] SGCA 44 (2 August 2018) [210]–[215] ('*Turf Club*').

<sup>124</sup> *Morris-Garner* [2018] 2 WLR 1353, 1381 [92]. See also 1382–3 [94]–[95], particularly points (1) and (10).

<sup>125</sup> See also *Turf Club*, denying that the award of compensation for infringement of rights leads to a quantum shift in the nature of compensation, because it is only permitted in a '*specific and limited category of cases*': [2018] SGCA 44 (2 August 2018) [208] (emphasis in original).

<sup>126</sup> Kit Barker, "Damages Without Loss": Can Hohfeld Help? (2014) 34(4) *Oxford Journal of Legal Studies* 631.



being obtained. The fee should then reflect the amount that P himself would reasonably have been able to ask for giving his permission.<sup>127</sup>

On Barker's analysis, the loss of this legal power is analogous to the loss of other valuable legal powers such as options, or indeed physical powers, such as the use of an arm or leg, both of which must be compensated through substantial damages.<sup>128</sup> This subtle analysis avoids many of the problems inherent in the other compensatory analyses. It seems to find some support from the UK Supreme Court's characterisation of user damages awarded under *Lord Cairns' Act* in *Morris-Garner* as being

the amount which the claimant could fairly and reasonably have charged for the voluntary relinquishment of a valuable right of which he had effectively been deprived by the refusal of an injunction ... The claimant does not literally lose the right in question, but, as Lord Nicholls stated [in *Attorney-General v Blake*], 'the court's refusal to grant an injunction means that in practice the defendant is thereby permitted to perpetuate the wrongful state of affairs he has brought about'.<sup>129</sup>

Notwithstanding the strength of the analysis, it appears to be no more possible for a wrongdoing defendant to strip a plaintiff of his legal powers to obtain an injunction than it lies in his hands to strip the plaintiff of his primary legal rights. As we saw earlier with the 'rights-based' analyses, it is therefore arguable that the legal power to protect the plaintiff's rights is never lost — only the practical capacity to exercise it.<sup>130</sup> Moreover if, as the Supreme Court states (here departing from Barker),<sup>131</sup> the question becomes one of practical loss of 'a valuable opportunity to exercise [the] right to control the asset'<sup>132</sup> via an injunction, the value of the plaintiff's power in practice to obtain injunctive relief (or see that the Court stops the infringement) must be more or less valuable depending on the particular facts of the case. This would mean that in some cases, the plaintiff's power may be virtually certain to lead to injunctive relief and in others, not at all. Further, a plaintiff's right to quia timet relief will be subject to consideration of a wide range of factors going to the 'balance of convenience'. Yet, as a matter of practice, courts seem to take none of these factors into account when assessing the plaintiff's right to user damages, which is measured by the objective value of the opportunity to use the benefit obtained by the defendant.

On balance, it must be accepted that user damages assessed by reference to the plaintiff's rights, powers or 'normative loss' represent a departure from the usual approach to compensation adopted elsewhere in the general law. As Lord Nicholls observed in *Attorney-General v Blake*, '[t]he reality is that the injured person's rights

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<sup>127</sup> Ibid 655.

<sup>128</sup> Ibid 654.

<sup>129</sup> [2018] 2 WLR 1353, 1375–6 [69] (citations omitted).

<sup>130</sup> Our sincere thanks to Professor Barker for his generosity in discussing his ideas and helping us to frame our reservations regarding his thesis. A further issue with the analysis is that if we see the loss in terms of the plaintiff losing the power at the point of breach to sell or relax the primary right to the defendant prior to the infringement, then (as with the broader rights-based analyses discussed earlier) reasonable fee damages should be available in all cases of rights violation, which does not yet seem to be the case.

<sup>131</sup> Barker's analysis expressly rejects the 'lost opportunity' analysis: Barker, above n 126, 638, 654–6.

<sup>132</sup> *Morris-Garner* [2018] 2 WLR 1353, 1379 [84].

were invaded but, in financial terms, he suffered no loss'.<sup>133</sup> Certainly, any normative analysis diverges from the factual approach generally adopted by courts to s 236 damages, by which courts look to see the extent to which the plaintiff is left worse off by reference to actual loss or damage.<sup>134</sup> Indeed, arguably it risks introducing fundamental conceptual incoherence into the statutory scheme. Descheemaeker has argued that the law of torts contains two different and mutually incompatible conceptions of harm.<sup>135</sup> On the one hand, the 'bipolar' model of harm wrongfully caused focuses on the extent to which a person is left financially or emotionally worse off because of the defendant's wrongdoing. On the other hand, there is a 'unipolar' model in which the very infringement of the plaintiff's right is itself considered the harm to be compensated. Using Descheemaeker's analysis, the language and structure of the *ACL*'s remedial scheme indicate a definitive choice by Parliament in favour of the bipolar model. This is particularly evident in the separation of the contravention question in s18 from identification of the causally-connected 'actual' harm question under ss 236 and 237. It follows that re-characterising 'loss or damage' as capturing purely normative harm arguably is inconsistent with the *ACL*.

Further, in the context of the *ACL*, characterising the infringement of a plaintiff's property right as the relevant damage for the purposes of a claim of misleading conduct is inherently problematic. In these cases, as *Larrikin Music (No 2)* itself demonstrates, the claim is at best parasitic upon the infringement of a property right. The immediate source of the claim for statutory relief is the defendant's misleading conduct, not breach of a property right — although, of course, the two events may coincide. Barker's 'loss of power to obtain an injunction' thesis is a more likely line of enquiry in the context of the *ACL*, which expressly permits, at the discretion of the court, injunctive relief to prevent misleading conduct under s 232 and compensation under s 243. However, as discussed above, it remains unclear how the power is ever 'lost' through the actions of the defendant, except to the extent that the plaintiff no longer has the practical opportunity to obtain injunctive relief. Further, when assessing user damages, courts do not appear to be interested in, or engaged in determining, the real or subjective value of that opportunity.

## C *Janus Damages?*

Recognising difficulties with a purely compensatory analysis of the user principle as applied at common law, some courts and commentators have preferred a dual characterisation in which damages awarded on a 'user principle' are recognised as having both compensatory and restitutionary characteristics. Indeed, the recognition of the relevance of a defendant's gain in the analysis comes through even in the most trenchant compensatory analysis. Thus the UK Supreme Court in *Morris-Garner* in the extracts set out above repeatedly emphasised that the defendant had 'taken something for nothing'<sup>136</sup> — in other words, had been enriched by its wrongful user.

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<sup>133</sup> [2001] 1 AC 268, 279.

<sup>134</sup> See, eg, *Marks* (1998) 196 CLR 494.

<sup>135</sup> Eric Descheemaeker, 'Unravelling Harms in Tort Law' (2016) 132(4) *Law Quarterly Review* 595.

<sup>136</sup> See above nn 127–9 and accompanying text.

Further, while rejecting the gain-based characterisation of user damages as a matter of authority, the Supreme Court acknowledged that

there is a sense in which it can be said that the damages [in the property cases] ‘may be measured by reference to the benefit gained by the wrongdoer from the breach’, provided that the ‘benefit’ is taken to be the objective value of the wrongful use.<sup>137</sup>

The leading authority in Australia reflecting the dual characterisation of user damages comes from the field of conversion of goods. In *Bunnings v CHEP*,<sup>138</sup> Bunnings had converted the plaintiff’s pallets by refusing to return them following the plaintiff’s demand and actively using them in its business. The plaintiff had difficulty establishing that it had suffered any loss as a result of Bunnings’ conversion. It had received compensation for the loss of the pallets from third parties and there was no evidence that it had lost concrete opportunities to hire the pallets out elsewhere while they were in Bunnings’ wrongful possession. Nonetheless, the New South Wales Court of Appeal awarded substantial damages measured on a user principle.

President Allsop (with whom Macfarlan JA agreed) discussed the leading English and Australian authorities on point and accepted that such awards have a distinctly restitutionary aspect. However, his Honour considered that the notion of loss or damage for the purposes of a damages award in tort was sufficiently broad to

includ[e] the denial and infringement of [the plaintiff’s] rights ... It is entirely logical and in accordance with justice and common-sense that a wrongdoer should pay a price for using the goods of another as a matter of compensation for the denial of the right concerned. I do not see this as contrary to, or undermining of, the principle of compensation.<sup>139</sup>

In a separate judgment, Giles JA expressly noted that the ‘jurisprudential basis for the award of damages’ in such cases is ‘open to debate’.<sup>140</sup> His Honour preferred a restitutionary analysis that saw damages representing ‘the expense saved by Bunnings through having the use of the pallets without paying for their hire’.<sup>141</sup> We return to consider whether it is better to eschew the dual characterisation of user damages in favour of a purely restitutionary analysis further in Part VD below.

A similar dualist approach to user damages was adopted by Yates J in the Federal Court of Australia in *Winnebago (No 4)*.<sup>142</sup> That decision was concerned solely with the assessment of damages for passing off, but there had also been earlier findings of misleading conduct under the *TPA*. In earlier proceedings, the Full Federal Court remitted the case to a single judge to consider whether the plaintiff was entitled to a reasonable royalty, notwithstanding that it was clear that the

<sup>137</sup> See *Morris-Garner* [2018] 2 WLR 1353, 1378 [79]. Both Yates J and Allsop CJ considered the earlier English authorities on this point during the *Winnebago* litigation discussed below.

<sup>138</sup> (2011) 82 NSWLR 420, followed and interpreted in *Macquarie Health (No 10)* [2016] NSWSC 1587 (10 November 2016) [152] as establishing that user damages are compensatory in nature.

<sup>139</sup> *Bunnings v CHEP* (2011) 82 NSWLR 420, 467 [175]. See also *Knott Investments Pty Ltd v Winnebago Industries Inc (No 2)* (2013) 305 ALR 387, 392 [26] (*‘Winnebago (No 2)’*).

<sup>140</sup> *Bunnings v CHEP* (2011) 82 NSWLR 420, 471 [194]. See also 472 [197]–[198].

<sup>141</sup> *Ibid* 473 [205].

<sup>142</sup> (2015) 241 FCR 271, followed by *Harcourts (No 5)* (2016) 119 IPR 449, 460–1 [54] (McKerracher J). See also *Bayer Pharma Aktiengesellschaft v Generic Health Pty Ltd* (2017) 124 IPR 23, 94–5 [319]–[325].

plaintiff never would have licensed its name to the defendant.<sup>143</sup> In the course of granting the remitter, Allsop CJ noted that although the authority of *Aristocrat* (discussed in Part VA) stood in the path of this relief, other cases

recognise that the use of property (here the reputation of the respondent) may be compensated for by reference to notions (perhaps restitutionary in essence) that unauthorised use of property has to be paid for: see generally the discussion of issues in the context of conversion in *Bunnings* ...<sup>144</sup>

In the subsequent hearing, Yates J held that user damages should indeed be awarded, considered that the reasoning of *Aristocrat* was at odds with long-established principle, restricted it as a binding authority to its context in copyright law and applied *Bunnings* by analogy. In taking these steps, his Honour engaged in a detailed and comprehensive examination of the general law authorities in England and Australia, demonstrating that user damages are not dependent on proof that the plaintiff would have agreed to licence the defendant's use, nor that the defendant had to be shown to have been willing to pay. His Honour identified that wrongful interference with the plaintiff's property right could itself constitute the 'damage' to be compensated for by the award of user damages. A similar analysis, in which *Winnebago (No 4)* and *Larrikin Music (No 2)* were both cited, was subsequently adopted in the High Court in New Zealand in *Eight Mile Style*.<sup>145</sup> That case involved copyright infringement by the New Zealand National Party of a song by rap artist Eminem. Following an extensive review of the authorities, Cull J concluded:

The user principle is not strictly compensatory in nature as it is not remedying the plaintiff's financial loss. Rather, the user principle recognises the infringement that has invaded the monopoly a plaintiff has on their intellectual property rights and the defendant's gain in this infringement. It is therefore both compensatory and restitutionary in nature.<sup>146</sup>

The dual characterisation adopted in these cases would potentially legitimise similar measures of user damages under s 236 of the *ACL*, if we accept that a plaintiff is left worse off by loss of dominion of rights, loss of powers to obtain *ex ante* injunctive relief, or by way of normative loss suffered through misleading conduct.<sup>147</sup> We have seen earlier that there are difficulties, however, with these analyses.

Further, as Barker has observed, on its face the idea that a single award of damages can be both compensatory and restitutionary in nature seems nonsensical: '[w]henever there is any factual disparity between B's gain and A's loss, it is pretty obvious that a single monetary award cannot represent both amounts.'<sup>148</sup> Certainly, in the case of user damages, we have seen that they come primarily into play

<sup>143</sup> *Winnebago (No 2)* (2013) 305 ALR 387.

<sup>144</sup> *Ibid* 392 [26] (citations omitted).

<sup>145</sup> [2017] NZHC 2603 (25 October 2017).

<sup>146</sup> *Ibid* [338] (emphasis in original).

<sup>147</sup> *Henderson v Radio Corporation Pty Ltd* (1960) SR (NSW) 585, 599, where Evatt CJ and Myers J, in an action of passing off involving the unauthorised appropriation of the plaintiffs' images falsely to suggest their endorsement of a product, stated that:

The professional recommendation of the respondents was and still is theirs, to withhold or bestow at will, but the appellant has wrongfully deprived them of their right to do so and of the payment or reward on which, if they had been minded to give their approval to the appellant's record, they could have insisted.

<sup>148</sup> Barker, above n 126, 646.

precisely where compensation measured in the usual way would result in no substantial monetary award. Barker therefore suggests that what must be meant by this hybrid characterisation is that the ‘*effect of an award* can be to eradicate both some loss to A and some gain to B’.<sup>149</sup>

This seems more likely and, coincidentally, is an approach that fits nicely with the requirements of s 237(2) of the *ACL* (being the gateway to the wide range of orders available under s 243) that any order made under s 243 must be one that the court considers will:

- (a)     compensate ... in whole or in part for the loss or damage ... or
- (b)     prevent or reduce the loss or damage suffered, or likely to be suffered, by the injured person or any such injured persons.<sup>150</sup>

On this approach, the award of user damages need not be purely compensatory in character.<sup>151</sup> Provided that some loss or damage is identified, restitutionary damages will have the *effect* of reducing that loss, even though the inherent or primary aim or purpose of the remedy is to reverse the defendant’s gain.<sup>152</sup> It remains, however, to identify the gateway to restitutionary relief — the ‘loss or damage’ to which restitutionary relief may respond. As we saw earlier, focusing on the infringement of *proprietary* rights (as demonstrated in *Winnebago (No 4)* and *Larrikin Music (No 2)*) distracts from the point that s 18 of the *ACL* addresses misleading conduct, not infringement of proprietary rights. Further, it seems from our earlier discussion under Part II of this article that the aim of s 237(2) is to require more by way of loss or damage than simple proof of contravention of the statutory prohibition on misleading conduct.

It may therefore be more appropriate and realistic to view the awards as potentially falling within the expanded conception of loss or damage the subject of s 237 of the *ACL*, which we have seen adopted in cases of statutory orders akin to rescission. A monetary order based on a user sum can, in this context, be seen as ‘*regaining through restitution a position lost* by the conduct complained of’<sup>153</sup> thereby ‘*reduc[ing] the loss or damage suffered*’<sup>154</sup> by the plaintiff. Particularly where loss in the stricter sense of *ACL* s 236 is very difficult to ascertain or measure, and where there has been a clear and wrongful taking of a benefit by the defendant from the plaintiff’s assets through the misleading conduct, an award that reverses that wrongful transfer to restore the parties to their former position seems appropriate and adapted to achieve the protective purpose of the statute.

Drawing from these authorities, and consistently with the broader approach taken to s 237 in the statutory rescission cases, it is possible to support damages assessed on the user principle where the defendant has obtained the benefit of

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<sup>149</sup> Ibid (emphasis in original).

<sup>150</sup> Emphasis added.

<sup>151</sup> *Tenji* (2000) 98 FCR 324, 333–4 [20] (French J).

<sup>152</sup> Cf *Turf Club*, which distinguishes between normative restitution (which seeks to restore some benefit to the plaintiff) and descriptive restitution (which may be compensatory in purpose, but measured by reference to the gain obtained by the defendant): [2018] SGCA 44 (2 August 2018) [210]–[215] (Andrew Phang Boon Leong JA for the Court).

<sup>153</sup> *Munchies* (1988) 58 FCR 274, 287–8 (emphasis added).

<sup>154</sup> *ACL* s 237(2)(b).

unauthorised use of the plaintiff's property as a result of her or his misleading conduct. Restitutionary damages operate to prevent or reduce the loss of the plaintiff's original position. This broader approach to the compensatory effect of ss 237 and 243 orders may be justified in light of the structure and protective purpose of the statutory remedial scheme and the essentially restitutionary nature of the awards made by way of rescission, refund, repayment and, it would be added, reasonable fees and royalties for wrongful user. Indeed, awards of reasonable fees and royalties line up with other restitutionary orders available under s 243. On this analysis, awards of user damages made in the 'celebrity endorsement' cases are restitutionary responses to the misleading use of the celebrity's image. The defendant is required to 'give back' to the plaintiff the benefit received from that unauthorised use, thereby restoring both parties so far as is practicable to their former positions.

## D *Restitution Unchained from Compensation*

Before leaving this discussion, it must be acknowledged that although potentially justified in light of the language, purpose and judicial development of the basis for statutory relief, the use of restitutionary damages in this manner does stretch the usual conception of a response to 'loss or damage' to breaking point.<sup>155</sup> The approach is only plausible in the statutory context because the *ACL* already expressly contemplates what appear to be restitutionary orders, and because courts have interpreted the concept of loss under s 237 sufficiently widely to accommodate the making of orders akin to rescission. Moreover, at the end of the day, these orders are highly effective in promoting the twin purposes of fair business practices and consumer protection under the *ACL*.

However, the work needed to justify these awards within the confines of the statutory regime should give us reason to pause and reconsider the approach. As a regime of consumer protection, the *ACL* needs to cast a wide shadow over the market to prompt compliance with the regime and the efficient settlement of disputes where they arise. An essential requirement for its success and, indeed, the iterative function of legislation that sets aspirational standards of conduct, is that the regime be clear and accessible. If, as appears to be the case, highly technical and nuanced approaches are required in order to give meaningful and necessary redress under the statute, the efficacy of the regime cannot help but be undermined. Moreover, there is a real danger that the courts' current interpretive approach to the boundaries of loss under the *ACL*, although defensible in the particular statutory context, will lead to a confusion of compensatory and restitutionary damages more broadly and so undermine principle and coherence in the law. Considerations of remoteness and

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<sup>155</sup> Cf the warning of McHugh J in *Newcastle City Council v GIO General Ltd* (1997) 191 CLR 85, 113: Even if extrinsic material convincingly indicates the evil at which a section was aimed, it does not follow that the language of the section will always permit a construction that will remedy that evil. If the legislature uses language which covers only one state of affairs, a court cannot legitimately construe the words of the section in a tortured and unrealistic manner to cover another set of circumstances.

This warning was adopted in *Taylor v The Owners — Strata Plan No 11564* (2014) 253 CLR 531, 548–9 [39] (French CJ, Crennan and Bell JJ).

scope of liability, for example, have no part to play where a court is seeking to restore some benefit to the plaintiff. Relevant defensive considerations will also differ.<sup>156</sup> For this reason, the most recent edition of *McGregor on Damages* eschews extended meanings of loss and, accordingly, compensation.<sup>157</sup> Instead, it advocates recognition of the discrete nature and operation of restitutionary damages (including by way of user damages) for common law, equitable and statutory wrongs.

It would be possible to avoid the identified danger of incoherence arising from an over-inclusive conception of ‘loss or damage’ coupled with the ambiguous directive contained in ss 237 and 243, and moreover, to align the remedial scheme of the *ACL* with other general law and statutory doctrines concerned with misleading conduct. This could be done by reforming the legislation to make express provision for restitutionary awards. This is by no means impossible: a striking feature of the wider Australian statutory landscape is that other legislation prohibiting misleading conduct does precisely that, such as under retail tenancy legislation.<sup>158</sup> Although that option cannot be canvassed in this article, it is clear that courts consider restitutionary remedies to be appropriate and, indeed, required to effect the instrumental purposes of the statute in some cases of misleading conduct. Indeed, as noted in *Demagogue*, the statute was intended to provide remedial options beyond those offered at general law.<sup>159</sup> It appears strange in that context that such difficult, although we would say ultimately principled, interpretive gymnastics are required to find room for restitutionary remedies within the sumptuous ‘remedial smorgasbord’ otherwise on offer.

## VI Conclusion

The task of interpreting and applying legislation such as s 18 of the *ACL* and its associated remedies is perhaps surprisingly complex. The apparently simple instruction not to mislead, combined with the ambition to provide individual plaintiffs with relatively straightforward access to remedies, gives rise to intricate questions about the choice and ambit of language in the relevant sections of the legislation and the interaction with established general law principles. These are important questions because, as we saw at the outset, the vindication of the plaintiff’s right not to be misled turns on the availability of a remedial regime that can traverse even the more difficult cases where the loss is not apparent or is non-existent.

The potential range and measure of damages and other orders under the *ACL* ultimately depends upon the scope of the repeated criterion of ‘loss or damage’, seen in light of the broader language, structure and purpose of the *ACL*. We have seen that courts give a generous interpretation to these words when considering the

<sup>156</sup> In some cases involving good faith defendants to claims of restitution, change-of-position considerations may be relevant, for example.

<sup>157</sup> Edelman, Varuhas and Colton, above n 15, 452–7 [14-011]–[14-022].

<sup>158</sup> *Commercial Tenancy (Retail Shops) Agreements Act 1985* (WA) s 16D(3)(a); *Retail Leases Act 1994* (NSW) s 72(1)(a). See also *Spuds Surf Chatswood Pty Ltd v PT Ltd (No 4)* where the NSW Civil and Administrative Tribunal made what it identified as a restitutionary award responding to unconscionable conduct under s 72AA(1)(a) of the *Retail Leases Act 1994* (NSW): [2015] NSWCATAP 11 (12 February 2015) [213].

<sup>159</sup> (1992) 39 FCR 31, 32–3 (Black CJ), 42–3, 45 (Gummow J), 48 (Cooper J).

possibility of orders under ss 237–9, which has justified the award of restitutionary relief. The award of user damages based on a misuse of a plaintiff's property where there has been no pecuniary loss is consistent with this approach. However, because this is instrumental legislation, operating within a broader legal context, there are other considerations before sanctioning this approach. These include considerations of the integrity of the legislative scheme itself and the gravitational impact of the current generous approach on our broader, general law understandings of concepts of loss and damage. For these reasons, it may be prudent to consider legislative reform to give express authorisation for restitutionary remedies that are so evidently valued in practice.



# Finality and Fairness in Australian Class Action Settlements

Michael Legg\* and Samuel J Hickey†

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## Abstract

The extent to which a group member is bound by the outcome in a class action is of great significance to group members, parties and the justice system generally as it raises the core concerns of finality and fairness. In relation to judgment, the High Court of Australia in the *Timbercorp* class action determined that the resolution of a class action will not dispose of the individual claims of group members that fall beyond the scope of the common issues that were the subject of the proceeding. However, in relation to settlement, the position is unclear because courts have exhibited divergent reasoning in relation to the resolution of the individual claims/issues of group members, as exemplified by the *Great Southern* and *Willmott Forests* class actions. The purpose of this article is to employ a claims/issues framework as an analytical tool to ascertain the extent to which a group member's claims/issues can be determinatively resolved by settlement.

## I Introduction

The extent to which a group member is bound by the outcome in a class action because of judgment or settlement is of great significance to group members, representative parties (plaintiffs), defendants and the justice system generally. The group member will want to know which, if any, of their claims or part thereof are to be decided through the class action. This will impact their decision-making as to: whether they need to bring their own individual claim; whether they need to opt out of the class action to preserve their claim; or whether to take other steps to protect their interests. The representative party needs to know the extent of their authority to represent group members. This, in turn, impacts the calculus of the plaintiff lawyer and litigation funder in the conduct or financing of the class action respectively. Equally, defendants will be concerned to know if the class action will resolve all claims against them, except for those of group members that opt out, or whether they may face further litigation. Moreover, the justice system seeks to achieve finality and fairness, which requires all participants to know the extent to which their rights are to be determined, and the steps they can take to protect those rights.

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In relation to judgment, the High Court of Australia in the *Timbercorp* class action determined that the resolution of a class action will not dispose of the individual claims of group members that fall beyond the scope of the common issues that were the subject of the proceeding.<sup>1</sup> However, in relation to settlement, the position is less clear because judgments in the *Great Southern*<sup>2</sup> and *Willmott Forests*<sup>3</sup> class actions exhibited divergent reasoning in relation to the resolution of the individual claims/issues of group members. The purpose of this article is to examine the extent to which a group member's claims/issues can be determinatively resolved by settlement, including whether group members can be precluded from raising claims or defences based on their unique circumstances in future litigation. To this end, we present a framework consisting of four mutually exclusive categories to classify the claims of group members. This framework clarifies the uncertainties in the case law by identifying the kinds of claims that can be finally resolved through judgment and settlement, and those that cannot.

The structure of this article is as follows. Part II begins by explaining the principles of fairness and finality with specific reference to the difficulties that arise in the class action because of the existence of group members. The relevant provisions of Australia's class actions regimes will also be summarised. This Part then sets out our taxonomical framework for examining the scope, or meaning, of claims/issues in a class action which will be used to examine the reasoning in the *Timbercorp*, *Great Southern* and *Willmott Forests* class actions. This framework is based on close analysis of the statutory regime governing class actions (pt IVA of the *Federal Court of Australia Act 1976* (Cth) and its State counterparts<sup>4</sup>) and the case law interpreting these instruments. Part III will set out the High Court's reasoning in the *Timbercorp* class action and employ the claims/issues framework introduced in Part II to explain its ramifications. Part IV addresses the settlements in the *Great Southern* and *Willmott Forests* class actions and outlines the jurisprudence that emerged from these cases. Part V then uses the claims/issues framework to determine the degree of finality that can be achieved in a class action settlement.

## II Background

### A Finality and Fairness

Finality is a defining tenet of judicial power. It posits that once controversies have been judicially resolved, they are not to be reopened except in limited circumstances.<sup>5</sup> The importance of finality is obvious: it protects the judicial

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<sup>1</sup> *Timbercorp Finance Pty Ltd (in liq) v Collins* (2016) 259 CLR 212 ('*Timbercorp*').

<sup>2</sup> *Clarke (as trustee of the Clarke Family Trust) v Great Southern Finance Pty Ltd (recs and mgrs apptd) (in liq)* [2014] VSC 516 (11 December 2014) ('*Great Southern*').

<sup>3</sup> *Kelly v Willmott Forests Ltd (in liq) (No 4)* (2016) 335 ALR 439 ('*Willmott Forests*').

<sup>4</sup> *Supreme Court Act 1986* (Vic) pt 4A; *Civil Procedure Act 2005* (NSW) pt 10; *Civil Proceedings Act 2011* (Qld) pt 13A.

<sup>5</sup> *D'Orta-Ekenaike v Victoria Legal Aid* (2005) 223 CLR 1, 17 [34]. See also *Bailey v Marinoff* (1971) 125 CLR 529; *Gamsar v Nominal Defendant* (1977) 136 CLR 145; *DJL v Central Authority* (2000) 201 CLR 226; *Burrell v R* (2008) 238 CLR 218, 223 [15].

function from collateral attack by precluding parties from contending, outside of judicial review, that a decision was wrong.<sup>6</sup> Further, without an element of finality, judicial power cannot be exercised effectively to decide the rights and liabilities of parties.<sup>7</sup> The importance of finality in litigation has also been articulated in policy terms: the public has an interest in efficient and economic litigation rather than duplication of costs and delay;<sup>8</sup> and, in relation to the litigants themselves, ‘a party should not be twice vexed in the same matter’.<sup>9</sup>

The principle of finality manifests through multiple procedural rules in civil litigation, relevantly here, the doctrine of *Anshun* estoppel.<sup>10</sup> *Anshun* estoppel precludes parties from asserting a claim or issue of law or fact if that claim or issue was so connected to the subject matter of an earlier proceeding involving that party that it was unreasonable that the claim or issue had not been raised in that earlier proceeding.<sup>11</sup> In the context of class actions, finality is especially important due to the number of persons that might comprise a claimant group and look to the class action for resolution of their disputes. Finality is also significant for respondents, with the class action providing a means to define and conclude their liability.<sup>12</sup> Indeed, a central feature of the class action is that it seeks to resolve issues once for numerous group members so as to avoid re-litigating those issues.<sup>13</sup>

In class actions, the importance of finality must be tempered by the need to take account of the representative nature of the class action and the situation of individual group members. Class actions are commenced by a representative party who nominates themselves as the person to bring and conduct the proceedings.<sup>14</sup> The consent of a person to be a group member, or to the choice of representative party, is not required.<sup>15</sup> They may not know of the commencement of the proceeding, nor wish that it be brought, yet they are included, subject to being afforded an opportunity to later exclude themselves or opt out.<sup>16</sup> Group members may, or may not, enter into a retainer with the solicitor conducting the class action.<sup>17</sup> Consequently they may have received no legal advice as to their interests. Group

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<sup>6</sup> Justice Margaret Beazley and Chris Frommer, ‘The Distinctive Character of the Judicial Function’ in Michael Legg (ed), *Resolving Civil Disputes* (LexisNexis, 2016) 14.

<sup>7</sup> Ibid. See also *Kable v Director of Public Prosecutions for NSW* (2013) 252 CLR 118, 135 [38]–[39].

<sup>8</sup> *Johnson v Gore Wood and Co* [2002] 2 AC 1, 31 (Lord Bingham). See also *Boland v Dillon* [2015] NSWCA 183 (2 July 2015) [60] (referring to ‘the public interest in the finality of controversies’); *Wentworth v Rogers (No 5)* (1986) 6 NSWLR 534, 538.

<sup>9</sup> *Johnson v Gore Wood and Co* [2002] 2 AC 1, 31.

<sup>10</sup> While the case law primarily focuses on *Anshun* estoppel, it does establish that abuse of process and issue estoppel may also be relevant doctrines, although they are not discussed in this article.

<sup>11</sup> *Port of Melbourne Authority v Anshun Pty Ltd* (1981) 147 CLR 589; *Timbercorp* (2016) 259 CLR 212, 226 [14]; *Tomlinson v Ramsey Food Processing Pty Ltd* (2015) 256 CLR 507, 517–18 [22].

<sup>12</sup> *Giles v Commonwealth of Australia* [2014] NSWSC 83 (21 February 2014) [81]; *Melbourne City Investments Pty Ltd v Treasury Wine Estates Ltd* (2017) 252 FCR 1, 21–2 [74] (‘*Melbourne City Investments*’).

<sup>13</sup> *A S v Minister for Immigration and Border Protection* [2014] VSC 593 (28 November 2014) [54].

<sup>14</sup> See, eg, *Johnston v Endeavour Energy* [2015] NSWSC 1117 (19 August 2015) [64].

<sup>15</sup> *Federal Court of Australia Act 1976* (Cth) s 33E. Consent can be sought and provided, but is not required: *P Dawson Nominees Pty Ltd v Multiplex Ltd* (2007) 242 ALR 111, 123 [49].

<sup>16</sup> *Mobil Oil Australia Pty Ltd v Victoria* (2002) 211 CLR 1, 31–32 [38]–[41] (‘*Mobil Oil*’); *Johnston v Endeavour Energy* [2015] NSWSC 1117 (19 August 2015) [64].

<sup>17</sup> See, eg, *Australian Securities Investment Commission v Richards* [2013] FCAFC 89 (12 August 2013) (‘*Richards*’); *Willmott Forests* (2016) 335 ALR 439.

members may have their rights determined without them being present before the court or being able to individually put forward their interests and arguments, yet they can be bound by the outcome of the class action.<sup>18</sup> Group members are thus at risk of unfair treatment. However, as Gleeson CJ stated in *Mobil Oil*, the goal of the class action regime is to deal with a multiplicity of claims together, consistent with ‘the requirements of fairness and individual justice’.<sup>19</sup> In order to ameliorate the risk of unfairness, Australian judges seek to safeguard the interests of group members throughout the litigation process.<sup>20</sup> This role is most apparent in the context of applications brought before a court for settlement approval, in which a court will assume a protective role akin to the way it approaches infant compromises<sup>21</sup> or claims involving persons with disabilities.<sup>22</sup>

## B *Australia’s Class Action Regime*

It is necessary to outline the relevant provisions of Australia’s class action regime as it provides the statutory framework that governs how class actions operate. Reference is primarily made to the federal provisions under pt IVA of the *Federal Court of Australia Act 1976* (Cth) as, for present purposes, there are no significant differences between the Federal provisions and their State counterparts. The article’s analysis pertains equally to the Federal and State regimes. The numbering of the Victorian provisions which are referred to below mirrors that of the Federal legislation.

The first relevant section is s 33C(1), which provides that where:

- (a) 7 or more persons have claims against the same person; and
- (b) the claims of all those persons are in respect of, or arise out of, the same, similar or related circumstances; and
- (c) the claims of all those persons give rise to a substantial common issue of law or fact;

a proceeding may be commenced by one or more of those persons as representing some or all of them.

Section 33C has two important features. First, in conjunction with s 33D, it authorises the representative party to commence proceedings on behalf of the rest of the group, and for the representative party to continue proceedings in that same capacity. Second, the provision mandates the requirements for a class action to be brought, including the existence of ‘a substantial common issue of law or fact’.

<sup>18</sup> *Mobil Oil* (2002) 211 CLR 1, 32 [41]; Michael Legg, ‘Judge’s Role in Settlement of Representative Proceedings: Lessons from United States Class Actions’ (2004) 78 *Australian Law Journal* 58, 63–4.  
<sup>19</sup> *Mobil Oil* (2002) 211 CLR 1, 24 [12].

<sup>20</sup> See *Mobil Oil* (2002) 211 CLR 1, 27 [21]–[22] (Gleeson CJ) citing *Carnie v Esanda Finance Corporation Ltd* (1995) 182 CLR 498, 408 (Brennan J) for the need for judicial supervision of class actions to ensure that the interests of group member are not prejudiced by the conduct of the litigation on their behalf.

<sup>21</sup> *Richards* [2013] FCAFC 89 (12 August 2013) [8]; *P Dawson Nominees Pty Ltd v Brookfield Multiplex Ltd (No 4)* [2010] FCA 1029 (21 September 2010) [23].

<sup>22</sup> *Money Max Int Pty Ltd (Trustee) v QBE Insurance Group Ltd* (2016) 245 FCR 191, 225 [171]. See also *Mercedes Holdings Pty Ltd v Waters (No 1)* (2010) 77 ASCR 265, 272 [28], in which Perram J explained that judges presiding over class actions in Australia essentially discharge a supervisory beneficial jurisdiction.

Section 33H(1) requires that the originating process define the group by specifying ‘the questions of law or fact common to the claims of the group members’.

Australia adopts an opt-out class action model, whereby group members are included in the class action based on the group definition rather than consent. Section 33J provides that group members have the right to opt out of a class action by giving written notice that they intend to do so. Under s 33X(1)(a), group members must also be provided with notice of the right to opt out.

Although ss 33C and 33D focus on common issues, s 33Q arms the court with case management powers where the determination of the common issues will not finally determine the claims of all group members to resolve the remaining issues. Alternatively, a court may discontinue the class action once the common issues have been resolved, so that the remaining issues are pursued through other means.<sup>23</sup>

The central provision in relation to finality in class actions is s 33ZB, which reads as follows:

A judgment given in a representative proceeding:

- (a) must describe or otherwise identify the group members who will be affected by it; and
- (b) binds all such persons other than any person who has opted out of the proceeding under section 33J.<sup>24</sup>

Section 33ZB ensures that group members who have not opted out of the proceedings are bound by a court’s judgment. Group members who do opt out of the class action do not participate in any judgment award or settlement, and their claims survive the resolution of the class action and can be pursued separately.

Where a class action is to be resolved by settlement, s 33V provides that settlement must be approved by the court. Section 33V has been interpreted to mean that a court’s task in a settlement approval application is to decide if it is satisfied that the settlement is fair and reasonable having regard to the interests of the group members who will be bound by it.<sup>25</sup>

Finally, s 33ZF gives the court the power ‘[i]n any proceeding (including an appeal) conducted under this Part’ to make any order ‘of its own motion or on application’ which it ‘thinks appropriate or necessary to ensure that justice is done in the proceeding’.<sup>26</sup>

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<sup>23</sup> *Federal Court of Australia Act 1976* (Cth) s 33N. See *Zhang v Minister for Immigration, Local Government and Ethnic Affairs* (1993) 45 FCR 384, 403–4; *Bright v Femcare Ltd* (2002) 195 ALR 574, 580 [18].

<sup>24</sup> The Victorian equivalent, *Supreme Court Act 1986* (Vic) s 33ZB, differs in that s 33ZB(b) states ‘subject to section 33KA, binds all persons who are such group members at the time the judgment is given’. Section 33KA allows for an application that a person cease to be a group member or not become a group member.

<sup>25</sup> *Australian Competition and Consumer Commission v Chats House Investments Pty Ltd* (1996) 71 FCR 250, 258; *Lopez v Star World Enterprises Pty Ltd* [1999] FCA 104 (28 January 1999) [16]; *Richards* [2013] FCAFC 89 (12 August 2013) [7]–[8].

<sup>26</sup> *Federal Court of Australia Act 1976* (Cth) s 33ZF grants standing to parties and group members while *Supreme Court Act 1986* (Vic) s 33ZF only grants standing to a party. Both allow the court to proceed of its own motion.

### C *Claims/Issues Framework for Class Actions*

A class action may determine or resolve all or part of a group member's claim. The scope of a binding judgment or settlement in a class action may be conceived of in terms of the following kinds of issues and claims:

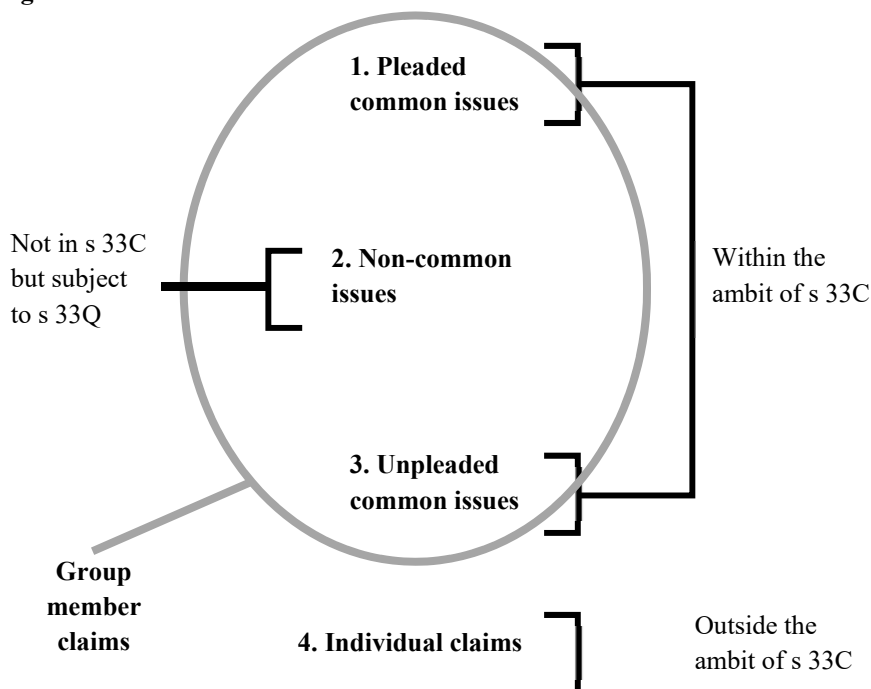
- (1) common issues that are pleaded or specified to be resolved by the class action; that is, the issues derived from the claims that fall within the ambit of s 33C(1).
- (2) the individual or non-common issues that are part of the claims that give rise to the common issues that are pleaded in the class action (for example, causation and damages).
- (3) unpleaded or unspecified common issues that meet the class action requirements under s 33C(1), but are not included in the class action.
- (4) individual claims that are separate from the claims being pursued in the class action; that is, claims that do not give rise to common issues that could be included consistent with the class action requirements.

The claims/issues framework is an analytical tool aimed at assisting in determining the ability of the representative party to bind group members to the outcome of a judgment or settlement, and to allow for the respective positions to be contrasted, by reference to the above categories. It is important to highlight the distinction between claims that fall into Category Three and Category Four. Category Three issues are common to the group members and satisfy the requirements of s 33C but are not included in the class action.<sup>27</sup> Category Four claims by comparison are the individual claims of class members that cannot be raised in the class action for lack of compliance with the commonality aspect of s 33C(1)(c). Figure 1 below shows the relationship between each of the categories and s 33C.

As an analytical tool, the framework's taxonomy does not beget legal conclusions and the categories simply serve as a way of clarifying what courts are referring to when mentioning common and individual claims. This article will focus, in particular, on Category Three and Category Four in the context of settlement, as it is the resolution of these kinds of claims/issues that pose the greatest risk of unfairness for individual group members and that, due to the tension in the case law, gives rise to greatest legal uncertainty.

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<sup>27</sup> Common issues may not be included in a class action by inadvertence, but they may also be excluded in an effort to focus on the most significant common issues that affect the likelihood of success in the class action and advance the determination of group member claims.

**Figure 1:** Claims/issues framework

### III Finality and Class Action Judgments

#### A Background to Timbercorp

A class action proceeding was brought against members of the Timbercorp Group in the Supreme Court of Victoria under pt 4A of the *Supreme Court Act 1986* (Vic) following the collapse of that group in 2009 and its subsequent liquidation. The class action was brought on behalf of about 18 500 investors who had invested in horticultural and forestry managed investment schemes ('MISs') operated by the Timbercorp Group. The class action concerned alleged breaches of statutory disclosure obligations and sought relief including declarations that the representative party and the group members were not liable under the loan agreements that had been entered into between Timbercorp Finance and various group members for the purpose of funding the group members' participation in the schemes.<sup>28</sup> The common questions in the class action did not raise any issues about the validity or enforceability of the loans arising out of the lending process or the advancement of moneys under the loans.<sup>29</sup>

<sup>28</sup> *Timbercorp* (2016) 259 CLR 212, 223 [1]–[2], 224 [7] (French CJ, Kiefel, Keane and Nettle JJ), 242–3 [83]–[87] (Gordon J).

<sup>29</sup> *Ibid* 223 [1]–[2], 226 [14] (French CJ, Kiefel, Keane and Nettle JJ), 249 [119] (Gordon J).

The class action was unsuccessful at first instance and on appeal.<sup>30</sup> Timbercorp Finance brought separate proceedings for the balance of the outstanding loan amounts. Mr and Mrs Collins and Mr Tomes had been members of the class action proceeding (but neither were representative parties). In the proceedings brought by Timbercorp Finance, Mr and Mrs Collins and Mr Tomes each sought to raise claims and defences challenging the validity and enforceability of the loan agreements that had not been raised in the class action.

At trial, Robson J found that the individual group members were not precluded from raising their defences.<sup>31</sup> An appeal against this decision was dismissed by the Victorian Court of Appeal.<sup>32</sup> The primary issue before the High Court of Australia was whether the individual group members were entitled to raise defences to the debt recovery proceedings brought against them, or instead, were barred from doing so by *Anshun* estoppel or abuse of process.

## B *The High Court's Reasoning*

The High Court unanimously dismissed the appeal and held that the individual group members were entitled to raise their defences in the debt recovery proceedings. The plurality comprised French CJ, Kiefel, Keane and Nettle JJ, while Gordon J wrote a separate concurring judgment.

For the purpose of determining whether the group members were prevented from raising their defences by *Anshun* estoppel, the plurality first considered Timbercorp Finance's submission that all members of the claimant group were privies in interest with the representative party. The doctrine of privies in interest posits that an individual who claims through another is subject to all estoppels affecting the person through whom that individual claimed.<sup>33</sup> If the representative party had been privies in interest with all of the other group members, then the question of whether it had been unreasonable for Mr and Mrs Collins and Mr Tomes not to have raised their defences in the class action would depend on whether it had been unreasonable for the representative party not to have raised those defences. If *Anshun* estoppel were approached in this fashion, it would be much more likely that the issue would be resolved in favour of Timbercorp Finance's liquidators.

The plurality found that a representative party represents group members only with respect to the claims that give rise to the common issues of law and fact, and that a representative party and group members are privies in interest only with respect to those claims.<sup>34</sup> Section 33ZB therefore did not bind group members in respect of individual claims beyond the scope of the common questions,<sup>35</sup> and group members were not privies in interest with a representative party in respect of their

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<sup>30</sup> *Woodcroft-Brown v Timbercorp Securities Ltd (in liq)* [2011] VSC 427 (1 September 2011); *Woodcroft-Brown v Timbercorp Securities Ltd (in liq)* [2013] VSCA 284 (10 October 2013).

<sup>31</sup> *Timbercorp Finance Pty Ltd (in liq) v Collins* [2015] VSC 461 (2 September 2015).

<sup>32</sup> *Timbercorp Finance Pty Ltd (in liq) v Collins* [2016] VSCA 128 (1 June 2016).

<sup>33</sup> *Timbercorp* (2016) 259 CLR 212, 236 [54].

<sup>34</sup> *Ibid* 231 [36]–[37], 234–5 [49].

<sup>35</sup> *Ibid* 235 [52].



own individual claims.<sup>36</sup> This was so regardless of whether those individual claims should have been raised in the class action.<sup>37</sup> In reaching the same conclusion, Gordon J stated that pt 4A only resolved common questions of law and fact, and that the interests of a representative party and group members only aligned to the extent that each had an interest in those common questions.<sup>38</sup>

The plurality then went on to address the concepts of relevance and reasonableness that follow from the test for *Anshun* estoppel, namely: ‘there could be no estoppel “unless it appears that the matter relied upon as a defence in the second action was so *relevant* to the subject matter of the first action that it would have been *unreasonable* not to rely on it”’.<sup>39</sup> The plurality did not need to consider the representative party’s reasonableness in not bringing the group members’ claims because there was no privity. In relation to Mr and Mrs Collins and Mr Tomes, the plurality found that it could hardly have been expected that they would have raised their individual defences in the class action where the common issues related to risks and misrepresentations affecting the MISs.<sup>40</sup> Indeed, the defences to the loan agreements were irrelevant to the issues raised in the class action.<sup>41</sup> Further, there was no risk of the individual defences giving rise to an inconsistency with respect to the findings in the class action.<sup>42</sup> The plurality also found that even if the defences had been relevant to the class action, there would remain questions as to whether Mr and Mrs Collins and Mr Tomes could and should have raised their defences in the class action.<sup>43</sup> Justice Gordon addressed this issue of reasonableness further, noting that a mechanical approach should not be applied and attention must be paid to the particular circumstances of the case,<sup>44</sup> including ‘the scope of the group proceeding as determined by the definition of the group members and the common questions; the role of group members in a group proceeding; the counterclaim and its management; and the nature of the opt out procedure’.<sup>45</sup>

The plurality also dismissed Timbercorp Finance’s contention that group members should have opted out of the class action when an opt-out notice had been published if they had wished to raise individual claims in future litigation. This submission had been based on the erroneous notion that the representative party in the group proceeding represented the unpleaded claims of the other group members; this not being the case, there was no need for Mr and Mrs Collins and Mr Tomes to opt out in order to preserve their position with respect to the claims now the subject of the defences.<sup>46</sup>

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<sup>36</sup> Ibid 235–6 [53].

<sup>37</sup> Ibid 235–6 [53].

<sup>38</sup> Ibid 254 [142].

<sup>39</sup> Ibid 236–7 [56] (emphasis in original), quoting *Port of Melbourne Authority v Anshun Pty Ltd* (1981) 147 CLR 589, 602.

<sup>40</sup> Ibid 237 [58].

<sup>41</sup> Ibid.

<sup>42</sup> Ibid 237–8 [61].

<sup>43</sup> Ibid 237 [59].

<sup>44</sup> Ibid 248 [111]–[115].

<sup>45</sup> Ibid 248 [115].

<sup>46</sup> Ibid 239 [67].

## C *Application of Claims/Issues Framework*

The High Court's discussion of privity establishes that group members are bound by judgment on the common issues (Category One). As the representative party in *Timbercorp* was unsuccessful, there was no need to consider associated individual issues such as causation and damages. However, if the representative party had been successful, then the group members' associated individual issues would have required determination through further trials or use of some form of alternative dispute resolution (Category Two).<sup>47</sup> To this end, the trial of a class action resolves the common issues and typically the entirety of the representative party's claim.<sup>48</sup> Judgment and reasons in relation to the representative party's claim can provide precedential guidance as to how group members' Category Two claims may be resolved, although they do not necessarily determine these claims. Category Two claims may be determined as part of subsequent case management through the court relying on s 33Q.

The High Court also clarified the position in relation to Category Three and Category Four. In relation to Category Three claims, it is relevant that the plurality observed that privity operated so that 'one who claims through another is, to the extent of his claim, subject to ... all estoppels affecting the person through whom he claims'.<sup>49</sup> This means that, if the representative party is subject to *Anshun* estoppel because there are claims that *could* have been brought because they gave rise to common issues and *should* have been brought because it was unreasonable not to bring them, but they were not included, then group members may also be prevented from subsequently bringing those claims in separate proceedings. However, the plurality noted that an exception to this position might arise in cases where group members lack control over the proceedings, as '[i]t would be quite unjust for a person whose legal interests stood to benefit by making a legal claim to be precluded if they did not have some measure of control of the proceedings in question'.<sup>50</sup>

The plurality's focus on control complicates the position on whether Category Three claims can be resolved by judgment. The plurality did not specify the degree of control that a claimant would have to possess in order for a judgment to prevent them from bringing their unpleaded claim in subsequent litigation. Further, an analysis of the degree of control required to bind Category Three claims in a judgment context is beyond the scope of this article, which is primarily concerned with settlement. However, it is unlikely that the plurality meant that Category Three claims cannot be resolved by judgment unless the owner of that claim was able to have that claim raised in the class action. In an opt-out class action, group members are highly unlikely to be able to exercise such control over which

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<sup>47</sup> *Federal Court of Australia Act 1976* (Cth) ss 33Q–33S. See, eg, *McMullin v ICI Australia Operations Pty Ltd* (No 6) (1998) 84 FCR 1, 3–4 ('*McMullin* (No 6)'); *Wotton v State of Queensland* (No 7) [2017] FCA 406 (20 April 2017).

<sup>48</sup> Federal Court of Australia, *Class Actions Practice Note — General Practice Note (GPN-CA)*, 25 October 2016, [3.2], [12.1] ('*Class Actions Practice Note (GPN-CA)*'). See, eg, *Stanford v DePuy International Ltd* (No 6) [2016] FCA 1452 (1 December 2016) [26]; *Perera v Getswift Ltd* (2018) 357 ALR 586, 640 [206].

<sup>49</sup> *Timbercorp* (2016) 259 CLR 212, 236 [54].

<sup>50</sup> *Ibid.*

claims are raised, and requiring that individual group members actually have the discretion and influence to raise claims on their own behalf would undercut the utility of the class action as a representative procedure. The better view is that the control of a group member should be gauged by reference to the opt-out rights that were afforded to them and the content of the opt-out notice; these factors are explored in relation to settlement below.

The resolution of Category Four claims is not as complex; it is important to recall that the loan agreements that were the subject of Mr and Mrs Collins' and Mr Tomes' defences did not satisfy the requirements to be part of the common questions of the class action. The defences thus fell into Category Four and could not be resolved by judgment: a representative party cannot bring proceedings, or bind group members through the outcome of a trial, in relation to claims in Category Four because those claims are beyond the ambit of s 33C(1).

#### IV The Contrasting *Great Southern* and *Willmott Forests* Class Action Settlement Judgments

The factual backgrounds of *Great Southern* and *Willmott Forests* were similar to *Timbercorp*. In each case, the claimants alleged that the defendants that had managed agricultural MISs had breached statutory disclosure obligations. The claimants argued, among other things, that they would not have entered into loan agreements to finance their participation in these schemes but for the defendants' allegedly unlawful conduct. The claimants thus sought relief including declarations that the loan agreements were void and unenforceable.<sup>51</sup> *Great Southern* and *Willmott Forests* were both decided prior to *Timbercorp*, and in both cases the court was asked to approve a settlement that included terms admitting the validity and binding nature of loan agreements that individual group members in each case sought to dispute ('enforceability admissions').<sup>52</sup> The parties seeking settlement approval in both cases also sought an order *nunc pro tunc* under s 33ZF mandating that the representative party had the authority of the rest of the group to enter into the settlement agreement.<sup>53</sup> The *Great Southern* settlement was approved by the Supreme Court of Victoria. The *Willmott Forests* settlement was rejected by the Federal Court of Australia.

##### A *Great Southern*

The *Great Southern* proceedings comprised 16 class actions brought following the collapse of the Great Southern Group. In July 2014, the representative parties agreed to settle their claims and an application was made under s 33V of the *Supreme Court Act 1986* (Vic).

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<sup>51</sup> *Great Southern* [2014] VSC 516 (11 December 2014) [88]; *Willmott Forests* (2016) 335 ALR 439, 445–46 [14]–[16], 463 [117].

<sup>52</sup> The sequence of decisions was the *Great Southern* settlement approval judgment, the *Timbercorp* decision at first instance and then the *Willmott Forests* settlement rejection judgment.

<sup>53</sup> *Great Southern* [2014] VSC 516 (11 December 2014) [7]; *Willmott Forests* (2016) 335 ALR 439, 447 [23].

A portion of the group members objected to the settlement agreement, and four grounds of objection were put forward for refusing the application under s 33V.<sup>54</sup> First, the objecting group members claimed that the enforceability clauses were unfair because they went beyond the relief sought by the respondents in the class action, such that the settlement deed purported to achieve an outcome that went beyond the ambit of the class action and could not have otherwise been achieved via judgment.<sup>55</sup> However, Croft J found that there was no substance to this objection because ‘the enforceability of the loan deeds was at the very heart of the Great Southern proceedings’ and the relief available in the proceedings was contingent upon the validity of the clauses.<sup>56</sup>

Second, the objecting group members argued that the opt-out notices did not put them on notice of the risk that they might lose individual claims or defences; that is, the settlement went beyond the terms of the notice.<sup>57</sup> Justice Croft found that it was quite clear the enforceability of the loan deeds had been central to the proceedings and that the notice had provided group members with sufficient warning that any potential settlement might resolve claims relating to those agreements that had not been raised in the class actions.<sup>58</sup>

The third objection was that the enforceability clauses were generally not fair or reasonable. In rejecting this ground, Croft J took into account, among other things, the fact that the settlement reflected a genuine commercial compromise reached by negotiating parties vying to achieve finality.<sup>59</sup>

The final objection was that the enforceability clauses would prevent group members from raising their individual defences relating to the loan agreements in subsequent debt recovery proceedings.<sup>60</sup> Justice Croft noted that the clauses would indeed prevent such defences from being raised in this way, but that the settlement was nonetheless fair and reasonable. In any event, it was not appropriate for the Court to consider this ground because the individual defences had been posed at a hypothetical level as the objecting group members could not point to any defence that might arise in future proceedings.<sup>61</sup> His Honour went on to find that, even if the objecting group members could point to actual defences, they would be prevented from relying on those defences for two reasons.

First, they had failed to opt out of the class action, which in turn meant that they had elected to be bound by the claims made in the class action. If the objecting group members had wished to raise individual claims or defences relating to the loan agreements in future proceedings, then they should have opted out of the class actions when given the chance.<sup>62</sup> The purpose of the opt-out procedure was to

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<sup>54</sup> Some group members had previously unsuccessfully sought to be removed as group members: *Clarke v Great Southern Finance (in liq)* [2014] VSC 569 (14 November 2014).

<sup>55</sup> *Great Southern* [2014] VSC 516 (11 December 2014) [87].

<sup>56</sup> *Ibid* [91].

<sup>57</sup> *Ibid* [78].

<sup>58</sup> *Ibid* [98].

<sup>59</sup> *Ibid* [100].

<sup>60</sup> *Ibid* [77].

<sup>61</sup> *Ibid* [119].

<sup>62</sup> *Ibid* [130]–[132].

preserve the right of individuals with claims arising from the same subject matter as the class action to choose whether to commence individual proceedings and the necessary corollary of this for group members who did not opt out was that they were taken to have chosen to be bound by the issues raised in the class action.<sup>63</sup> Second, the defences would be bound by the doctrine of *Anshun* estoppel (or would constitute an abuse of process).<sup>64</sup> That is, if the class action went to judgment or settled, group members would be estopped from raising subsequent claims or defences that posited the loan deeds were unenforceable.<sup>65</sup> To this end, the enforceability clauses did not detract from the fairness and reasonableness of the settlement; they simply provided certainty.<sup>66</sup>

In considering the unreasonableness requirement of *Anshun* estoppel, his Honour noted that it would have been unreasonable for group members to raise their defences because, if they had wished to have done so, they should have opted out of the class action.<sup>67</sup>

Justice Croft approved the settlement and ordered pursuant to s 33ZF that the representative parties had the group members' authority, *nunc pro tunc*, to enter into and give effect to the settlement deed. His Honour's decision was not appealed by those group members who sought to contest their obligations under the loan agreements until over four years later, when the appeal was out of time, and an application for an extension of time to apply for leave to appeal the orders made in *Great Southern* was denied.<sup>68</sup> Rather, a number of those group members sought to avoid the effect of the settlement that had been approved when they became the subject of separate loan enforcement proceedings that sought repayment.<sup>69</sup>

## B *Willmott Forests*

*Willmott Forests* concerned four related investor class actions brought following the collapse of the Willmott Group. The representative parties entered into a settlement agreement with the respondents, and an application for settlement approval was heard by Murphy J.<sup>70</sup> Similarly to *Great Southern*, the proposed settlement attributed to all group members enforceability admissions that loan agreements entered into for the purpose of funding participation in investment schemes were binding and enforceable, thereby preventing group members from raising defences based on their own unique circumstances in future proceedings. Consequently, some of the group objected to the proposed settlement.

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<sup>63</sup> Ibid [123].

<sup>64</sup> Ibid [126].

<sup>65</sup> Ibid [126].

<sup>66</sup> Ibid [126].

<sup>67</sup> Ibid [131]–[132].

<sup>68</sup> *Dimitrov v Bendigo & Adelaide Bank Ltd* [2019] VSCA 41 (6 March 2019).

<sup>69</sup> See, eg, *Byrne v Javelin Asset Management Pty Ltd* [2016] VSCA 214 (13 September 2016) ('*Byrne*'); *Bendigo and Adelaide Bank Ltd v Pekell Delaire Holdings Pty Ltd* (2017) 118 ACSR 592 ('*Pekell*'); *Dimitrov v Supreme Court of Victoria* (2017) 92 ALJR 12; *Bendigo and Adelaide Bank Ltd v Lonergan* [2018] VSC 357 (3 July 2018); *ABL Custodian Services Pty Ltd v Freer* [2018] VSC 355 (3 July 2018); *Bendigo and Adelaide Bank Ltd v Laszczuk* [2018] VSC 388 (10 August 2018).

<sup>70</sup> *Willmott Forests* (2016) 335 ALR 439.

The parties seeking settlement approval made three submissions in support of the fairness of the binding loan enforceability admissions that are relevant for present purposes. First, it was submitted that the admissions were necessary to achieve finality of litigation, which was in the public interest.<sup>71</sup> Justice Murphy found that the parties seeking settlement gave too much weight to the importance of finality in litigation.<sup>72</sup> The better view was that the binding loan enforceability admissions would cause undue detriment to group members because they would bar group members from denying the enforceability of the loan agreements for any reason, even in relation to claims or defences that had not been pleaded and are based on individual or unique circumstances.<sup>73</sup> This was so notwithstanding that none of the objecting group members could point to a particular defence that they might raise in future proceedings.<sup>74</sup> His Honour noted that many of the group members would gain little from the settlement if it incorporated the binding loan enforceability admissions because the amount of settlement proceeds that would be distributed to them paled in comparison to what the liquidators of the Willmott Group would be able to claim from them in enforcing the loan agreements.<sup>75</sup>

Second, the parties seeking settlement approval argued that group members had been given the opportunity to opt out of the proceedings and they should have done so if they wished to pursue other claims in separate proceedings.<sup>76</sup> This submission raises two matters for consideration: the role of the opt-out mechanism and the sufficiency of the opt-out notice. His Honour focused on the latter. Justice Murphy found that the opt-out notices had not adequately warned group members that by failing to opt out they would lose the ability to raise claims based on their individual circumstances in future proceedings that had not been pleaded in the class action.<sup>77</sup> As such, they were not sufficient to bind the individual claims of group members to the settlement agreement. Justice Murphy approached the sufficiency of the notices by requiring consideration of the context in which group members read the notice, the actual terms of the notice and the audience to which the notice was directed so that it could be found that the notice unambiguously warned of the extent to which claims would or might be precluded in a manner that was understandable by a layperson.<sup>78</sup>

Justice Murphy also reviewed the opt-out notices issued in *Great Southern* and opined that they also were not sufficient to have prevented group members from bringing future actions based on their individual circumstances.<sup>79</sup> His Honour further disagreed with Croft J's finding in *Great Southern* that a necessary corollary of members not opting out of proceedings is that they should be taken to accept that the claims pleaded in their class action represented all of the claims available to them.<sup>80</sup>

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<sup>71</sup> Ibid 462–3 [115].

<sup>72</sup> Ibid 465 [126], 467 [134].

<sup>73</sup> Ibid 465 [127].

<sup>74</sup> Cf *Great Southern*, [2014] VSC 516 (11 December 2014) [119].

<sup>75</sup> *Willmott Forests* (2016) 335 ALR 439, 466 [130]–[131].

<sup>76</sup> Ibid 463 [116], 468 [141].

<sup>77</sup> Ibid 471 [153].

<sup>78</sup> Ibid 471 [156].

<sup>79</sup> Ibid 471 [155].

<sup>80</sup> Ibid 470 [152].

Finally, the parties seeking settlement approval submitted that if the proceedings continued to judgment, and the applicants were unsuccessful (which, it was submitted, was likely), group members would be estopped from challenging the enforceability of the loan agreements under either the doctrine of *Anshun* estoppel or the principles relating to abuse of process.<sup>81</sup> Consequently, the enforceability admissions were not unfair because group members would likely lose their right to pursue the individual claims or defences even if the settlement was not approved.<sup>82</sup> Justice Murphy noted that it was common ground that judgment or settlement in a pt IVA proceeding would, by virtue of s 33ZB, preclude group members from asserting a claim that had been unsuccessfully raised in the class action (Category One).<sup>83</sup> His Honour also noted the view that a judgment or settlement *may* in some circumstances bind group members in respect of common claims that could have been pleaded in the class action but were not (Category Three).<sup>84</sup> However, it was not necessary for Murphy J to decide the precise application of *Anshun* estoppel and abuse of process to class actions because insufficient evidence had been adduced as to the nature of any individual claims of group members.<sup>85</sup>

Nonetheless, Murphy J did go on to consider the application of *Anshun* estoppel to group members at a hypothetical level, noting two relevant enquiries, the first being whether group members could have raised their individual claims within the class actions framework by making an application under ss 33Q, 33R or 33S of the *Federal Court of Australia Act 1976* (Cth).<sup>86</sup> The settlement parties submitted that, not only were parties entitled to make such applications, they were required to do so if their claims were to escape the application of *Anshun* estoppel or abuse of process.<sup>87</sup> His Honour did not accept this submission. The position of the parties seeking settlement approval mandated that group members should either give up their individual claims at the opt-out stage of the proceedings or otherwise bring their own proceeding; this would lead to a multiplicity of proceedings and was generally inconsistent with the aims of pt IVA.<sup>88</sup> Further, the position of group members is a ‘passive’ one, and this points away from any requirement on group members to identify their individual claims additional to the common claims and opt out to avoid an *Anshun* estoppel.<sup>89</sup> Justice Murphy also construed ss 33Q, 33R or 33S as not allowing for, or requiring, group members to raise individual claims.<sup>90</sup> The applicants’ arguments regarding *Anshun* estoppel and abuse of process ultimately came down to the proposition that, if group members did not opt out, pt IVA litigation would be their only chance of litigating their rights, even in relation to claims that had not been pleaded and that fell beyond the scope of s 33C. Justice Murphy rejected this view.<sup>91</sup>

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<sup>81</sup> Ibid 463 [120].

<sup>82</sup> Ibid.

<sup>83</sup> Ibid 482–3 [208].

<sup>84</sup> Ibid.

<sup>85</sup> Ibid 483 [210].

<sup>86</sup> Ibid 483 [211].

<sup>87</sup> Ibid.

<sup>88</sup> Ibid 484 [215]–[216].

<sup>89</sup> Ibid 485 [217].

<sup>90</sup> Ibid 486–8 [218]–[229].

<sup>91</sup> Ibid 488–9 [230]–[231].

Having found that group members could not have, nor were they required to, raise their individual claims in order to avoid the operation of *Anshun* estoppel, Murphy J then turned to the second issue: whether it had been unreasonable for group members not to have raised their individual claims, and found in the negative.<sup>92</sup> In so finding, his Honour was influenced by the fact that there was no evidence suggesting that group members actually could have made an application under pt IVA to agitate their individual claims (that is, they lacked control over the proceedings).<sup>93</sup>

His Honour refused to grant settlement approval as the settlement was not fair or reasonable.<sup>94</sup>

## V Finality and Class Action Settlements

The above discussion of *Timbercorp*, *Great Southern* and *Willmott Forests* raises a number of topics for consideration in determining which claims/issues can legitimately be included in a class action settlement. Our particular emphasis is on Category Three issues and Category Four claims. First, what is the scope of a representative party's authority on behalf of group members to negotiate and enter into a settlement agreement? Second, what role does s 33Q and the court's power to deal with 'remaining issues' perform in dealing with non-pleaded claims/issues in a settlement? Third, does the opt-out procedure allow for the inclusion of non-pleaded claims/issues in a settlement? Fourth, can notices be used to extend a representative party's authority to settle claims/issues beyond those pleaded? Fifthly, can *Anshun* support releases that dispose of unpleaded group member claims/issues? Sixthly, can the court's power to ensure that justice is done in s 33ZF be employed to approve a settlement that goes beyond the pleaded claims? The proper analysis of these topics is clarified below by the application of the issues/claims framework.

### A The Representative Party's Authority

The class actions legislation clearly empowers a representative party to commence proceedings, to continue proceedings and to bring an appeal.<sup>95</sup> It expressly states that they may also settle their individual claims.<sup>96</sup> The legislation requires that any settlement or discontinuance of the class action be approved by the court,<sup>97</sup> but does not expressly state that the representative party may settle or discontinue a class action, subject of course to court approval. Nonetheless, it would be implicit that a

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<sup>92</sup> Ibid 490 [238].

<sup>93</sup> Ibid 490 [240].

<sup>94</sup> Ibid 465 [126]. His Honour relied on his discretion under s 33V. Although arguments were put as to the scope of the representative party's authority, his Honour did not decide this issue: 461–2 [112]–[114]. A revised settlement was subsequently approved in *Kelly v Willmott Forests Ltd (in liq) (No 5)* [2017] FCA 689 (20 June 2017).

<sup>95</sup> *Federal Court of Australia Act 1976* (Cth) ss 33A, 33C, 33D.

<sup>96</sup> Ibid s 33W.

<sup>97</sup> Ibid s 33V.



representative party who commences proceedings can conclude them other than by judgment (that is, by settlement or discontinuance).<sup>98</sup>

In *Timbercorp*, the High Court explained the representative party's authority by reference to the concept of privity. The plurality stated in reference to ss 33C(1) and 33H:

These provisions identify the subject matter of a group proceeding as a claim which gives rise to common questions of law or fact. The plaintiff represents the group members with respect to their interests in that regard and the group members claim through the plaintiff to the extent of that interest. Their relationship is therefore that of privies in interest with respect to that claim.

However, other provisions of Pt 4A also make plain that group members may have other, individual, claims which do not form part of the subject matter of the group proceeding.<sup>99</sup>

The plurality then went on to explain: 'The provisions of Pt 4A therefore confirm that a plaintiff in group proceedings represents group members only with respect to the claim the subject of that proceeding, but not with respect to their individual claims.'<sup>100</sup> Justice Gordon reached the same conclusion.<sup>101</sup>

In *Dillon v RBS Group (Australia) Pty Ltd (No 2)*, Lee J posed the question of '[W]hat ... is one to do with a provision of a proposed settlement in which the applicants have purported to bind the group members to something that goes beyond the limit of [the] statutory agency?'<sup>102</sup> The statutory agency here is shorthand for the claims giving rise to the common issues that are part of the class action. Justice Lee followed the reasoning in *Timbercorp*, noting that it did not speak directly to settlement, but it nonetheless addressed 'the foundational notion that the representative person, or applicant, only represents group members with respect to the claim which is the subject of the proceeding, and no further'.<sup>103</sup> His Honour concluded:

It should go without saying that an applicant is only entitled to deal with any other person's rights to the extent that the applicant is representing those rights. Indeed, it is simply wrong in principle for an applicant to presume to deal with the rights of third parties except to the extent that they are empowered by statute to deal with those rights. It follows it is inconsistent with the nature of the role of a representative party under Part IVA of the Act, as part of seeking to resolve a representative proceeding, to seek to settle all individual claims of group members howsoever arising against a respondent (in contradistinction to the *claim* the subject of the relevant proceeding).<sup>104</sup>

In contrast, the Victorian Court of Appeal in *Pekell* took a different approach.<sup>105</sup> The Court stated that *Timbercorp* dealt with judgment and did not apply

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<sup>98</sup> *Farey v National Australia Bank Ltd* [2016] FCA 340 (6 April 2016) [46] ('*Farey*').

<sup>99</sup> *Timbercorp* (2016) 259 CLR 212, 234–5 [49]–[50].

<sup>100</sup> *Ibid* 235–6 [52]–[53].

<sup>101</sup> *Ibid* 253–4 [138]–[144].

<sup>102</sup> [2018] FCA 395 (20 March 2018) [51] ('*Dillon*').

<sup>103</sup> *Ibid* [49]–[50].

<sup>104</sup> *Ibid* [60] (italics in original). See also *Liverpool City Council v McGraw-Hill Financial Inc* [2018] FCA 1289 (9 August 2018) [123].

<sup>105</sup> (2017) 118 ACSR 592, 608 [56].

with equal force to claims resolved by settlement.<sup>106</sup> Further, it did not follow that a representative party could not settle a class action in a manner that affects the individual claims of group members.<sup>107</sup> There was nothing within pt 4A of the *Supreme Court Act 1986* (Vic) to circumscribe a court's power to approve such a settlement.<sup>108</sup> Rather s 33ZF empowers a court to make orders 'binding a plaintiff, group members and other parties to the settlement or authorising a plaintiff to enter into and give effect to the settlement on behalf of group members'.<sup>109</sup> The Court of Appeal explained that: '[s]uch an order supplies the privity which, as the High Court observed in *Timbercorp*, is otherwise absent in respect of the individual claims of group members'.<sup>110</sup> The Court went on to say that it would be highly surprising if pt 4A precluded parties from resolving claims between them on terms that also bring finality to other issues outstanding between those parties.<sup>111</sup>

The differing approaches in *Dillon* and *Pekell* may be reconciled by focusing on the explanation in *Timbercorp* that the express terms of the class actions framework allow only for a representative party to represent group members in relation to the common issues. This interpretation of the statutory regime extends to settlement as corollary of s 33C setting the extent of commonality in all class actions. However, the representative party may be able to obtain the authority to settle the individual claims/issues of group members in another manner, such as through s33ZF, as accepted by the Victorian Court of Appeal in *Pekell*. This is the subject of the discussion below in Part VF of this article, where it is argued that while the s 33ZF power is available, it should have a limited operation in relation to Category Four claims. In terms of the claims/issues framework, this interpretation means that the representative party can clearly settle Category One claims.

## **B     *Individual Issues and s 33Q***

It is convenient at this point to indicate that the terminology of individual issues or claims can be confusing. The claims/issues framework above differentiates between: individual issues associated with the claims that give rise to the common issues in the class action — that is, the non-common issues such as causation and damages (Category Two); and individual claims that are separate from the common claims (Category Four).

The Victorian Court of Appeal, prior to the High Court's determination in *Timbercorp*, explained that although the commencement of the class action focused on common issues, it was possible to resolve claims that went beyond those common issues.<sup>112</sup> Support for this proposition relies upon s 33Q, which states that if 'the question or questions common to all group members will not finally determine the claims of all group members, the Court may give directions in relation to the determination of the remaining questions'. The directions power may be used to

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<sup>106</sup> Ibid.

<sup>107</sup> Ibid.

<sup>108</sup> Ibid.

<sup>109</sup> Ibid 608–9 [58].

<sup>110</sup> Ibid.

<sup>111</sup> Ibid 608 [57].

<sup>112</sup> *Timbercorp Finance Pty Ltd v Collins* [2016] VSCA 128 (1 June 2016) [193].

establish one or more sub-groups, with their own sub-group representative, or for an individual group member to appear to resolve an issue that relates only to that group member.<sup>113</sup> Other steps may also be taken.<sup>114</sup> Further, where the directions-making power is insufficient to resolve an issue, s 33S allows for directions for the commencement of a separate proceeding for an individual or of a further class action for a sub-group of group members.

Sections 33Q, 33R and 33S all address Category Two of the framework. Specific legislative authority is given to the court to address Category Two through directions so as to promote finality. In contrast, Category Four claims are not before the court. The representative party does not have authority to bring Category Four claims and so the court never has jurisdiction over those claims. They simply have not been commenced in the court. These provisions also do not apply to Category Three as s 33Q addresses non-common or remaining issues. Category Three refers to unpleaded common issues.

It follows, that while Category Two is not part of, or resolved by a judgment on the common issues, it is inextricably part of a group member's cause of action and arguably needs to be included in any settlement to achieve finality. However, the better view would seem to be that the power to include Category Two in a settlement derives from the court's powers, and not the authority of the representative party, express or implied.<sup>115</sup> To the extent s 33Q is insufficient alone, it may be combined with, or inform orders under, s 33ZF. This is discussed below in Part VF of this article. Alternatively, it could be argued that there is no need to address Category Two in a settlement because once Category One is addressed by releases, Category Two has no independent existence.

## C Opt Out and its Variations

The mandatory opt-out right is a key protection for group members as it provides the mechanism for a group member who does not want their claim determined by the class action to exclude themselves. It is the necessary corollary of allowing class actions to be commenced without group member consent.<sup>116</sup> The conventional approach to opt out is that it occurs soon after the close of pleadings, or at least prior to any resolution, including a settlement.<sup>117</sup> Consequently, the opportunity to opt out must be directed to both judgment and settlement. This was the situation in each of

<sup>113</sup> *Federal Court of Australia Act 1976 (Cth)* ss 33Q(2)–(3), 33R.

<sup>114</sup> *Johnson Tiles Pty Ltd v Esso Australia Pty Ltd (No 3)* [2001] VSC 372 (5 October 2001) [37]; *Milfull v Terranora Lakes Country Club Ltd* [2002] FCA 178 (1 March 2002) [23]; *Muswellbrook Shire Council v The Royal Bank of Scotland NV* [2016] FCA 819 (9 June 2016) [10], [16], [22], [24].

<sup>115</sup> See *Timbercorp* (2016) 259 CLR 212, 251 [127].

<sup>116</sup> Australian Law Reform Commission, *Grouped Proceedings in the Federal Court*, Report No 46 (1988) [188].

<sup>117</sup> Federal Court of Australia, *Practice Note CM 17: Representative Proceedings Commenced under Part IVA of the Federal Court of Australia Act 1976 (Cth)*, 9 October 2013, [7.3]: 'The usual practice is to send opt-out notices to group members shortly after the close of pleadings.' But see *Class Actions Practice Note (GPN-CA)* [11.6]: 'The timing of the opt-out notice to group members is a matter to be dealt with at a case management hearing.'

*Timbercorp, Great Southern and Willmott Forests*.<sup>118</sup> However, the right to opt out may arise contemporaneously with settlement, especially an early settlement.<sup>119</sup> There may also be an opportunity for a second opt out as part of a settlement.<sup>120</sup> Alternatively, there may be a class-closure process where group members are asked to register (opt in) to facilitate settlement negotiations, including a mediation, or as part of a proposed settlement.<sup>121</sup> In *Farey*, Beach J suggested in obiter dicta that a group member's participation in an opt-in process (or choosing not to opt out) could be relied upon to ascribe an implied authority to the representative to enter into broad releases of liability on that group member's behalf.<sup>122</sup>

Although the opt-out mechanism is seen as a protection for group members, the statement in *Farey* and the views expressed in *Great Southern and Willmott Forests*, raise for consideration whether the an opt-out opportunity can prevent a group member from pursuing certain claims/issues after a settlement.

Turning back to *Timbercorp*, the plurality reasoned that as the representative party can only bring claims that satisfy the requirements of s 33C, these are the only claims that form part of the class action and the right or need to opt out is only in relation to those common claims, not Category Four 'unpleaded claims'.<sup>123</sup> The High Court's approach makes it clear that it is the claims in Category One that the opt-out right is addressed to and, as the group members' individual Category Four claims are not part of the class action, there is no need to opt out so as to preserve them. Category Two stays or goes with Category One because opting out of the class action removes the group member and all their claims from the proceeding, not just the common issues that the claim(s) gave rise to. However, this still leaves it unclear as to the position in relation to Category Three. As opting out removes the group member and all their claims, it would clearly be effective in preserving a group member's ability to bring forward common issues that had not been pleaded (Category Three). The more difficult question is what not opting out means for a Category Three claim/issue, especially as failing to opt out does not equate with agreement or consent.<sup>124</sup> The case law has dealt with this issue through the lens of *Anshun* estoppel, which is discussed below in Part VE.

<sup>118</sup> In relation to *Timbercorp*, opt-out notices were published in November 2010, with a further notice to take account of amendments to the pleadings approved for publication in March 2011: *Timbercorp Finance Pty Ltd (in liq) v Collins* [2015] VSC 461 (2 September 2015) [63]–[75]. The hearing commenced on 23 May 2011 and judgment was handed down on 1 September 2011. In relation to *Great Southern*, the opt-out notices were published in March 2012 and the settlement negotiations occurred between February and July 2014: *Great Southern* [2014] VSC 516 (11 December 2014) [92], [108], [112]. In relation to *Willmott Forests*, the opt-out notices were sent to group members on 14 March 2015 and 3 April 2015 and the settlement agreement was exchanged on 7 April 2015: *Willmott Forests* (2016) 335 ALR 439, 447 [23], 448 [29].

<sup>119</sup> See, eg, *Harrison v Sandhurst Trustees Ltd* [2011] FCA 541 (20 May 2011) [26]; *Inabu Pty Ltd v Leighton Holdings Ltd* [2014] FCA 622 (6 June 2014).

<sup>120</sup> *Class Actions Practice Note (GPN-CA)* [14.2]; *Willmott Forests* (2016) 335 ALR 439, 447 [21]–[23].

<sup>121</sup> *Melbourne City Investments* (2017) 252 FCR 1, 21–2 [74].

<sup>122</sup> *Farey* [2016] FCA 340 (6 April 2016) [48].

<sup>123</sup> *Timbercorp* (2016) 259 CLR 212, 239 [67] (French CJ, Kiefel, Keane and Nettle JJ), 253 [136] (Gordon J). See also *Timbercorp Finance Pty Ltd v Collins* [2016] VSCA 128 (1 June 2016) [185].

<sup>124</sup> Geoffrey Miller, 'Conflicts of Interest in Class Action Litigation: An Inquiry into the Appropriate Standard' (2003) *University of Chicago Legal Forum* 581, 586; Simone Degeling and Michael Legg, 'Class Action Settlements, Opt-out and Class Closure: Fiduciary Conflicts' (2017) 11 *Journal of Equity* 319, 339–41.

In addition to *Anshun* estoppel, attention must also be given to variations on the traditional opt-out approach as potential ways to include Category Three and Category Four in a settlement. In a registration context where group members effectively opt in to a settlement, consent may be more readily found if the scope of the settlement is clearly explained so that it may be understood by the group members. However, where registration occurs after opt out then there is no meaningful way to avoid being bound by the terms of the settlement.<sup>125</sup> The choice is only between receiving something and receiving nothing for giving up the claims specified in the settlement agreement. The group member cannot meaningfully withhold their consent. This may be addressed, as it was in *Willmott Forests*, by informing group members that they can seek to challenge the orders. However, this raises the issue of the group members' ability to effectively challenge the course of a class action.<sup>126</sup> Alternatively, the registration process could also provide for a right to opt out of the settlement. Some sort of half-way approach could be crafted where registration results in receiving the benefit of the settlement and providing broader releases, while those that fail to register make no recovery, but also are only bound by narrower releases consistent with the authority pt IVA grants to a representative party. It is important to recognise that the opt-out, registration and settlement process can develop and change, as it has in the past, so that other creative approaches may develop. It is not possible to deal with all potential eventualities here.

Category Three issues are within the representative party's authority to raise in the class action as they fall within the ambit cast by s 33C, but for some reason the representative party does not exercise that authority to include those common issues at commencement. However, to achieve finality, it is desirable that these claims be included in a settlement. Whether a representative party will have the authority to include Category Three issues in a settlement will depend, in part, upon the content of the opt-out notice and the time at which it was sent to group members. The content of opt-out notices is dealt with below in Part VD of this article. In relation to timing, for a failure to opt out to allow for the settlement to have a binding effect on Category Three issues, group members should know the claims/issues being included in the class action and subsequently falling within the scope of the settlement. To this end, the failure to opt out might only enable the release of Category Three issues in situations where the opt-out notice clearly stated the nature of the releases contained in the settlement and was sent to group members at or after the time that the terms of the settlement became known to group members. Informing group members at settlement once the opportunity to opt out has passed is insufficient because there is no longer a real choice. These matters speak to s 33V and whether the settlement is fair and reasonable.

Excepting an exercise of s 33ZF, in order to include Category Four claims in a settlement there must be actual consent to broader releases because pt IVA does not provide the representative party with statutory authority to bring these claims. This means group members must have the opportunity to choose whether to have

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<sup>125</sup> *Willmott Forests* (2016) 335 ALR 439, 472 [162].

<sup>126</sup> Michael Legg, 'Class Action Settlements in Australia — The Need for Greater Scrutiny' (2014) 38(2) *Melbourne University Law Review* 590.

their claims that are not within the representative party's statutory authority under pt IVA included or not.

Even when express consent is sought and a group member can exclude themselves from the class action, there remains a potential problem. The group member is forced to choose between the value of the settlement and the value of their Category Four individual claim. If the group member wants to pursue their individual claim, they must give up the right to participate in the settlement — they cannot have both.

## D *The Content of Notices*

If granting group members the ability to opt out or opt in to a settlement can indeed extend a representative party's authority to bind group members in relation to Category Three issues, and tend toward an exercise of discretion under s 33ZF to bind Category Four claims, then the focus must shift to the form and content of the notice. Both the *Great Southern* and *Willmott Forests* judgments stated that where group members will lose their right to claim, the notice must define the scope of the proceeding and explain the ramifications of decisions to do nothing, to opt out or to register to participate in a settlement, depending on the actions available.<sup>127</sup>

*Great Southern* and *Willmott Forests* illustrate that the standard for discerning the clarity of a notice is not straightforward. In *Great Southern*, individual group member claims/defences were extinguished by the combination of: general statements about how class actions operate; references to the determination of 'rights, if any, to compensation or other relief'; and reference to seeking orders that would render the loans void.<sup>128</sup> In contrast, in *Willmott Forests*, the detailed explanation of how class actions operate, the claims being brought and the effect of the various options was insufficiently clear to support orders that would extinguish individual group member claims/defences.<sup>129</sup> However, both outcomes in *Great Southern* and *Willmott Forests* depended on comprehension of the context of the notices. The *Great Southern* notice limited the inability to make claims in other proceedings to those 'in relation to the matters the subject of the Great Southern group proceedings', but the enforceability of loans was said to be one of those subjects.<sup>130</sup> In *Willmott Forests*, the notice said that group members would lose their 'rights to bring any claim against any of the Respondents in relation to the allegations made in these class action proceedings', but individual claims/defences about the enforceability of loans was not an allegation in the class action.<sup>131</sup>

More generally, in *Willmott Forests*, Murphy J placed greater emphasis on the clarity of the notice, and was more prepared to take account of group members' lack of understanding. His Honour held that if it were to be contended that failing to opt out would or might be preclude group members from advancing claims/issues

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<sup>127</sup> *Great Southern* [2014] VSC 516 (11 December 2014) [46]; *Willmott Forests* (2016) 335 ALR 439, 471 [154].

<sup>128</sup> *Great Southern* [2014] VSC 516 (11 December 2014) [92]–[98].

<sup>129</sup> *Willmott Forests* (2016) 335 ALR 439, 468–80 [141]–[198].

<sup>130</sup> *Great Southern* [2014] VSC 516 (11 December 2014) [94], [107].

<sup>131</sup> *Willmott Forests* (2016) 335 ALR 439, 479–80 [193]–[198].

that are not pleaded in the class action, ‘the opt out notice must unambiguously state this warning in terms that are understandable by a layperson’.<sup>132</sup> Justice Croft’s analysis was far less forgiving: ‘the opt out notice [was] sufficiently clear to anybody who had any interest in the Great Southern proceedings’.<sup>133</sup>

We note that, due to the diversity of persons who might comprise a class; each with varying degrees of sophistication, Murphy J’s insistence on clear terms is preferable.

## E *Anshun Estoppel*

*Anshun* estoppel was relied upon by the parties seeking settlement approval in *Great Southern* and *Willmott Forests* to justify precluding group members from raising their individual claims in future proceedings. In both cases, the parties seeking settlement approval argued that the enforceability admissions were not unfair, because if the matters proceeded to judgment, group members would still be prevented from raising these individual claims. *Anshun* estoppel is not applied directly but rather its possible future application is used to justify extending the scope of a settlement. This position was only accepted in *Great Southern*.

The *Anshun* estoppel argument or analogy only applies to Category Three claims/issues. The first limb of an *Anshun* estoppel is relevance or connection. The claim or issue to be estopped must be ‘so relevant’ or connected to the subject matter of the first action. A Category Three issue may satisfy this requirement because, as defined above, it is an unpleaded common issue that meets the requirements in s 33C. In contrast, a Category Four claim does not meet the s 33C requirements and could not be included in the class action, meaning it could not satisfy the relevance requirement.

However, assuming a Category Three issue meets the relevance requirement, it is still necessary to satisfy the second limb: unreasonableness. The focus for judgment is on the unreasonableness of the representative party, as the privy in interest of the group members, in not bringing forward the Category Three issues.<sup>134</sup> However, in the settlement context, the focus has been on the reasonableness of the group member in wanting to agitate ‘fresh’ claims or issues in separate proceedings.<sup>135</sup> The reason for this focus appears to be that the group member’s actions should be assessed by reference to what they could have done to avoid being bound by the actions of their privy, the representative party.

Justice Gordon in *Timbercorp* noted that unreasonableness is not subject to a mechanical approach, and that attention must be paid to all of the circumstances.<sup>136</sup> This is discussed further below. Nonetheless, the case law has focused on two key factors that may determine whether it was unreasonable for a group member to have failed to raise a particular claim or issue in the class action. The first is the

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<sup>132</sup> *Willmott Forests* (2016) 335 ALR 439, 471 [156].

<sup>133</sup> *Great Southern* [2014] VSC 516 (11 December 2014) [98].

<sup>134</sup> *Timbercorp* (2016) 259 CLR 212, 231 [37].

<sup>135</sup> *Great Southern* [2014] VSC 516 (11 December 2014) [131].

<sup>136</sup> *Timbercorp* (2016) 259 CLR 212, 248 [111]–[115].

employment of the opt-out mechanism and the second is whether group members had the ability and opportunity to raise their claim in the class action.

## 1 *The Opt-Out Mechanism*

In *Great Southern*, Croft J found that group members would be estopped from raising their defences in subsequent proceedings because it would be unreasonable for them to do so in light of them having not opted out; by not opting out, group members had accepted the pleaded claims as representing all of the claims available to them.<sup>137</sup> Justice Murphy in *Willmott Forests* disagreed with Croft J's position as holding in all situations.<sup>138</sup> In *Timbercorp*, Gordon J expressly disapproved of the contention that

if a group member does not either opt out of a group proceeding or seek directions in relation to their individual claim, then it will automatically be 'unreasonable in the context of that first proceeding' for them not to have done so, such that an *Anshun* estoppel will arise.<sup>139</sup>

This was because the statement was too absolute in its expression. The effect of the opt-out opportunity will turn on specific circumstances, which would include factors such as the timing of the opportunity, the content of the notice, and the characteristics of the group.

As explained above, failing to opt out is incompatible with client consent. A group member's failure to exclude themselves cannot be equated to consenting to the representative party's choice of common issues or that the group member does not wish to bring forward other common issues. The meaning of not opting out is unclear or unknown.<sup>140</sup> Nonetheless, as the High Court identified in *Timbercorp*, pt IVA operates by allowing a representative party to choose the common issues that are brought forward and binds group members who do not opt out to the determination of those issues.<sup>141</sup> However, the terms of the notice, as discussed above, will be crucial. Reasonableness would turn on whether a notice brought to the attention of group members the risk of unpleaded common issues (Category Three) later being included in settlement so that they could not be pursued separately.<sup>142</sup>

## 2 *Control*

In *Willmott Forests* and *Timbercorp*, both courts considered whether group members had control over the proceedings that would have enabled them to have raised their

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<sup>137</sup> *Great Southern* [2014] VSC 516 (11 December 2014) [132].

<sup>138</sup> *Willmott Forests* (2016) 335 ALR 439, 470 [152].

<sup>139</sup> *Timbercorp* (2016) 259 CLR 212, 248 [113]–[114].

<sup>140</sup> *Timbercorp Finance Pty Ltd (in liq) v Collins* [2015] VSC 461 (2 September 2015) [670], [682]. It may be the case that the group members are content with the common issues being pursued, but equally a group member may not know they are part of the class action, not have received the notice, or not understood the importance of the notice, at all or in relation to its ramifications for unpleaded Category Three issues.

<sup>141</sup> *Federal Court of Australia Act 1976* (Cth) ss 33A 33ZB; *Timbercorp* (2016) 259 CLR 212, 233 [44], 235–6 [52]–[53].

<sup>142</sup> *Timbercorp Finance Pty Ltd v Collins* [2016] VSCA 128 (1 June 2016) [201].



claims. Had such control existed, it would have been unreasonable for the defences to have been raised in subsequent proceedings.

The rationale behind this enquiry was stated by the plurality in *Timbercorp*: '[i]t would be quite unjust for a person whose legal interests stood to benefit by making a legal claim to be precluded if they did not have some measure of control of the proceedings in question.'<sup>143</sup> This begs the question: what degree of control must group members be able to exercise over the proceedings in order for it to be unreasonable for them to raise further issues in future proceedings?

The role of group members is necessarily a passive one, and in most cases they will not be able to exert the degree of control required to raise other issues.<sup>144</sup> It would only be in those rare circumstances in which a group member possesses sophistication, knowledge and resources that they would be able to agitate their individual issues of their own volition.<sup>145</sup> Even then, the group member needs to convince the representative party (and their lawyer) or the court that additional common issues should be the subject of the class action. As such, it will be unlikely that the *Anshun* estoppel analogy will prevent group members raising further issues in proceedings subsequent to a class action, subject of course to the effect of the opt-out opportunity discussed above.

### 3 *Difficulties associated with Anshun Estoppel*

Although *Anshun* estoppel may provide a useful theoretical tool for discerning the scope of the representative party's authority in a settlement context, in practice it faces several challenges that undermine its utility. In discerning whether *Anshun* estoppel arises on a particular set of facts, a court must determine whether the relevant connection exists between successive proceedings and whether, in light of that connection, it would be unreasonable to raise the claim or issue in question. Much will depend on the particular circumstances of a given case, as courts take into account

all the relevant facts, including the character of the previous proceeding, the scope of any pleadings, the length and complexity of any trial, any real or reasonably perceived difficulties in raising the relevant claim earlier, and any other explanation for the failure to raise the claim previously.<sup>146</sup>

Typically, *Anshun* estoppel is raised when a second claim is commenced, and the respondent raises the estoppel as a defence.<sup>147</sup> In most cases, the court is therefore able to compare the pleaded claim in the second action with the completed first action in making its determination as to the elements of the estoppel. However, in the class action settlement context, judges are unlikely to have the material necessary

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<sup>143</sup> *Timbercorp* (2016) 259 CLR 212, 236 [54].

<sup>144</sup> *Willmott Forests* (2016) 335 ALR 439, 485 [217].

<sup>145</sup> See, eg, the representative party in *Lifeplan Australian Friendly Society Ltd v S&P Global Inc* [2018] FCA 379 (8 March 2018).

<sup>146</sup> *Gibbs & McAllion Lloyd Pty Ltd v Kinna* [1999] 2 VR 19, 28 [28]. See also 26–7 [23].

<sup>147</sup> See, eg, *Sahab Holdings Pty Ltd v Castle Constructions Pty Ltd* [2014] NSWSC 1281 (19 September 2014); *Solak v Registrar of Titles* [2011] 33 VR 40; *Stewart v Biodiesel Producers Ltd* [2009] WASC 145 (28 May 2009); *Redwood Pty Ltd v ASX-Perpetual Registrars Ltd* [2007] NSWCA 286 (18 October 2007); *Powell v Aymkone Pty Ltd* [2008] NSWSC 1270 (28 November 2008).

to determine whether an *Anshun* estoppel ought to arise because the class action is being settled and the second claim is not yet in existence.

## F Court Power

In *Byrne* and *Pekell*, the Victorian Court of Appeal found that s 33ZF provided the power to make orders *nunc pro tunc* authorising the representative party in *Great Southern* to enter into and give effect to the settlement on behalf of group members.<sup>148</sup> In *Pekell*, the Court added that an order of this kind provides the element of privity that was otherwise absent in respect of the individual claims of group members; and this in turn allows class actions to be settled on terms preventing group members from raising individual claims.<sup>149</sup> Neither judgment needed to assess whether such an order could have, or should have, been made (that is, whether Croft J's discretion miscarried)<sup>150</sup> as they were not dealing with an appeal from the decision in *Great Southern*, but rather the interpretation of the orders and settlement deed approved by Croft J.<sup>151</sup> Nonetheless, s 33ZF is regularly invoked to authorise representative parties to settle class actions on behalf of group members.<sup>152</sup> However, the question remains: what is the scope of the representative party's extended authority that the court may approve, or what is meant by a group member's 'individual claim'?<sup>153</sup>

Section 33ZF was 'intended to confer on the Court the widest possible power to do whatever is appropriate or necessary in the interests of justice being achieved in a representative proceeding'<sup>154</sup> and the breadth of the power has been reiterated on numerous occasions since.<sup>155</sup> Although a plenary power, it is not unlimited and any order must be in keeping with the requirements in the text of the provision.<sup>156</sup> Where a court exercises the statutory power in s 33ZF, the court must determine that such orders are 'appropriate or necessary to ensure that justice is done in the

<sup>148</sup> *Byrne* [2016] VSCA 214 (13 September 2016) [55]; *Pekell* (2017) 118 ACSR 592 608–9 [58].

<sup>149</sup> *Pekell* (2017) 118 ACSR 592, 608–9 [58].

<sup>150</sup> See *House v R* (1936) 55 CLR 499, 504–5.

<sup>151</sup> *Byrne* [2016] VSCA 214 (13 September 2016) [56]; See also *Pekell* (2017) 118 ACSR 592, 606–7 [51]–[52], where the Court of Appeal made it clear that Croft J's orders had effect irrespective of whether there was any excess of jurisdiction citing *New South Wales v Kable* (2013) 252 CLR 118, 133 [32], 134 [36].

<sup>152</sup> *Byrne* [2016] VSCA 214 (13 September 2016) [55] and the cases cited in that paragraph.

<sup>153</sup> See *Pekell*, which speaks of it being highly surprising if pt 4A prevented finality in relation to 'other issues outstanding between those parties or, in the case of a plaintiff, the group members that plaintiff represents' and further that full releases of 'all outstanding claims, whether at issue in the relevant proceedings or not' was not uncommon (emphasis added): (2017) 118 ACSR 592, 608 [57].

<sup>154</sup> *McMullin (No 6)* (1998) 84 FCR 1, 4.

<sup>155</sup> See, eg, *Courtney v Medtel Pty Ltd* (2002) 122 FCR 168, 182 [48] ('*Courtney*'); *Wotton v Queensland* (2009) 109 ALD 534, 545 [41]: 'This provision, like all provisions conferring jurisdiction or granting powers to a court, should not be construed narrowly by making implications or imposing limitations which are not found in its express words: *Owners of the Ship 'Shin Kobe Maru' v Empire Shipping Co Inc* (1994) 181 CLR 404, 421'.

<sup>156</sup> *Earglow Pty Ltd v Newcrest Mining Ltd* (2015) 230 FCR 469; *Johnston v Endeavour Energy* [2015] NSWSC 1117 (19 August 2015) [92]; *Camping Warehouse v Downer EDI* [2016] VSC 784 (21 December 2016) [45]; *Re Banksia Securities Ltd (rec & mgr apptd)* [2017] VSC 148 (31 March 2017) [108]; *TW McConnell Pty Ltd as trustee for the McConnell Superannuation Fund v SurfStitch Group Ltd (subject to deed of company arrangement) (No 3)* [2018] NSWSC 1749 (15 November 2018).

proceeding'. The Full Court of the Federal Court has determined that the statutory test under s 33ZF will not be satisfied on the basis that orders were merely convenient or useful, but rather the proposed order must be reasonably adapted to the purpose of seeking or obtaining justice in the proceeding.<sup>157</sup>

In the current context, where orders are being sought to extinguish group members' claims, it is relevant to consider judicial statements about the operation of s 33ZF and group members. In *Courtney*, Sackville J stated:

In construing s 33ZF, it is also appropriate to recognise the unusual position of group members in a representative proceeding brought pursuant to Part IVA. Group members may benefit from the representative proceeding but their rights also might be adversely affected, since they are bound by any judgment in the proceeding unless they have opted out: s 33ZB(b). Consent is not required for a person to become a group member: s 33E(1). A group member must be given notice of his or her right to opt out of the proceeding (s 33X(1)(a)), but the group member will not necessarily receive personal notice of that right: s 33Y(5). ... In a representative proceeding involving substantial numbers of group members, it is very likely that some, whether by choice, lack of means or lack of information, will not engage a lawyer.<sup>158</sup>

Justice Sackville went on to state that judicial control of a class action may be essential to protect the interest of group members and that '[s] 33ZF is directed to just such an issue'.<sup>159</sup>

Similarly, in *Blairgowrie*, Wigney J stated that where s 33ZF is concerned, the court should ensure that absent group members are not prejudiced by the determinations and orders made by the court under the section and that, '[t]he role of the Court in this respect is protective'.<sup>160</sup> The reference to the court's protective jurisdiction has previously arisen in the context of s 33V, where the jurisprudence has recognised that a settlement must be in the interests of group members as a whole, not just the representative party and respondent, and the court acts akin to a guardian for the unrepresented group members.<sup>161</sup> Thus, when considering whether to make an order under s 33ZF in a settlement approval application, in line with its protective role, the Court should exercise s 33ZF in accordance with s 33V and consider whether 'the rights or interests of group members [are] not adequately protected, or [are] materially prejudiced or adversely affected by the order', as such an order would be unlikely to be appropriate or necessary to ensure that justice was being done.<sup>162</sup>

The question as to the scope of releases and preclusion of future claims that relies on s 33ZF is to be determined by reference to achieving justice. A number of

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<sup>157</sup> *Money Max Int Pty Ltd v QBE Insurance Group Ltd* (2016) 245 FCR 191, 224 [165]. The 'reasonably adapted' test was employed again by the Full Court of the Federal Court in *Melbourne City Investments Pty Ltd* (2017) 252 FCR 1, 21–2 [74].

<sup>158</sup> *Courtney* (2002) 122 FCR 168, 182 [49]. See also *Blairgowrie Trading Ltd v Allico Finance Group Ltd (rec & mgrs app) (in liq)* (2015) 325 ALR 539, 560 [114] ('*Blairgowrie*').

<sup>159</sup> *Courtney* (2002) 122 FCR 168, 183 [51].

<sup>160</sup> *Blairgowrie* (2015) 325 ALR 539, 560–61 [115].

<sup>161</sup> *Australian Competition and Consumer Commission v Chats House Investments Pty Ltd* (1996) 71 FCR 250, 258; *Lopez v Star World Enterprises Pty Ltd* [1999] FCA 104 (28 January 1999) [16]; *Richards* [2013] FCAFC 89 (12 August 2013) [7]–[8].

<sup>162</sup> *Blairgowrie* (2015) 325 ALR 539, 560–61 [115].

contextual factors need to be considered in seeking to determine what justice requires in terms of the allowable scope of a settlement, or more specifically whether unpleaded claims that fall into Category Two, Category Three and Category Four could be included in a settlement.

The above discussion in relation to s 33Q suggests that extending a settlement to Category Two should not be problematic. The court has specific power to address Category Two in terms of case management steps to achieve finality. The statutory regime provides for the resolution of Category Two and s 33ZF would be filling a statutory gap in relation to settlement where pt IVA is silent.<sup>163</sup> Category Three could also be included in a settlement subject to specific findings that it is just in the circumstances to preclude the pursuit of further common issues that had not been previously raised, including, in particular, the content of the opt-out notices.

Turning to Category Four, a helpful starting point is to consider the position in relation to judgment. The class action is designed to resolve common questions that arise from the same, similar or related circumstances. The class actions regime only provides the representative party with authority to act on the group member's behalf and bind them in relation to claims that satisfy s 33C. In short, if the proceedings were litigated, they would not resolve individual claims that are in Category Four. It has been observed that the decision in *Timbercorp* did not extend to settlements.<sup>164</sup> Nonetheless, the High Court's construction of the class actions statute is universal and applies to both judgment and settlement.

The class actions statute does not grant the representative party authority to bring Category Four claims before the court. This creates a particular problem for employing s 33ZF, which is applicable to 'any proceeding (including an appeal) conducted under this Part' and allows orders 'the Court thinks appropriate or necessary to ensure that justice is done in the proceeding'. Arguably, a standalone claim cannot be subject to an order relying on s 33ZF where it could not be included in a class action because it did not satisfy s 33C. A Category Four claim is not 'conducted under this Part'. Equally, it might be said that the orders are not aimed at justice 'in the proceeding'. On this approach, s 33ZF is not applicable on its own terms and could not provide the power to include Category Four claims into a class action settlement.<sup>165</sup> However, it may also be argued that the class action before the court grounds the power in s 33ZF and that then allows the court to make orders that would bring Category Four claims into the class action provided it is 'appropriate or necessary to ensure that justice is done'.

This then prompts for consideration: why is settlement different from judgment and what factors operate in the settlement context to make it in the interests of justice to take a position contrary to what a litigated outcome could achieve? The answer appears to be two-fold. The first is that broader releases may be necessary to achieve the settlement (but only insofar as the representative has authority to do

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<sup>163</sup> *McMullin (No 6)* (1998) 84 FCR 1, 3–4.

<sup>164</sup> *Pekell* (2017) 118 ACSR 592, 608 [56].

<sup>165</sup> This argument was dismissed in *Pekell*, but it is unclear what categories of claims the Court of Appeal had in mind: *ibid* 608–9 [58].

so).<sup>166</sup> The price of achieving the product of the settlement, whether that be compensation and payment of costs, or simply the avoidance of costs if the case were to fail, is no further claims by group members against the respondent. Second, courts see settlement as being in the litigants' and public's interest.<sup>167</sup> Finality, saving costs and expeditious resolution of proceedings have been conceived of as being central to achieving justice.<sup>168</sup> However, they do not trump justice, but rather are considerations to be weighed in determining where justice lies.<sup>169</sup>

Achieving justice includes affording individual group members procedural fairness. The class actions regime alters the usual requirements for procedural fairness, such as notice and the opportunity to be heard, including to present evidence and argument. Instead, the regime provides for: a representative who shares a sufficient interest in resolving common issues; a right to opt out; notices; court approval of settlements; and the ability to seek to replace a representative party that is an inadequate representative.<sup>170</sup> However, this alternate regime only applies to the claims that satisfy s 33C. Category Four claims, which exist wholly outside s 33C, are not subject to this regime of curtailed procedural fairness. As a result, if Category Four claims were to be included in a settlement, then the court must ensure that 'justice is done', which includes procedural fairness. A highly relevant factor would be whether the group member consents to their inclusion by instructing lawyers to include the claims in the settlement — perhaps through an opt-in or registration process (as discussed above)<sup>171</sup> or another court procedure such as joinder would need to be employed.<sup>172</sup> The granting of an opportunity to opt out of, or object to, a settlement that purports to bind Category Four claims puts the cart before the horse. Category Four claims are not part of the class action. The representative party has no statutory authority to include Category Four claims in a settlement. It is not a case of removing Category Four claims from a proposed settlement, but rather finding authority to include them.

<sup>166</sup> *Tongue v Council of the City of Tamworth* [2004] FCA 209 (23 March 2004) [45]; *Harrison v Sandhurst Trustees* [2011] FCA 541 (20 May 2011) [26]; *Liverpool City Council v McGraw-Hill Financial Inc* [2018] FCA 1289 (9 August 2018) [125].

<sup>167</sup> *Harrison v Sandhurst Trustees Ltd* [2011] FCA 541 (20 May 2011) [26]. This reasoning may be supported by analogy with class-closure orders that are permitted when they operate to facilitate the desirable end of settlement and achieve finality for group members and respondents: *Melbourne City Investments* (2017) 252 FCR 1, 21–2 [74].

<sup>168</sup> *Aon Risk Services Australia Ltd v Australian National University* (2009) 239 CLR 175, 213 [98]; *Federal Court of Australia Act 1976* (Cth) pt VB; *Pearson v State of Queensland* [2017] FCA 1096 (14 September 2017) [14].

<sup>169</sup> Michael Legg, 'Reconciling the Goals of Minimising Cost and Delay with the Principle of a Fair Trial in the Australian Civil Justice System' (2014) 33(2) *Civil Justice Quarterly* 157.

<sup>170</sup> See *Femcare Ltd v Bright* (2000) 100 FCR 331, 347 [65]: 'The price of providing a mechanism for the vindication of rights held in common with others may be departure to some extent from the procedures ordinarily applicable in litigation inter partes.'

<sup>171</sup> Registration processes are usually undertaken as a step towards, or as part of, a settlement. However, if a closed-class definition was adopted, then it may be possible to have group members consent to Category Four claims being included in any subsequent settlement as part of the execution of retainers and/or funding agreements. Equally, consent could be obtained from a closed class at the time settlement was being negotiated.

<sup>172</sup> See, eg, *Federal Court Rules 2011* (Cth) r 9.05.

To the extent that *Pekell*<sup>173</sup> may be read as permitting settlements to release a group member's Category Four claims without consideration of how those claims are brought within the representative party's authority consistent with procedural fairness, the argument presented here regards this as wrong in principle. We suggest that before using s 33ZF to bind Category Four claims to a settlement agreement, the requirements of that section (that the court thinks an order is 'appropriate or necessary to ensure that justice is done in the proceeding') are highly unlikely to be satisfied without the court itself first ensuring that the holders of the Category Four claims consented to the inclusion of these claims.

Moreover, while the consent of claim holders should be highly influential in deciding whether to order the resolution of Category Four claims under s 33ZF, other factors may come into play as well. For example, it may also be apposite for courts to undertake pointed enquiry into whether the settlement specifically accounts for the fact that particular group members are being prevented from litigating their individual claims that were entirely unrelated to the class action being settled by reflecting the value of those claims in the settlement amount paid to those group members.

Ultimately, s 33ZF should not be exercised so as to bind Category Four claims to a settlement agreement and achieve finality except where procedural fairness is afforded and it is necessary to achieve a fair outcome in the proceedings.

## VI Conclusion

The above analysis leads to the conclusion that a settlement can include: the common issues that are pleaded in the class action (Category One); and the individual or non-common issues associated with, or part of, the claims that give rise to the common issues that are pleaded in the class action (Category Two).

Unpleaded or unspecified common issues that meet the requirements of pt IVA of the *Federal Court of Australia Act 1976* (Cth) (or its State counterparts) (Category Three) may be the subject of settlement based on the opt-out opportunity provided the opt-out notice adequately brings the risk of Category Three issues being included in a future settlement to the attention of group members. Further Category Three issues may be included in a settlement based on an analogy with *Anshun* estoppel. However, it must have been reasonable for the group members not to take steps to avoid being bound by the actions of the representative party, including opting out. Much will turn on the information communicated to group members. Further, great care is required because the court may not be well-placed to determine if the *Anshun* analogy is apt in a particular case.

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<sup>173</sup> (2017) 118 ACSR 592, 608–9 [57]–[58]. See also *Money Max Int Pty Ltd (Trustee) v QBE Insurance Group Ltd*, which accepted that *Timbercorp* may mean that a representative party lacks authority to settle group members' Category Four claims, but nonetheless made orders approving releases 'from claims by [group] members that are individual to the [group] member and outside the subject matter of the proceeding' without group member consent. The orders were agreed to so as to achieve finality and because the existence of Category Four claims was said to be 'theoretical': (2018) 358 ALR 382, 400–2 [95]–[100].

The individual claims of group members that are separate from the claims being pursued in the class action — that is, claims that could not be included consistent with the class actions legislation (Category Four) — cannot be part of a class action settlement unless a court has so ordered pursuant to s 33ZF. In our view, such claims should only be included through obtaining group member consent. The agitation of individual claims that are separate from the claims being pursued in the class action lies at the very heart of the tension between finality and fairness in settlement approval applications. These claims evoke considerations of finality because they pose an obvious risk of repeat litigation for respondents, yet their resolution without the affirmative consent of the claim holder often results in a perverse denial of procedural fairness and a manifestly unfair result.

Our conclusions in relation to the four categories of claims/issues assume the correct identification of each category when a settlement is proposed. However, this may be difficult as shown by the contrasting positions in *Great Southern* and *Willmott Forests* despite their very similar factual positions. Indeed, the terminology used in many of the cases does not clearly delineate the type of claim/issue that is under consideration. Consequently, we hope that use of the claims/issues framework will assist in clarifying exactly what claims or issues are being resolved by a settlement, which will in turn assist in the judicial analysis that is required in making orders under ss 33V and 33ZF of the class actions legislation.





# *Why We Use Private Trusts in Australia: The Income Tax Dimension Explained*

Alex C Evans\*

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## *Abstract*

The trust has become a pervasive vehicle in the Australian economic landscape. In 2015–16, returns were lodged with the Australian Taxation Office for 845 925 trusts and the total reported business income derived through trusts was \$368 billion. There has been enormous growth both in the number and use of private trusts since the late 1970s. Although the markers have been evident for decades and were appreciated in practice, private trusts did not feature heavily in Australian academic literature until more recently. Many of the existing analyses have broadly described that tax settings contributed significantly to the trust's popularity in both the public and private contexts. However, to date, none have clearly explained why the income tax settings acted as an accelerant for the movement towards private trusts. This article is novel as it explains the material income tax settings and correlates changes in those settings with statistical data that evidences that movement. The article argues that discretionary trusts have become popular, at least partly, because of favourable income tax treatment. The article sets out shortcomings of the Australian Labor Party's 2017 proposal to change the rules for taxing discretionary trusts and recommends two directions for future reform efforts by either major political party.

## **I Introduction**

The trust relationship ('trust') is widely used in the Australia. While trusts are used in both the public ('public trusts') and private contexts ('private trusts'), this article focuses on private trusts.

It is difficult to make accurate general statements about private trusts because there are few disclosure requirements for trustees in Australia and the Australian Taxation Office ('ATO') only publishes data about trusts very

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selectively for privacy reasons.<sup>1</sup> However, it is incontrovertible that private trusts are now commonly used by taxpayers in different circumstances for a variety of purposes. For example, the litigation involving the Hancock/Rinehart family trust was a high profile illustration of the use of trusts by high net wealth individuals,<sup>2</sup> and it is clear from previous Australian Government announcements regarding reforming the rules for taxing trusts that trusts are popular with farmers and small business.<sup>3</sup>

Although private trusts are often used in the traditional way — for intergenerational wealth transfer and asset protection — they are also used for carrying on business — in the sense that the trustee carries on business for the beneficiaries.<sup>4</sup> The use of private trusts in this way, referred to as the private ‘trading trust’,<sup>5</sup> is regarded as a peculiarly ‘Australian idiosyncrasy’.<sup>6</sup> As an example, in the United States of America (‘US’), carrying on a business is anathema to the private trust, and the US federal income tax code recharacterises trusts that do this as corporations.<sup>7</sup> Despite the fact this use of trusts is unusual, until recently both of the major Australian political parties had accepted it, with each publicly stating at different times words to the effect that ‘where used appropriately’ trusts are ‘a legitimate structure through which Australians should

<sup>1</sup> Ashton de Silva et al, ‘Current Issues with Trusts and the Tax System: Examining the Operation and Performance of the Tax System in relation to Trusts, with a Particular Focus on Discretionary Trusts linked to High Net Worth Individuals’ (2017) 7 (Independent Report commissioned by the ATO) (‘*RMIT Report*’). Among the few disclosure requirements, trustees are required to provide trustee beneficiary statements to the ATO: *Income Tax Assessment Act 1936* (Cth) div 6D (‘*ITAA 1936*’).

<sup>2</sup> The ultimate action and decision in relation to the replacement of Ms Gina Rinehart as trustee was *Hancock v Rinehart* [2015] NSWSC 646 (28 May 2015). However, there were several earlier proceedings that were primarily designed to prevent the main litigation being pursued, see, eg, *Rinehart v Welker* [2012] NSWCA 95 (20 April 2012); *Welker v Rinehart (No 10)* [2012] NSWSC 1330 (31 October 2012); *Rinehart v Hancock* [2013] NSWCA 326 (3 October 2013). Other related questions of law have recently been decided in relation to this trust: see, eg, *Rinehart v Hancock Prospecting Pty Ltd* [2019] HCA 13 (8 May 2019).

<sup>3</sup> See, eg, Peter Costello, ‘Entity Taxation’ (Media Release, No 008, 27 February 2001) <<http://www.petercostello.com.au/press/2001/2445-entity-taxation-a>> (‘*Entity Taxation Retraction Media Release*’); Bill Shorten, ‘Farmers Benefit with Changes to Trust Laws’ (Media Release, No 25, 16 December 2010) <<http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=ressreleases/2010/025.htm&pageID=003&min=brsa&Year=2010&DocType=0>> (‘*2010 Announcement*’); Treasury, Australian Government, *Modernising the Taxation of Trust Income – Options for Reform: Consultation Paper* (November 2011) 2 <[https://treasury.gov.au/sites/default/files/2019-03/Consultation\\_Paper\\_Modernising\\_Taxation.pdf](https://treasury.gov.au/sites/default/files/2019-03/Consultation_Paper_Modernising_Taxation.pdf)> (‘*2011 Consultation Paper*’). The statistics for 2015–16 also bear out that trusts are used at different scales: Australian Taxation Office (‘ATO’), *Tax Statistics 2015–16*, Table 5 (2016) <<https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Taxation-statistics/Taxation-statistics---previous-editions/Taxation-statistics-2015-16/>> (‘*ATO Tax Statistics 2015–16*’).

<sup>4</sup> The statistical information on which this labelling is based, however, is potentially unreliable because it is done under the self-assessment system: Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Family Businesses in Australia — Different and Significant: Why They Shouldn’t Be Overlooked* (2013) 125–6 <[http://www.aph.gov.au/Parliamentary\\_Business/Committees/Joint/Corporations\\_and\\_Financial\\_Services/Completed\\_inquiries/2010-13/fam\\_bus/report/index](http://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/Completed_inquiries/2010-13/fam_bus/report/index)>.

<sup>5</sup> Kevin Lindgren, ‘The Birth of the Trading Trust’ (2011) 5(1) *Journal of Equity* 1.

<sup>6</sup> Harold AJ Ford and Ian Hardingham, ‘Trading Trusts: Rights and Liabilities of Beneficiaries’ in Paul Finn (ed), *Equity and Commercial Relationships* (Lawbook, 1987) 48, 53; Nuncio D’Angelo, *Commercial Trusts* (LexisNexis, 2014) 72.

<sup>7</sup> *Morrissey v Commissioner*, 296 US 344, (1935); US Treasury Regulation § 301.7701-4(a).

be able to conduct their personal and business affairs' and they were not a form of tax avoidance.<sup>8</sup>

The Australian Labor Party ('ALP') appeared to refine its position in July 2017 in relation to discretionary trusts, except ones used by farmers ('*ALP's 2017 Proposal*').<sup>9</sup> As articulated, the argument underlying the *ALP's 2017 Proposal* was that 'the vast majority of wealth in private trusts is held by the wealthiest households' and 'discretionary trusts are being used to reduce high income earners' tax liabilities through "income splitting".<sup>10</sup> Income splitting 'involves the transfer of income from a taxpayer with a high marginal tax rate to another person with a nil or low marginal rate' because then 'the income is subject to lower tax and this benefit can be shared between the high and low rate taxpayers'.<sup>11</sup> Income splitting commonly occurs between the higher earning taxpayer and their lower paid or unpaid spouse,<sup>12</sup> 'in return for domestic services or perhaps, love and affection, certainly for child-rearing services'.<sup>13</sup> Such 'deal(s)' happen when the tax unit is an individual (rather than tax being calculated based on the family's aggregated income) and where there are concessions or reduced rates for the second earner.<sup>14</sup> But it can also happen between the higher earning taxpayer and dependents, including adult children.

Discretionary trusts can facilitate income splitting between spouses and such practices are currently accepted by the ATO.<sup>15</sup> The *ALP's 2017 Proposal* involved imposing tax at 30% (the current tax rate for most companies) on distributions from a discretionary trust to beneficiaries aged over 18 years. This is an extension of the change made by the Coalition Government in 1980 to apply punitive tax rates, both in and out of the trust context, when parents divert income to their children aged under 18 years.<sup>16</sup> That practice developed because children generally do not have significant amounts of income from other sources, so each child could benefit from the tax-free threshold (the amount each taxpayer is permitted to earn up to before income tax is imposed). This meant that the tax burden across all the income was nil or very low. The ALP's proposed extension of that change makes some sense given more adults are continuing to live with and be somewhat economically dependent on their parents into their twenties and

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<sup>8</sup> 2011 Consultation Paper, above n 3, 2. For a statement from a previous Coalition Government, see *Entity Taxation Retraction Media Release*, above n 3.

<sup>9</sup> Australian Labor Party, *A Fairer Tax System: Discretionary Trust Reform* (July 2017) <[https://d3n8a8pro7vhmx.cloudfront.net/australianlaborparty/pages/7652/attachments/original/1501324995/170729\\_Shorten\\_Trusts\\_Fact\\_Sheet\\_FINAL.PDF?1501324995](https://d3n8a8pro7vhmx.cloudfront.net/australianlaborparty/pages/7652/attachments/original/1501324995/170729_Shorten_Trusts_Fact_Sheet_FINAL.PDF?1501324995)>.

<sup>10</sup> Ibid.

<sup>11</sup> Miranda Stewart, 'Domesticating Tax Reform: The Family in Australian Tax and Transfer Law' (1999) 21(3) *Sydney Law Review* 453, 466–7. See the discussion of property in Judith Grbich, 'The Position of Women in Family Dealing: The Australian Case' (1987) 15(3) *International Journal of the Sociology of Law* 309, 319.

<sup>12</sup> Ibid 468. See also Patricia Apps, 'Chapter 3: Individual Taxation Versus Income Splitting' in Richard Krever and John Head (eds), *Tax Units and the Tax Rate Scale* (Australian Tax Research Foundation, 1996) 81.

<sup>13</sup> Grbich, above n 11, 315.

<sup>14</sup> Ibid.

<sup>15</sup> Ibid.

<sup>16</sup> *ITAA 1936* pt 3 div 6AA.

even later.<sup>17</sup> The ALP's proposal is broadly analysed in Part VII as part of a discussion of reform and future directions.

The pervasiveness of the trust in Australia is evident from the number of returns filed for trusts relative to other vehicle types. Data released by the ATO shows that in 2015–16, returns were filed for 845 925 trusts.<sup>18</sup> This is 95 241 lower than the number of returns filed for companies (941 166).<sup>19</sup> However, as Graph 1 below shows, based on returns filed, over the past 25 years, the growth in the number of trusts has outpaced the growth in the number of companies and, as a result, the number of trusts and companies are now very close. In contrast, the number of partnerships peaked in 1993–94 and has been declining since. In 2015–16, there were more than double the number of trusts (845 925) as partnerships (321 360).<sup>20</sup> Based on returns filed, trusts overtook partnerships as the preferred alternative to the corporation in 2002–03.

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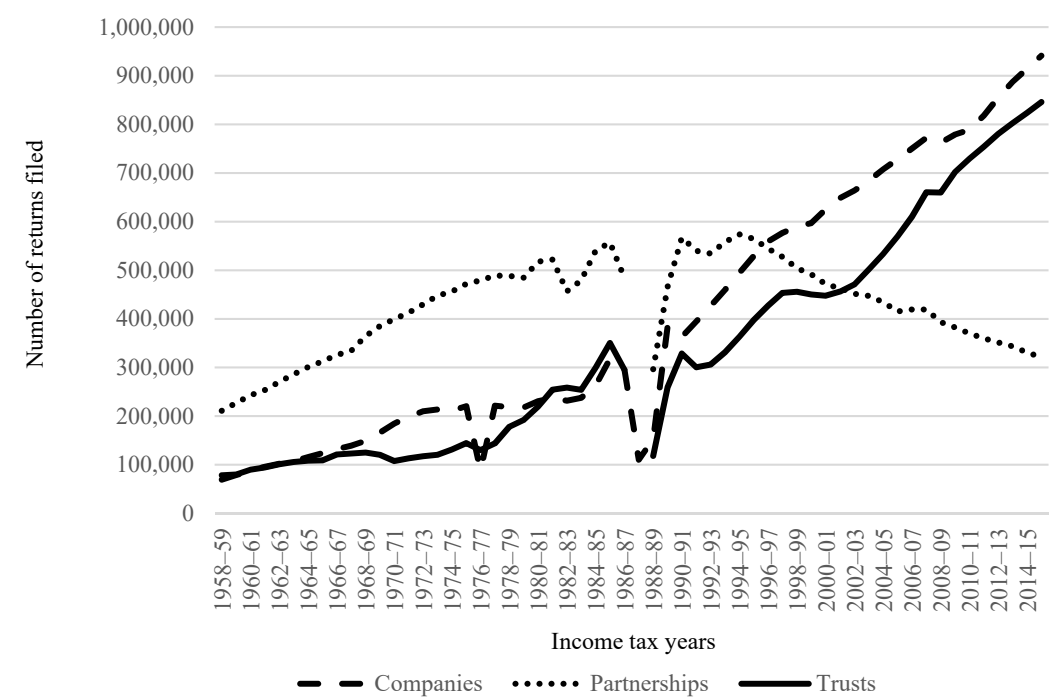
<sup>17</sup> Organisation for Economic Co-operation and Development ('OECD'), *Most Youth Live with their Parents and Patterns Have Changed since the Recession* (5 October 2016) Society at a Glance 2016 <[https://doi.org/10.1787/soc\\_glance-2016-graph41-en](https://doi.org/10.1787/soc_glance-2016-graph41-en)>. See also Edgar Liu and Hazel Easthope, 'Multi-generational Households in Australian Cities' (AHURI Final Report No 181, UNSW-UWS Research Centre, February 2012).

<sup>18</sup> *ATO Tax Statistics 2015–16*, above n 3, Trusts Table 15. Note the *RMIT Report* states that in 2015, 2.6 million trusts were 'known' to the ATO. That report describes a distinction between active and inactive trusts, and this seems to correlate best with the number of trusts based on filed returns: *RMIT Report*, above n 1, 97.

<sup>19</sup> *ATO Tax Statistics 2015–16*, above n 3, Companies Table 9.

<sup>20</sup> *Ibid* Partnerships Table 14.

**Graph 1:** Number of returns filed for companies, partnerships and trusts from the 1958–59 income year to the 2015–16 income year<sup>21</sup>



<sup>21</sup> Author’s chart based on numbers of returns filed for companies, partnerships and trusts taken from *ATO Tax Statistics 2015–16*, above n 3, Snapshot Table 6. The graph omits information in particular years in which there was no reliable data for different reasons, for example in 1987–88 and 1988–89 the statistics only had partial coverage (they only included taxable companies).

While there was an awareness of the popularity of trusts in Australia in practice, the growth in non-charitable, commercial trusts largely did not feature in Australian academic literature until 2005. When this growth was noticed, outside of government reform efforts, the literature primarily focused on public trusts or only selective aspects of the income tax treatment of private trusts.<sup>22</sup> However, critical analysis of the income tax rules and issues relating to private trusts did appear in practitioner-oriented commentary before 2005.<sup>23</sup> Although some Australian treatises on trusts continued to be produced periodically as a matter of course,<sup>24</sup> these did not clearly signal the huge growth in the number of private trusts. Academic literature has only focused on this and the private trust's growing sophistication more recently.<sup>25</sup>

Since 2005, others have explored how the trust evolved from being used in the more traditional way to being a business vehicle. Mees et al outlined the

<sup>22</sup> On public trusts: Bernard Mees, Monica Wehner and Pamela Hanrahan, 'Fifty Years of Managed Funds in Australia' (Preliminary Research Report, Centre for Corporate Law and Securities Regulation, 2005); John Glover and Paul von Nessen, 'Unintended Consequences: International Accounting Standards, Public Unit Trusts and the Rule Against Perpetuities' (2006) 80(1) *Australian Law Journal* 675; Nuncio D'Angelo, 'The Trust: Evolution from Guardian to Risk-Taker, and How a Lagging Insolvency Law Framework has Left Financiers and Other Stakeholders in Peril' (2009) 20(4) *Journal of Banking and Finance Law and Practice* 279; Nuncio D'Angelo, 'The Unsecured Creditor's Perilous Path to a Trust's Assets: Is a Safer, More Direct US-style Route Available?' (2010) 84(12) *Australian Law Journal* 833; Nuncio D'Angelo and Helena Busljeta, 'The Trustee's Lien or Charge Over Trust Assets: A PPSA Security Interest or Not?' (2011) 22(4) *Journal of Banking and Finance Law and Practice* 251; Lindgren, above n 5; D'Angelo (2014), above n 6; Graeme Cooper, 'Comment: Reforming the Taxation of Trusts: Piecing Together the Mosaic' (2013) 35(1) *Sydney Law Review* 187. On private trusts, see, eg, Brett Freudenberg, 'Are Asset Revaluation Reserve Distributions "Ordinary Income" for Discretionary Beneficiaries?' (2005) 20(1) *Australian Tax Forum* 3; Brett Freudenberg, 'Are Transparent Companies the Way of the Future for Australia?' (2006) 35(3) *Australian Tax Review* 200; Brett Freudenberg, 'Fact or Fiction? A Sustainable Tax Transparent Form for Closely Held Business in Australia' (2009) 24(3) *Australian Tax Forum* 373; John Glover, 'Dissecting Trusts and Trusteeship: CGT and Stamp Duty Consequences' (2007) 36(4) *Australian Tax Review* 201; John Glover, 'Dissatisfied Beneficiaries: Challenging Discretionary Trustees' (2009) 83(2) *Law Institute Journal* 54; John Glover, 'Are the Lights Changing for Discretionary Trusts?' (2010) 84(1/2) *Law Institute Journal* 34.

<sup>23</sup> See, eg, Terry Murphy, 'Implications of Income Distributions' (The Tax Institute, Victorian Division, 16 March 1998); Terry Murphy, 'Trusts from Here to...' (The Tax Institute, Western Australian Division, 21 October 1999); Paul Hockridge, 'Review of Business Taxation: Implications for Trusts' (The Tax Institute, Victorian Division, 16 March 1998); Peter Slegers, 'Tax Analysis: The New CGT Legislation: More Certainty, but Technical and Policy Problems Persist' (1999) 33(8) *Taxation in Australia* 418; Peter Slegers, 'Trusts in Transition: Technical Paper – "Trusts and the New CGT Concessions"' (The Tax Institute, South Australian Division, 10 March 2000).

<sup>24</sup> See, eg, *Jacobs' Law of Trusts in Australia*: (LexisNexis Butterworths: 1<sup>st</sup> ed, 1958; 2<sup>nd</sup> ed, 1967; 3<sup>rd</sup> ed, 1971; 4<sup>th</sup> ed, 1977; revised reprint, 1979; 5<sup>th</sup> ed, 1986; 6<sup>th</sup> ed, 1997; 7<sup>th</sup> ed, 2006; 8<sup>th</sup> ed, 2016).

<sup>25</sup> See, eg, Lindgren, above n 5; Anthony Slater, 'Taxing Trust Income after Bamford's Case' (2011) 40(2) *Australian Tax Review* 69; Freudenberg (2005), above n 22; Freudenberg (2006), above n 22; Freudenberg (2009), above n 22; John Glover, 'Resettlements: Revenue Consequences of Varying Discretionary Trusts' (2005) 79(10) *Australian Law Journal* 109; John Glover, 'Shams, Reimbursement Agreements...and the Return of Economic Equivalence?' (2008) 43 *Taxation in Australia* 21; John Glover, 'Taxing Liquidation Distributions: An Assessment of Australian Deemed Dividend and Capital Gains Regimes and How They Interrelate' (2005) 34(2) *Australian Tax Review* 88; John Glover, 'The Rule against Perpetuities and Its Application to Unit and Discretionary Trusts' (2007) 14(3) *Australian Property Law Journal* 225.

evolution of the public trust in Australia.<sup>26</sup> D'Angelo provided a condensed summary of the development of the commercial public unit trust and the trading trust.<sup>27</sup> Lindgren gave a detailed account of the origins of the trading trust and focused on its evolution from the unincorporated joint stock company.<sup>28</sup> Slater described the change in the law around the turn of the 20<sup>th</sup> century that permitted trustees to use trust property for carrying on business in a broader article about the implications of the High Court's 2010 decision in *Commissioner of Taxation v Bamford*.<sup>29</sup> Both D'Angelo and Lindgren's accounts began with a detailed analysis of the relevant law and historical events in the United Kingdom ('UK'). Slater and D'Angelo's accounts identify that tax was a critical factor in the trust's evolution in Australia throughout the 20<sup>th</sup> century.<sup>30</sup> However, they do not explain the relevant tax settings, nor explain why those settings were so crucial in accelerating the significant shift towards trusts generally and private trusts in particular.

In 2013, Cooper observed that 'the last six years have seen enormous turmoil in the systems for taxing trusts'.<sup>31</sup> Cooper set out a chronology containing both the previous attempts at reforming the rules for taxing both private and public trusts and the legislative changes that had actually been made over time. In that process, he analysed the 'disparate range of causes and concerns which have coalesced around trusts'.<sup>32</sup> He argued that although 'the same policy and design issues' appeared in relation to private and public trusts, they were being 'solved' differently in different contexts.<sup>33</sup> Cooper argued that reform should be coherent across the two contexts. While Cooper's article is valuable, it did not explain what income tax factors led to the trust being used in either of the public or private context; it merely accepted this as a fact.

This article builds on existing knowledge in several important ways. First, it critically analyses the currently available statistical information on the number of trusts from 1958–59 to 2015–16. This information shows several key trends that, while they may have been known to those with extensive experience in practice, to date have not been identified in academic literature. For context, the Coalition Government's 2015 *Re:Think Tax Discussion Paper* only set out the numbers of companies, trusts and partnerships from the 1990–91 income year onwards.<sup>34</sup>

Second, the article explains how the method of taxation that largely applies to trusts (flow-through taxation) continues to be crucial to the development and popularity of the private trust. The article begins by setting out the anecdotal view that the shift towards private trusts occurred from the late 1970s into the 1980s,

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<sup>26</sup> Mees et al, above n 22.

<sup>27</sup> D'Angelo (2009), above n 22; D'Angelo, above n 6, 58–78.

<sup>28</sup> Lindgren, above n 5.

<sup>29</sup> (2010) 240 CLR 481 ('*Bamford*'); Slater, above n 25, 76–8.

<sup>30</sup> Anthony Slater, 'Amendment of Trust Instruments' (Speech delivered at the Society of Trust and Estate Practitioners, Sydney, NSW, 29 September 2009); D'Angelo, above n 6, 77.

<sup>31</sup> Cooper, above n 22, 187.

<sup>32</sup> Ibid.

<sup>33</sup> Ibid.

<sup>34</sup> Treasury, Australian Government, 'Re:Think Tax Discussion Paper' (Discussion Paper, Commonwealth of Australia, 30 March 2015) 108, Chart 6.2 ('*Re:Think Tax Discussion Paper*').

before extending that analysis in three significant ways. First, it observes that the number and use of trusts have continued to increase since the 1980s. For reasons that are explained later, this is significant after the 1987 introduction of the imputation system for income derived through companies. The article argues that the reasons for this increase fall into two groups: elements of the income tax treatment that make using trusts, particularly discretionary trusts, very attractive; and external changes that created greater certainty regarding the tax treatment of trusts. The article then critically analyses why, when both the trust and partnership are taxed using forms of flow-through taxation, using a trust can be more advantageous. The article shows that a key anxiety surrounding private trusts is whether business should be able to be carried on using the trust form. Part VII examines possible directions and challenges for reform. The extension of the existing Australian literature in these ways is novel.

## II Income Tax Law Terminology

As income tax law is a specialised and technical area, some background and terminology is necessary. First, there are two main methods for taxing income derived through vehicles — entity taxation and flow-through taxation. A full examination of each method is extensive and is not required for this article,<sup>35</sup> so an abbreviated summary is provided here. Entity taxation has long been associated with the corporation and flow-through taxation has been applied to partnerships and, by extension, trusts.<sup>36</sup>

### A Entity Taxation

Under entity taxation, the vehicle (for example, a corporation) is treated as an entity and tax is applied at the entity level based on the entity's attributes, but tax is also applied at the owner level (in the corporate tax, this is the shareholder level). Without any reconciliation, this results in two layers of tax (the 'classical system').<sup>37</sup> This is the system used in the US. However, in other countries, due to the argument that the classical system can produce double taxation, the system integrates or reconciles the two layers of tax in some way. One method, which Australia introduced in 1987, is the imputation system. Under imputation, the extent to which the company has paid tax on its income is taken into account in calculating the tax that is payable at the shareholder level. In Australia, the actual mechanics are:

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<sup>35</sup> That analysis is elsewhere: see, eg, Alex C Evans, 'The Design Elements of Entity Taxation' (2018) 47(3) *Australian Tax Review* 167; Alex C Evans, 'The Design Elements of Flow Through Taxation' (2019) 48(1) *Australian Tax Review* 42. Both derive from Alexandra C Evans, *What is a Conceptually Possible Flow Through Design for an Alternative Vehicle in the Private Context in Domestic Income Tax Legislation? With an Applied Case Study on the Australian Business Trust* (PhD, Sydney Law School, 2016) ch 3. This article draws on that previous work.

<sup>36</sup> An analysis of the reasons for that alignment is extensive and will be provided in forthcoming work by the author. That work derives from Evans (2016), above n 35, ch 4.

<sup>37</sup> Richard Vann, 'General Report: Trends in Company/Shareholder Taxation: Single or Double Taxation?' in Richard Vann et al (eds) (2003) 88a *Cahiers de Droit Fiscal International: Studies on International Fiscal Law* (Kluwer Law International) 21, 23 (note 4), 30.



- the dividend (say \$70) that a resident shareholder receives is grossed up to reflect the extent to which the dividend is franked — this is shown by the amount of the franking credit (assuming the \$70 dividend is fully franked, assume a \$30 franking credit); and
- the shareholder includes the total amount (\$100 = \$70 dividend + \$30 franking credit) in its assessable income, and then obtains a tax offset equal to the franking credit (\$30).<sup>38</sup>

To determine the entity's tax liability, its taxable income must be calculated. In Australia, this is done in the same way as for individuals; that is, assessable income minus deductions.<sup>39</sup> An important source of deductions can be a prior year tax loss. A tax loss arises when an entity's total deductions exceed its assessable income in an income tax year.<sup>40</sup> A hallmark characteristic of entity tax designs is that losses are trapped at the entity level and the entity is usually restricted in its ability to apply them under what are referred to as 'loss utilisation rules'.<sup>41</sup> In other words, the losses are not allocated to the owners.

A further crucial hallmark of an entity tax system is that distributions to owners have a 'homogenous' character.<sup>42</sup> The best example is that, in the corporate tax context, distributions of profits from a company are characterised as dividends. This means that an amount does not retain its original character (that is, the character the amount had when the entity derived the income) when the amount is distributed by the entity to owners. To give an illustration, different types of income (rent, income from active business, interest) distributed by a company are received by shareholders as a dividend.<sup>43</sup> While shareholders may benefit from any franking credit attached to the dividend, they are denied the benefit of any tax preferences (broadly, anything that reduces the tax rate)<sup>44</sup> that arise because of the original source of the income.

There are two key types of tax-preferred income in Australia: capital gains and dividends. The main reason capital gains are tax-preferred is because, since 1999, the capital gains tax ('CGT') rules have provided concessional treatment to individuals and trusts when they hold an asset for 12 months or more before doing something that triggers the production of a capital gain (discount capital gains treatment).<sup>45</sup> For example, a taxpayer sells an asset and this produces a capital

<sup>38</sup> *Income Tax Assessment Act 1997* (Cth) ('ITAA 1997') ss 207-20(1), (gross-up), 207-20(2) (offset).

<sup>39</sup> *Ibid* s 4-15.

<sup>40</sup> *Ibid* s 36-10. This can be modified by *ITAA 1997* s 36-55 where a company has excess franking offsets.

<sup>41</sup> See, eg, *ITAA 1997* s 36-17, which allows a corporation to deduct a tax loss from a prior year, and *ITAA 1997* sub-div 165-A, which lists requirements that a company must satisfy to use that tax loss in a later income year. *ITAA 1997* sub-div 165-CA replicates this for a capital loss.

<sup>42</sup> Alexander Easson and Victor Thuronyi, 'Chapter 21: Fiscal Transparency' in Victor Thuronyi (ed), *Tax Law Design and Drafting* (Part 1) (Kluwer, 2000) 925, 940. See also Peter Harris, *Corporate Tax Law: Structure, Policy and Practice* (Cambridge University Press, 2013) 13, 171. Corporate distributions are designated as dividends by *ITAA 1936* s 6 (definition of 'dividend').

<sup>43</sup> *ITAA 1936* ss 6 (definition of 'dividend'), 44.

<sup>44</sup> Harris, above n 42, 256; Alvin Warren, 'The Relation and Integration of Individual and Corporate Income Taxes' (1981) 94(4) *Harvard Law Review* 717, 777-86.

<sup>45</sup> *ITAA 1997* sub-div 115-A.

gain when the consideration the taxpayer receives exceeds its investment in the asset (the cost base).<sup>46</sup> In this case, the capital gain is reduced by 50% when the individual calculates its tax liability.<sup>47</sup> If the taxpayer only has one capital gain and it qualifies for discount treatment, the concession functionally cuts the rate that applies to the gain in half. There are other preferences for capital gains. Some capital gains are exempt, meaning that the amount of the capital gain is not included in the taxpayer's assessable income. An example is a capital gain that arises when a taxpayer sells an asset that they acquired before the CGT regime was introduced (pre-CGT assets).<sup>48</sup>

The second key type of preferred income in Australia is franked dividends. This is because, as discussed above, the shareholder obtains a tax offset equal to the franking credit and this reduces the shareholder's tax liability to reflect the tax the company has already paid.

## **B      *Flow-Through Taxation***

Many features of flow-through taxation are in stark contrast with those of entity tax designs. First, under flow-through taxation, while tax law may recognise the vehicle as an entity for administrative reasons, tax is only applied at the owner level and the tax calculation is based on the owner's attributes.<sup>49</sup> Fairly pure flow-through designs attribute both net income (calculated as assessable income minus deductions) and net losses (where deductions exceed the entity's assessable income) to owners.<sup>50</sup> Owners can then apply losses from the vehicle to reduce any income from other sources — that is, losses that flow through the vehicle are not quarantined in the owner's hands. This can be very valuable for owners. Second, and again in stark contrast with entity taxation, under flow-through taxation, amounts may retain their original character as they move through the vehicle to the owners. This can be very valuable to an owner and can significantly reduce their tax liability, sometimes to nil, where the income is tax-preferred. As discussed above, the two key types of tax-preferred income are capital gains and franked dividends.

Under flow-through designs, any tax preference that arises due to the amount's original source generally flows through to the owner (flow through of preferences). For example, the legislation allows franking credits to accompany the distribution through a partnership or trust to the underlying owner.<sup>51</sup> In the

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<sup>46</sup> Ibid s 104-10 (CGT event A1).

<sup>47</sup> Ibid s 115-100.

<sup>48</sup> Ibid s 104-10(5)(a) (CGT event A1). This exemption appears separately in many CGT events.

<sup>49</sup> American Law Institute, *Federal Income Tax Project, Subchapter K: Proposals of Partners, Adopted by the American Law Institute* (American Law Institute, 1984) 5.

<sup>50</sup> See, eg, the Australian partnership tax rules: *ITAA 1936* pt 3 div 5.

<sup>51</sup> *ITAA 1997* sub-div 207-B. For a discussion of the nature of a franking credit and its attachment to a dividend, see *Federal Commissioner of Taxation v Thomas* (2018) 357 ALR 445, 447–50 [2]–[19].

trust context, this is subject to further qualifications.<sup>52</sup> Where those requirements are met, the beneficiary receives the dividend (or its allocated part) and benefits from any franking credit attached. Again, this can be extremely valuable for the reasons described above in relation the imputation system. The legislation provides for the flow through of capital gains to a beneficiary, subject to similar qualifications, and preferences attaching to the capital gain also flow to the beneficiary.<sup>53</sup>

## C *Application of Each Method in Australia*

Subject to exceptions, in Australia the method of taxation generally follows legal form. That is, once a vehicle is established as a particular form, the income tax law respects that form and the vehicle is taxed under the rules for that vehicle. Generally, corporate tax rules apply to corporations, the partnership rules apply to partnerships and the rules for trusts apply to trusts.

The Australian corporate tax rules largely follow an entity tax design, but, as described above, since 1987 company and shareholder level taxes have been integrated under the imputation system.<sup>54</sup>

The Australian rules for taxing partnerships embody a fairly pure flow-through model as both net income and losses are attributed to partners and tax is only applied at the partner level.<sup>55</sup>

From the 5 May 2016, one of two sets of rules apply to trusts. The first set of rules apply to all trusts (the first paradigm).<sup>56</sup> Those rules largely embody a flow-through design as amounts are allocated to beneficiaries who are ‘presently entitled to a share of the income of the trust estate’ (‘present entitlement’).<sup>57</sup> Present entitlement is a technical tax term that was adapted from the trust law concept of entitlement.<sup>58</sup> Broadly, it requires the beneficiary to hold, at the end of the income year, an interest in the trust that is vested in interest and in possession, and for the beneficiary to have a right to call for that income.<sup>59</sup> But the first paradigm also incorporates elements from entity taxation: tax losses are trapped

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<sup>52</sup> Most importantly that the beneficiary is ‘specifically entitled’ to the franked distribution: *ITAA 1997* sub-div 207-C. Discretionary trusts must also have made the family trust election for this effect to be achieved. This is opaque in the legislation but this is through *ITAA 1936* pt 3A div 1A.

<sup>53</sup> *ITAA 1997* sub-div 115-C.

<sup>54</sup> Australia had a classical system from 1940 to 1987: Lynne M Oats, ‘Undistributed Profits Tax in Australia’ (1999–2000) 15(4) *Australian Tax Forum* 427, 429. There was a dividend deduction system from 1915 to 1922 and an imputation / exemption system from 1922 to 1940: Oats, 430, 431.

<sup>55</sup> *ITAA 1936* pt 3 div 5.

<sup>56</sup> *Ibid* pt 3 div 6.

<sup>57</sup> *Ibid* s 97.

<sup>58</sup> *Bamford* (2010) 240 CLR 481, 505. For further background, see Alex C Evans, ‘The Legislative Origin of Present Entitlement in Australia’ (2011) 40(4) *Australian Tax Review* 235.

<sup>59</sup> *Harmer v Federal Commissioner of Taxation* (1991) 173 CLR 264, 271 (‘*Harmer*’), cited with approval in *Bamford* (2010) 240 CLR 481, 505. Justice Hill stated that ‘the ability to demand and receive payment of income is “an indicia”, but not a prerequisite for present entitlement’: *Dwight v Commissioner of Taxation* (1992) 37 FCR 178, 189. Present entitlement needs only to exist at the end of the income year: *Colonial First State Investments Ltd v Federal Commissioner of Taxation* (2011) 192 FCR 298, 309 (Stone J).

at the trust level, and the trustee can be taxed as a proxy in particular circumstances, including where no beneficiary has the requisite entitlement, or the beneficiary is subject to a legal disability or is a non-resident of Australia for income tax purposes.<sup>60</sup> The second set of rules apply to a particular type of widely held trust called the Australian managed investment trust ('AMITs') and there is some excellent practically-oriented and applied literature on those rules.<sup>61</sup> However, further analysis, including the reasons why public trusts are taxed on a flow-through basis, will appear in future work by the author on public trusts.

### III Detailed Analysis of the Statistical Information that is Currently Publicly Available

The statistics referred to in Part I above underscore the point that trusts are currently very popular in Australia. However, more detailed statistical analysis is required to identify when the shift in favour of trusts occurred and to show material aspects of trust demographics. Graph 1 above shows that, as a general trend, the number of trusts has grown over the past 60 years. Graph 1 and the data underlying it also show that the number of trusts, income-year-on-income-year, increased significantly at several points. Those changes are discussed, given context and correlated with changes in tax settings for trusts and companies in Parts IV and V below.

The *ATO Tax Statistics* also provide the number of trusts from 1996–97 to 2015–16 for which returns were filed each year based on the trust's classification: public, private fixed trust, private discretionary trust, private hybrid trust and other.<sup>62</sup> The 1996–97 income tax year is the starting point because it is the first time that the ATO's statistics are broken down based on trust type. As background, the Australian income tax legislation does not define a private trust. However, it does define a public unit trust as one in which units are: listed for quotation in the official list of a stock exchange in Australia or elsewhere; or offered to the public; or held by 50 persons or more.<sup>63</sup> Practically, private trusts are trusts that are not public trusts. A discretionary trust is a term of usage and refers to a trust where the trust deed gives the trustee power to choose to which of a class of potential beneficiaries (the appointee) to make a distribution and how much to distribute to the appointee. Hybrid trusts combine elements of a unit trust and a discretionary trust. Usually 'distributions of income to beneficiaries are

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<sup>60</sup> *ITAA 1936* ss 95(1) (definition of net income), 97 (beneficiary taxation), 98 (trustee taxation as proxy for beneficiary).

<sup>61</sup> *ITAA 1997* div 276, as inserted by *Tax Laws Amendment (New Tax System for Managed Investment Trusts) Act 2016* (Cth). For analysis, see Josh Cardwell, 'A Review of the Proposed AMIT Regime — Exposure Draft: Tax Laws Amendment (New Tax System for Managed Investment Trusts) Bill' (Paper, Challis Discussion Group, Sydney, 6 May 2015) (copy on file with author); Manuel Makas and Graeme Cooper, 'Australia Introduces New Attribution Managed Investment Trusts Regime' (2015) 15(4) *Tax Planning International Asia-Pacific* 4.

<sup>62</sup> *ATO Tax Statistics 2015–16*, above n 3, Trusts Table 4; Table 4 in the relevant year's statistics for 1996–97 until 2015–16.

<sup>63</sup> *ITAA 1936* s 102P.

fixed and distributions of capital are at the discretion of the trustee or vice versa'.<sup>64</sup> While this label has not been picked up in academic literature on the taxonomy of trusts,<sup>65</sup> the ATO's rulings have been discussing hybrid trusts since at least 2009 and the term has appeared in discussions of trusts in income tax treatises.<sup>66</sup>

The data shows that, at each point between 1996–97 and 2015–16, the vast majority of trusts were private trusts.<sup>67</sup> For example, private trusts comprised over 99% of the total number of trusts in 1996–97 and just over 98.71% in 2015–16. While there has generally been growth in the number of public trusts (both listed and unlisted) over the data period, the proportion of the total number of trusts they comprise has not changed materially. For example, the proportion was just under 0.3% in 1996–97 and just over 0.69% in 2015–16. The data also shows that, consistently across the data period, the majority of trusts were discretionary trusts. While the exact proportion varies each year, it was 71.6% in 1996–97 and 78.7% in 2015–16. The data shows that generally the number of discretionary trusts has grown income-year-on-income-year, with some notable exceptions. For example, the number decreased in 2000–01 and 2015–16. These drops reflect decreases in the total number of trusts and, as set out in Parts IV and V, in some cases they can be correlated with particular changes in tax law. Further, while there has been some variation between years, the proportion of the total number of trusts represented by the other trust types was within a fairly narrow range over the data period. For example, private fixed trusts represented nearly 16% of trusts in 1996–97 and over 13% in 2015–16; and hybrid trusts represented just under 0.5% of trusts in 1996–1997 and just over 1.3% in 2015–16.

Graph 2 below shows the amount of total business income derived through all types of trusts from 1989–90 to 2015–16. The 1989–90 income year is the starting point because it is the first time the ATO started recording the total business income figure. It is not possible to chart this relative to a total business income figure derived in Australia because the information required to do this is not released by the ATO.

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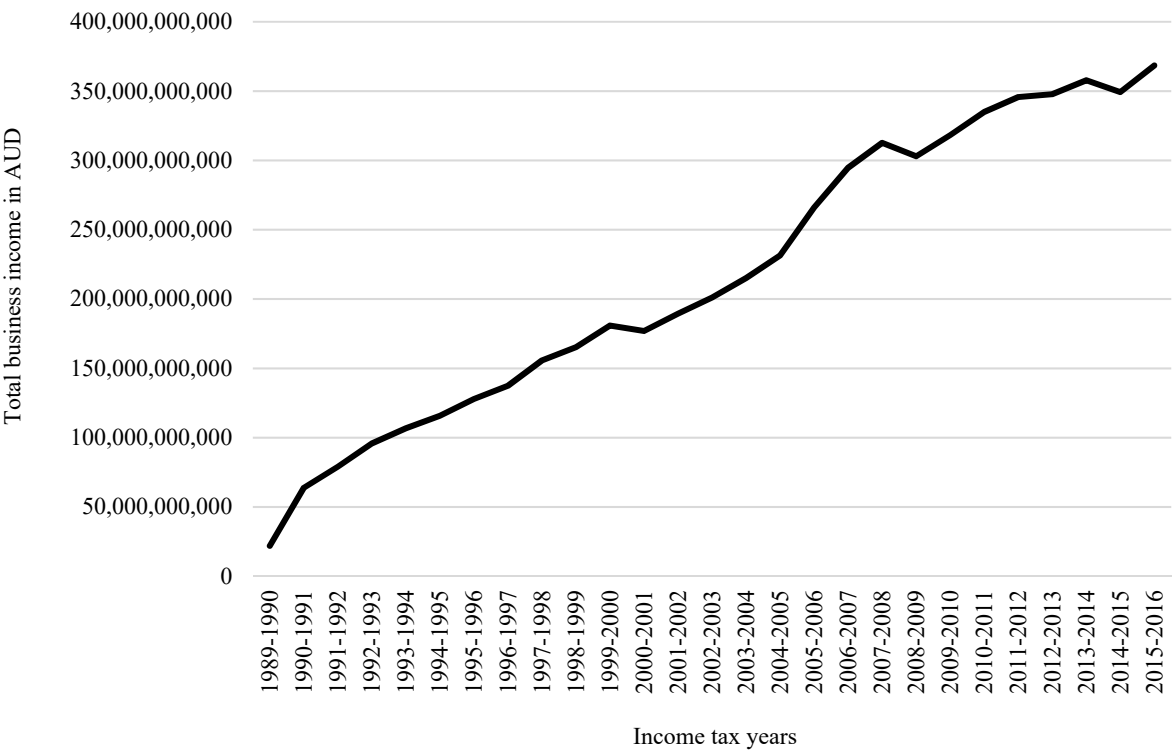
<sup>64</sup> Gordon Cooper and Chris Evans, *Australian CGT Handbook 2013–14* (Thomson Reuters, 5<sup>th</sup> ed, 2013) 360 [19 060].

<sup>65</sup> For example, there is no discussion of this term in John Heydon and Mark Leeming, *Jacobs' Law of Trusts* (LexisNexis Butterworths Australia, 8<sup>th</sup> ed, 2016) ch 3.

<sup>66</sup> ATO, *Taxation Determination — Income Tax: Is Interest on a Loan Fully Deductible under Section 8-1 of the ITAA 1997 When the Borrowed Moneys are Settled by the Borrower on Trust to Benefit the Borrower and Others?*, TD 2009/17, 15 July 2009, Example 4. The *ATO Tax Statistics* show that there were 9275 hybrid trusts (ie 1.2% of the trust population) in 2012–13: ATO, *Taxation Statistics 2012–13* (2013), Table 4, <<https://data.gov.au/dataset/taxation-statistics-2012-13/resource/b4437e2d-7a92-4b1e-a98f-4d535c8d2e4f>>. See the above definition for hybrid trust in Cooper and Evans, above n 64.

<sup>67</sup> This removes the percentage represented by 'Public unit trusts' and 'Other' categories in the supporting data.

**Graph 2:** Graph showing the total business income derived through trusts from 1989–1990 income year to the 2015–2016 income year<sup>68</sup>



<sup>68</sup> Author’s graph based on *ATO Tax Statistics 2015–16*, above n 3, Trusts Table 1.

Graph 2 makes clear that the total business income derived through all trusts has grown significantly over this period. This is also clear from the fact that the 2015–16 figure (\$368 468 000 000) was 16.78 times the 1989–90 figure (\$21 984 566 019). Another indication is that average change across the time period was 14%.

From 2011–12 to 2015–16, the ATO's statistics correlate total business income with the scale of the trust through which it was derived.<sup>69</sup> The ATO classifies entities in the following way for the purpose of these statistics.

**Table 1:** How the ATO determines entity size in *ATO Tax Statistics*<sup>70</sup>

Entity size	Total business income
Loss	Less than \$0
Nil	Equal to \$0
Micro	\$1 to less than \$2 million
Small	\$2 million to less than \$10 million
Medium	\$10 million to less than \$100 million
Large	\$100 million to less than \$250 million
Very large	\$250 million or more

The *ATO Tax Statistics* data shows two important points. First, the majority of trusts by number (between 57.8% and 58.61% across the data period) are nil trusts; that is, they either derive \$0 business income or their allowable deductions generate taxable income of nil.<sup>71</sup> The statistics do not provide general explanations of how trusts get to either result. There are, however, legitimate ways either result could happen, including, for example, where business expenses exceed the assessable income in any one year, or where the trustee can deduct a tax loss from a prior year. Because this proportion is so high, it would be valuable for the ATO to provide general explanations in future statistics. The next biggest group by number is micro trusts (comprising between 37.8% and 38.58% across the data period) followed by loss trusts (comprising between 0.066% and 0.0975% across the data period). The large and very large groups comprise a much smaller proportion of the

<sup>69</sup> *ATO Tax Statistics 2015–16*, above n 3, Trusts Table 15.

<sup>70</sup> Ibid 'Definitions and calculations' <<https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Taxation-statistics/Taxation-statistics-2015-16/?anchor=Definitions#Definitions>>.

<sup>71</sup> This is because the ATO takes the \$0 figure from Box 'S' in Item 5 in the Trust Tax return, which is a net income figure: see ATO, *Trust Tax Return* (2016) <<https://www.ato.gov.au/uploadedFiles/Content/MEI/downloads/Trust-tax-return-2016.pdf>>.

total number of trusts – between 0.0179% and 0.021%, and 0.004% to 0.0066% respectively across the data period.

Second, the *ATO Tax Statistics* data shows that the bulk of total business income derived through trusts (between 85.04% and 87.12% across the data period) is derived through micro-, small- and medium-sized trusts, with around one-third (ranging between 29.73% and 31.1% in the data period) of total business income concentrated in micro trusts.

These points clearly show that the most profitable business activities are concentrated at the micro, small and medium scale. The ATO publishes further information correlating, among other items, scale, total business income and broad industry type, but this is only available for micro and small trusts and is potentially unreliable because it is a self-labelling system.<sup>72</sup> However, the one point worth noting from 2015–16 is that over 86% of nil/loss trusts self-report as falling outside one of the industry groups (the biggest being ‘construction’, ‘financial and insurance services’ or ‘rental, hiring and real estate services’). This suggests that most loss trusts are concentrated in non-commercial areas.

## IV Trusts in the Private Context Pre-Imputation

### A Significant Change in the Way Trusts Could be Used

Before the 1970s, private trusts were primarily used in Australia in the more traditional way, as a mechanism for succession planning and intergenerational transfer of wealth. Vann has argued that before the 1970s in Australia, ‘most small business seem[s] to have been either in corporate or partnership form’.<sup>73</sup> This is supported by Graph 1 above.

The trust was not an alternative to the company before the 20<sup>th</sup> century because the orthodox view was that a trustee could not use trust assets in carrying on a business without clear authorisation in the trust deed, otherwise the trustee would be in breach of their fiduciary obligations.<sup>74</sup> Slater has argued that:

The reason was that the conduct of the business involved the undertaking of risks and liabilities which could put the entirety of the trust fund at risk, thereby imperilling the interests of the remaindermen for the sake of producing a larger income for the life tenant.<sup>75</sup>

However, that position changed in the early 1900s.<sup>76</sup> In two decisions in 1901 and 1903 following English precedents, Australian judges held that a trustee who held a power of conversion over a testator’s assets had an implied power to carry on

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<sup>72</sup> *ATO Tax Statistics 2015–16*, above n 3, Trusts Table 5.

<sup>73</sup> Richard Vann, ‘Structure of SME Taxation’ (Paper presented at Looking Forward at 100 years: Where Next for the Income Tax?, Tax and Transfer Policy Institute, Crawford School of Public Policy, Australian National University, 28 April 2015) Slide 8 <[https://taxpolicy.crawford.anu.edu.au/sites/default/files/events/attachments/2015-04/richard\\_vann\\_ttpi\\_conference\\_27\\_28\\_april\\_2015.pdf](https://taxpolicy.crawford.anu.edu.au/sites/default/files/events/attachments/2015-04/richard_vann_ttpi_conference_27_28_april_2015.pdf)>.

<sup>74</sup> Slater, above n 25, 77.

<sup>75</sup> *Ibid* 76–7.

<sup>76</sup> *Ibid*.



the testator's business for a period at the trustee's discretion or until the beneficiaries attained majority.<sup>77</sup> However, Slater has argued that this view did not become broadly accepted until the 'last quarter of the [20<sup>th</sup>] century'.<sup>78</sup> Consequently, trading trusts largely lay dormant until the 1970s.

## **B     *The Anecdotal Explanation for the Movement towards Trusts***

To date, the anecdotal view in tax has been that the most significant migration towards trusts occurred from the late 1970s through to the mid-1980s due to the combined effect of the income tax settings for private companies and a series of changes that made using companies even more unfavourable. Existing literature cites two main settings as crucial background.

### **1     *The Introduction of the Imputation System***

The first setting is that, as discussed above, until the introduction of the dividend imputation system in 1987, a company's income was subject to two layers of tax, because Australia taxed income derived through companies using a classical system.<sup>79</sup> This produced a heavy tax burden because, during this time, high rates of tax applied to both private companies (generally 45% from 1940 through to 1977) and individuals (the top rate was well above 60% throughout the 1970s).<sup>80</sup>

### **2     *Tax Settings for Private Companies***

The second setting was that Australia imposed undistributed profits tax on private companies to prevent them from being used as tax shelters. Sheltering in this context refers to the practice of directing income to a company to access a lower tax rate than the natural taxpayer's rate where the taxpayer is a shareholder in the company. This allows for tax at the higher rate to be deferred until the company distributes to the natural taxpayer (the shareholder). Undistributed profits tax was nothing new — it had been imposed since 1922.<sup>81</sup> Broadly, undistributed profits tax required a private company to distribute half of its after-tax business profits to shareholders within a year ('the minimum distribution requirement'). If a company did not meet

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<sup>77</sup> *Southwell v Martin* (1901) 1 SR (NSW) 32, 35; *Re Hammond*; *Hammond v Hammond* (1903) 3 SR (NSW) 270, 272. The English precedent cases include: *In re Chancellor* (1884) 26 Ch D 42; *In re Crowther* [1895] 2 Ch 56.

<sup>78</sup> Slater, above n 25, 76–7. Slater refers to a paper written by Adrian Abbott. Mr Slater QC and Mr Abbott no longer hold a copy of it.

<sup>79</sup> The dividend imputation system is now largely contained in *ITAA 1997* pt 3–6. Note that before the introduction of imputation, the intercorporate dividend rebate meant that dividends received by one company from another were exempt from tax: *ITAA 1936* s 46. Section 46 was removed, with the introduction of the consolidation rules for companies, in relation to franked dividends paid on or after 1 July 2002, and unfranked dividends paid on or after 1 July 2003: *New Business Tax System (Imputation) Act 2002* (Cth).

<sup>80</sup> Slater, above n 25, 77. For historic rates, see Treasury, Australian Government, *Brief History of Australia's Tax System* (2006) Economic Roundup Winter 2006 <[http://archive.treasury.gov.au/documents/1156/HTML/docshell.asp?URL=01\\_Brief\\_History.asp](http://archive.treasury.gov.au/documents/1156/HTML/docshell.asp?URL=01_Brief_History.asp)>.

<sup>81</sup> Oats, above n 54, 430. The way in which the base was calculated was adjusted several times after the introduction of the undistributed profits tax: Oats, above n 54.

the minimum distribution requirement, undistributed amounts were taxed at 50% in addition to paying company tax.<sup>82</sup>

During the 1960s and 1970s, the Australian Government closed off several avenues of tax planning and avoidance that had previously been available to taxpayers who used private companies. Those practices included schemes that were designed to avoid the application of undistributed profits tax either by: causing the company to fall outside the definition of a private company; and paying dividends through a series of companies (referred to as ‘snakes’ and ‘chains’)<sup>83</sup> so as to make the dividends effectively tax-free due to the intercompany dividend rebate.<sup>84</sup> The Government also made a series of other changes that made the private company less favourable.<sup>85</sup> In chronological order, first, it significantly tightened the loss utilisation rules that applied to companies between 1964 and 1973.<sup>86</sup> These changes put more restrictions on a company’s ability to apply unused losses from a previous year. The initial change correlates with an income-year-on-income-year increase of over 10% in the number of trusts between 1965–66 and 1966–67.<sup>87</sup> Second, during the 1970s, the Government expanded the definition of private company.<sup>88</sup> This made it much harder to avoid the private company classification and therefore undistributed profits tax. Third, it reduced the intercorporate dividend rebate for private companies to discourage ‘snakes’ and ‘chains’.<sup>89</sup> Fourth, the Government introduced a new regime that empowered the Commissioner of Taxation to determine that an amount loaned, paid or credited by a private company to a shareholder or their associate was really a distribution of profits and to recharacterise it as a dividend.<sup>90</sup> Such recharacterisation was disadvantageous because dividends were then subject to two layers of tax and, as outlined above, this could result in a very heavy tax burden.

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<sup>82</sup> Taxation Review Committee, Commonwealth of Australia, *Full Report: 31 January 1975* (1975) 225 [16.15] (*‘Asprey Report’*).

<sup>83</sup> Oats, above n 54, 449.

<sup>84</sup> Richard Vann, ‘Structural Issues in the Taxation of Small Business’ (Unpublished Draft dated 8 June 2015) 11 (copy on file with author). Vann also noted that ‘trafficking in excess distribution companies; dividend stripping; extracting value from companies in ways that did not attract deemed dividend treatment’: at 11.

<sup>85</sup> Other changes were that the excess distribution provisions were repealed in 1973 after their abuse: Oats, above n 54, 451.

<sup>86</sup> *Income Tax Assessment Act 1965* (Cth); Commonwealth, *Parliamentary Debates*, House of Representatives, ‘Notes to the Treasurer’s Second Reading Speech on *Income Tax Assessment Act 1965* (Cth)’; *Income Tax Assessment Act 1966* (Cth) ss 9, 10; Slater, above n 25, 77; Comment, ‘Amendments to Income Tax and Social Services Contribution Assessment Act — Outline of Proposals’ [1964] (November) *Taxation in Australia* 189, 191–2; Comment, ‘Amended Section 80 – Losses of Previous Years to be Allowable Deductions’ [1964] (November) *Taxation in Australia* 223, 224.

<sup>87</sup> See above n 21 for the source of the data.

<sup>88</sup> Anthony Slater, *Law and Taxation of Company Distributions in Australia* (CCH, 1982) 3,002 [343], 20,103 [1002]. See also Oats, above n 54, 450.

<sup>89</sup> Oats, above n 54, 448–50.

<sup>90</sup> *ITAA 1936* s 108. In 1998, this was developed automatically to deem those amounts to be dividends: *ITAA 1936* div 7A.

### 3 *Broader Factors*

Beyond the settings above, there are two broader factors that are likely to have played a role in the migration towards trusts.

#### (a) *The Use of Trusts in Avoidance Practices*

First, the favouring of private trusts coincided with a period of significant tax avoidance activity in the late 1970s and early 1980s and the literature observes that trusts were often used in that activity.<sup>91</sup> One of the key advantages of the lack of restrictions on trusts described above was the opportunity trusts provided for income splitting, which was explained in Part I. As an example, Vann has argued that as the tax-free threshold for individuals increased from '\$416 in 1971–1972 to \$4,595 in 1984–1985', it became popular to 'create present entitlements in beneficiaries [below the threshold] without actually distributing income to them' to minimise the overall tax burden on income derived through a trust.<sup>92</sup> This appeared to have a significant impact on the movement to trusts — there was a sustained increase of over 17% in the number of trusts income-year-on-income-year between 1983–84 and 1985–86.<sup>93</sup> The practice, described above, caused the Australian Government to state in its 1985 *Draft White Paper* that trusts had become 'widely regarded as providing the most effective and flexible means of splitting family income for tax purposes'.<sup>94</sup> While the Government considered treating private trusts as companies for tax purposes to close off the possibilities for income splitting in 1985, it did not pursue this, recognising that it would only push the income-splitting problem to partnerships.<sup>95</sup>

#### (b) *The Use of Trusts in More Sophisticated and Marketed Structures*

Others have also suggested that, as the treatment of trusts became more favourable relative to the treatment of companies, legal and accounting advisers developed and began to recommend particular structures to their clients involving trusts.<sup>96</sup> At the time, firms could market such structures fairly heavily and it is likely that this, at least in part, contributed to their use.<sup>97</sup> Such marketing is now effectively prohibited under rules that impose penalties for people who promote schemes and structures designed to avoid tax.<sup>98</sup>

<sup>91</sup> Vann, above n 84, 11; Trevor Boucher, *Blatant, Artificial and Contrived: Tax Schemes of the 70s and 80s* (ATO, 2010) chs 12, 26, 54. For some behaviours involving trusts, see Treasury, Australian Government, *Reform of the Australian Tax System: Draft White Paper* (Australian Government Publishing Service, 1985) 53 [5.9] ('*Draft White Paper*').

<sup>92</sup> Vann, above n 84, 11. It is noted that after 1980, this was only effective where the beneficiaries were not children because of the introduction of *ITAA 1936* pt 3 div 6AA.

<sup>93</sup> See above n 21 for the source of the data.

<sup>94</sup> *Draft White Paper*, above n 91, 53 [5.7].

<sup>95</sup> *Ibid* 54 [5.13].

<sup>96</sup> Vann, above n 73, Slide 7.

<sup>97</sup> I am indebted to a generous anonymous reviewer for this observation.

<sup>98</sup> *Taxation Administration Act 1953* (Cth) div 290 (promoter penalty law).

Initially, the structures were simple and the business was separated from the trust in the traditional way — that is: the business was carried on by a corporation; the assets used in that business were held subject to a trust; the trustee leased the assets comprising the trust property to the company; and the company paid the trustee rent.<sup>99</sup> Over time, more complex structures emerged with the trustee taking over the role of carrying on the business — that is, the trust was created over assets used in the business and the trustee was a company.<sup>100</sup> Protection of the trust property from third party liabilities in connection with the business under this second structure appears to rely on a view that: the trustee's right of indemnity (as against the trust property) can be excluded or reduced in the trust deed; the trustee's right of recourse against the beneficiaries is very narrow; and the scope for subrogation by third parties to the trustee's right is also narrow.<sup>101</sup>

#### 4 *The Anecdotal View*

The anecdotal view is that the factors described above caused the trust to become a more attractive alternative to a private company by the late 1970s. For clarity, the comparative advantages of using a trust at this time can be distilled to the following list:

1. Income derived through a trust was only subject to one layer of tax.
2. Although accumulated income was taxed punitively from 1964 onwards,<sup>102</sup> the punitive treatment could be avoided by ensuring that a beneficiary or beneficiaries were presently entitled each year.
3. Loss utilisation rules were not imposed on trusts until 1998,<sup>103</sup> so until then there were no restrictions on a trustee applying a past year loss in the trust context.
4. The recharacterisation rules in div 7A of the *ITAA 1936* did not apply to trusts until 2004 and even then, they could be 'overcome' using certain techniques.<sup>104</sup>

The anecdotal account is supported by the historical data that underlies Graph 1.<sup>105</sup> Table 2 (below) shows the income-year-on-income-year changes

<sup>99</sup> Nathan Isaacs, 'Trusteeship in Modern Business' (1929) 42(8) *Harvard Law Review* 1048, 1058.

<sup>100</sup> See, eg, Vann, above n 73, slide 7. See also Parliamentary Joint Committee on Corporations and Financial Services, above n 4, 124.

<sup>101</sup> As background, the trustee's right of indemnity is first against the trust property: Denis S K Ong, *Trusts Law in Australia* (Federation Press, 4<sup>th</sup> ed, 2012) 336; Donald Hill, 'Present Entitlement and Trust Accounting' (1983) 17 *Taxation in Australia* 850, 855. The trustee can only pursue beneficiaries who are absolutely entitled with respect to the trust personally when the trust property is insufficient to satisfy the trustee's right of indemnity: Ong, 336; *Hardoon v Belilios* [1901] AC 118, 124.

<sup>102</sup> *ITAA 1936* s 99A, as inserted by *Income Tax and Social Services Contribution Assessment Act (No 3) 1964* (Cth).

<sup>103</sup> *Ibid* sch 2F, as inserted by *Taxation Laws Amendment Act (Trust Loss and Other Deductions) Act 1998* (Cth).

<sup>104</sup> Vann, above n 84, 12.

<sup>105</sup> See above n 21 for the source of the data.

between 1974–75 and 1981–82.<sup>106</sup> It shows that the number of trusts grew significantly during this period.

The anecdotal view appears to assume that the shift towards trusts would decrease after 1987, with the introduction of imputation, because then income derived through both companies and trusts would be subject to one layer of tax. However, contrary to that, the increase in the number of trusts since 1987 — almost parallel to the growth in the number of companies (Graph 1 above) — indicates that the trust continued to offer some comparable advantage even after the introduction of imputation.

**Table 2:** Income-year-on-income-year changes in the number of trusts between 1974–75 and 1981–82

Between which income tax years	% change in number of trusts (year-on-year)
1974–75 and 1975–76	10.05%
1976–77 and 1977–78	10.67%
1977–78 and 1978–79	23.70%
1978–79 and 1979–80	7.97%
1979–80 and 1980–81	14.17%
1980–81 and 1981–82	15.99%

## V The Ongoing Comparative Advantage of a Trust Post-Imputation

This Part critically analyses the comparable advantage of a trust and argues that the reasons fall into two main groups. The first group are elements of the income tax treatment that make using trusts, particularly discretionary trusts, very attractive. The second group comprises external changes that created greater certainty regarding the tax treatment of trusts.

<sup>106</sup> The data for 1975–76 and 1976–77 is not included as there appears to be an error in the number of companies in 1976–77: see above n 21 for the source data. It is unclear if the data for partnerships and trusts for these years is accurate.

## A *Group 1: Elements of the Income Tax Treatment that Make Using Trusts, Particularly Discretionary Trusts, Very Attractive*

There are three dimensions to the favourable income tax treatment of trusts. The first is the treatment of income derived through trusts, the second is the CGT treatment of trusts and the third is the combined effect of the imputation system and refundability of franking credits. These are considered in turn below.

### 1 *Treatment of Income Derived through Trusts Generally*

As stated in Part II above, the first paradigm treats the trust as a fiscally transparent vehicle to the greatest extent possible. When the beneficiary is taxed, the net income is not taxed at the trust level. Rather, the beneficiary is taxed on its share of the net income at the beneficiary's tax rate.<sup>107</sup> Further, as described in Part II, amounts may pass through to the beneficiary with their character intact. For example, a dividend is taxed to the beneficiary as a dividend and a capital gain is taxed to the beneficiary as a capital gain.<sup>108</sup> In addition, amounts that flow from a trust are not quarantined in the beneficiary's hands. For example, if the trustee derives a net capital gain of \$100 in the 2017–18 income year and that net capital gain is successfully streamed to Beneficiary A, Beneficiary A can apply any unused net capital loss from other sources against the \$100 net capital gain from the trust to reduce Beneficiary A's overall income tax liability.<sup>109</sup> As explained in Part II, this is in stark contrast to the treatment of a dividend received by a shareholder in a company and it can be a significant benefit.

As the ALP's 2017 Proposal identified, discretionary trusts can be used for income splitting. It can be achieved using the following steps: the higher earning taxpayer gifts the family property to a trust; the family solicitor becomes the trustee; the higher earning taxpayer is employed by the trustee to carry on the business; the income from those activities can then be directed to the people to whom the trustee appoints the trust's net income; and the higher earning taxpayer maintains control in the form of being able to take back the trust property in the event of the failure of the marriage.<sup>110</sup> The legislation does not try to prevent such practices, for example, by reallocating the net income back to the higher earning taxpayer.<sup>111</sup> It taxes the trust's current year net income to the potential beneficiary in whose favour the

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<sup>107</sup> ITAA 1936 s 97.

<sup>108</sup> For franked dividends and capital gains, this is achieved through special rules that were introduced in 2011: ITAA 1997 sub-div 115-C, div 207-B; *Ibid* div 6E. Before then, the view in practice was that such amounts could be streamed to beneficiaries based on the decisions in *Charles v Federal Commissioner of Taxation* (1954) 90 CLR 598 and *Tindal v Commissioner of Taxation* (1946) 72 CLR 608, and there had been some support for that position in ATO rulings: see, eg, ATO, *Income Tax: Capital Gains Provisions: Interpretation and Operation*, IT 2328, [13] (withdrawn 2008); ATO, *Income Tax: Distribution by Trustees of Dividend Income under the Imputation System*, TR 92/13, [4].

<sup>109</sup> ITAA 1997 s 102-5. If Beneficiary A qualifies as a small business entity, it can also access a range of concessions: ITAA 1997 div 328.

<sup>110</sup> Grbich, above n 11, 325; Stewart, above n 11, 468.

<sup>111</sup> Evans (2016), above n 35, ch 5, 196, 197–8, 218–19.

trustee has exercised its discretion.<sup>112</sup> Putting aside the potential application of the general anti-avoidance provisions, the income tax legislation does not restrict the exercise of the trustee's discretion. The only limitations come from the trust deed and the trustee's compliance with the general law of trusts. This means that a trustee can choose to appoint the income of a trust to the person within the class of potential beneficiaries (the appointee) with the lowest marginal tax rate. The rate may not be the reason that the trustee selects that person. The trustee may select the youngest adult for some objective reason, such as that they have the lowest income from sources outside of the trust and need cash, or some subjective reason, such as being the grandmother's favourite.

From a trust perspective, the selection criteria are irrelevant, what matters only is that it is consistent with the terms of the trust and the trustee's obligations at trust law. However, the way in which the trustee exercises their discretion can minimise the overall tax that is paid on income flowing through a discretionary trust. Further, assuming the trustee's discretion is broad, the trustee can change the appointee from one year to the next. This can also result in tax minimisation over time. Again, such a change could be motivated by non-tax reasons, such as, continuing the example above, the oldest adult could become the grandmother's new favourite. Again, beyond the general anti-avoidance rule, the income tax legislation does not currently contain any measures to curb the extent to which a trustee exercises their discretion to minimise tax. For example, there is no requirement that the trustee identify the appointee at the start of each income year. The income tax legislation merely requires the trustee to exercise their discretion by the end of the income tax year (30 June).<sup>113</sup> The statistical analysis in Part III above showed the popularity of the discretionary trust. It is argued that this is partially due to this freedom to select persons within a class of potential beneficiaries, which is not possible through a company, coupled with the ability to split income. This is sometimes loosely referred to in practice as the flexibility of a discretionary trust.

## 2 CGT Treatment of Trusts

As stated above, the second favourable dimension of the tax treatment of trusts is the CGT rules. There are two key points. The first applies to all trusts.<sup>114</sup> As described in Part II above, the legislation has provided discount capital gains treatment for individuals and trusts. If the discount treatment applies, an individual or trust is able to reduce their capital gain by 50% in calculating their net capital gain.<sup>115</sup> In the context of a trust, the benefit of the discount is passed to the

<sup>112</sup> *ITAA 1936* ss 95A(1), 97, 101. For a recent discussion of the application of these sections, see *Hart v Federal Commissioner of Taxation* [2018] FCAFC 61 (20 April 2018) [47]–[57].

<sup>113</sup> Trustees were previously given extra time (two months) to exercise their discretion, but the ATO removed this latitude on 24 August 2011: see ATO, *Trusts: Interpretation of Section 101 in Relation to Section 99 and 99A under 1964 Amending Legislation*, IT 328 (withdrawn); ATO, *Discretionary Trusts: Section 101 – Resolutions of Trustee*, IT 329 (withdrawn). The rule for streaming capital gains to specifically entitled beneficiaries does, however, allow two additional months: *ITAA 1997* s 115-228(1) (definition of 'share of net financial benefit', para (c)).

<sup>114</sup> It is noted that, unlike at general law, the income tax legislation treats a trust as a separate entity for tax law purposes: *ITAA 1997* s 960-100(f).

<sup>115</sup> *Ibid* s 115-100(a). The net capital gain is calculated using the method statement in s 102-5.

beneficiaries who are specifically entitled to the capital gain.<sup>116</sup> The discount treatment is not available to companies.<sup>117</sup>

The second point applies only to discretionary trusts. The CGT rules produce capital gains or capital losses for taxpayers when certain trigger events happen. One event that applies to trusts is when the trustee pays a beneficiary an amount of trust capital in relation to their interest in the trust. This is 'CGT event E4' ('E4').<sup>118</sup> Broadly, E4 brings to account distributions of trust capital that have not previously been taxed to the trustee and would otherwise not be taxed in the beneficiary's hands. The ATO's interpretation of E4 is that it cannot happen in relation to a discretionary trust because persons within a class of potential beneficiaries do not have an 'interest in the trust', which is one of the conditions for E4 to apply.<sup>119</sup> While this position is correct as a matter of law,<sup>120</sup> it means that amounts of trust capital are able to be distributed to potential beneficiaries of a discretionary trust tax-free. This is inconsistent with distributions of capital made by fixed trusts (because E4 applies) and the return of share capital by companies (because CGT event G1 applies).<sup>121</sup>

The availability of discount treatment to trusts, and by extension beneficiaries, and not to companies is a significant advantage of using a trust generally. The combination of the flexibility in allocating the tax liability on current year net income of a trust to persons selected by the trustee and the fact that discretionary trusts are excluded from CGT event E4 make discretionary trusts an extremely attractive alternative to a company.

### 3 *The Combined Effect of the Imputation System and Refundable Credits*

As discussed above, trusts are often used in combination with other vehicles, particularly the company, in fairly sophisticated structures. A recent structure, that became popular after the introduction of cash refunds to taxpayers for excess franking credits in 2000, is for a discretionary trust that is used to carry on business to have a corporate beneficiary, sometimes known as a 'bucket company',<sup>122</sup> often as the default beneficiary.<sup>123</sup> In this structure, the trustee will generally distribute to

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<sup>116</sup> Ibid sub-div 115-C.

<sup>117</sup> This is no accident. The exclusion of companies is made complete by *ITAA 1997* s 115-225 which unwinds the effect of the discount where the trustee is taxed on accumulated income under *ITAA 1936* s 99A. For the logic behind excluding companies, see Peter Costello, 'The New Business Tax System' (Media Release, No 058, 21 September 1999) <<http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/1999/058.htm&min=phc&DocType=0>>, Attachment D <<http://ministers.treasury.gov.au/ministers/phc/content/PressReleases/1999/attachments/058/D.PDF>>.

<sup>118</sup> *ITAA 1997* s 104-70.

<sup>119</sup> See ATO, *Taxation Determination — Income Tax: Capital Gains: Does CGT Event E4 in Section 104-70 of the Income Tax Assessment Act 1997 Happen if the Trustee of a Discretionary Trust Makes a Non-Assessable Payment to: (A) A Mere Object; or (B) A Default Beneficiary?*, TD 2003/28, 26 November 2003.

<sup>120</sup> *Gartside v IRC* [1968] AC 553.

<sup>121</sup> *ITAA 1997* s 104-135.

<sup>122</sup> *Re:Think Tax Discussion Paper*, above n 34, 108. For discussion of structures involving bucket companies, see *RMIT Report*, above n 1, 73.

<sup>123</sup> 'A discretionary trust deed often nominates a person who will be entitled to the income of the trust if the trustee fails to exercise their discretion. That person is called the default beneficiary': Cooper and Evans, above n 64, 360 [19 060]. Practically, discretionary trust deeds almost always provide a



individuals with lower rates first and then to the bucket company. The goal is to cap the tax rate at the corporate tax rate (30%). The company can then loan some money back to the trust (provided this complies with div 7A of the *ITAA 1936*, which essentially requires that the loan have arm's length terms) or distribute it to shareholders. Sometimes the individual potential beneficiaries of the discretionary trust are also the company's shareholders; sometimes the shareholder is a second discretionary trust.<sup>124</sup> As described above, Australian tax law allows franking credits to flow through a trust with the dividend to the beneficiary. Where the beneficiary is an individual and has a tax rate that is less than the level of company tax paid, under current law, the beneficiary can be refunded the difference.<sup>125</sup> The 2019 Federal Election result seemed to show, at least in part, how important the cash refund for individuals and superannuation funds is to particular demographic groups as commentators have argued that campaigning around this issue may have contributed to the Coalition's victory.<sup>126</sup>

These three dimensions of the income tax treatment for trusts are very significant. Each is valuable in isolation, but they are extremely valuable when used in combination, which is possible when discretionary trusts are used.

## **B      *Group 2: External Changes that had a Positive Effect or Created Greater Certainty for the Taxation of Trusts***

There were two main sources of external change that helped to make private trusts more attractive. The first was the High Court decision in *Harmer*,<sup>127</sup> and the second was unsuccessful attempts by successive governments to reform the rules for taxing trusts.

### **1      *The Harmer Decision***

The decision in *Harmer* was handed down on 12 December 1991. That decision was significant for all trusts because it contained a very broad definition for present entitlement ('the *Harmer* definition').<sup>128</sup> As stated in Part II, present entitlement is the primary mechanism for determining whether the net income of a trust is taxed to the beneficiary at the beneficiary's rate or to the trustee of a trust as a proxy or at a

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default beneficiary because this means that the trustee will avoid being assessed on the trust's net income at a punitive rate: *ITAA 1936* s 99A.

<sup>124</sup> See, eg, Ben Walker, *Bucket Companies: The Least Known and Most Underutilised Strategy to Save Thousands in Tax*, Inspire Tax Planning <<https://inspire.business/bucket-companies-save-thousands-in-tax/>>.

<sup>125</sup> *ITAA 1997* s 67-25(1).

<sup>126</sup> Australian Labor Party, 'A Fairer Tax System: Ending Cash Refunds for Excess Imputation' (12 March 2018) 7 <[https://d3n8a8pro7vnm.cloudfront.net/australianlaborparty/pages/7652/attachments/original/1520827674/180313\\_Fact\\_Sheet\\_Dividend\\_Imputation\\_Reform.pdf?1520827674](https://d3n8a8pro7vnm.cloudfront.net/australianlaborparty/pages/7652/attachments/original/1520827674/180313_Fact_Sheet_Dividend_Imputation_Reform.pdf?1520827674)>. For commentary, see, eg, Jennine Khalik, 'How the Coalition Played a Long Game To Win the Franking Credits Debate', *Crikey* (online), 21 May 2019 <<https://www.crikey.com.au/2019/05/21/franking-credits-victory-election/>>; Benjamin Clark, 'Australia Can't Build a Future on Franking Credits', *Crikey* (online), 21 May 2019 <<https://www.crikey.com.au/2019/05/21/franking-credits-future/>>.

<sup>127</sup> (1991) 173 CLR 264.

<sup>128</sup> *Ibid* 271.

punitive rate.<sup>129</sup> Before *Harmer*, the meaning of present entitlement primarily derived from three cases and practitioners were required to conglomerate and reconcile statements of principle from those cases. While two of those cases, *Federal Commissioner of Taxation v Whiting*<sup>130</sup> and *Taylor v Federal Commissioner of Taxation*,<sup>131</sup> were High Court authorities and they advanced the meaning for present entitlement as a concept, they were old, their factual backgrounds were specific, and the statements of principle were difficult to read as a cohesive and lineal progression.<sup>132</sup> The third case, *Commissioner of Taxation v Totledge*,<sup>133</sup> contained a more sophisticated articulation and it used terms that were more easily applicable in real life; however, it was a Full Federal Court decision. The *Harmer* litigation came as a gift for practitioners. This was because the parties put an agreed statement of the meaning of present entitlement to the High Court bench. The High Court decision states that definition on the basis that the parties had removed it from contention in the case:

The parties are agreed that the cases establish that a beneficiary is ‘presently entitled’ to a share of the income of a trust estate if, but only if: (a) the beneficiary has an interest in the income which is both vested in interest and vested in possession; and (b) the beneficiary has a present legal right to demand and receive payment of the income, whether or not the precise entitlement can be ascertained before the end of the relevant year of income and whether or not the trustee has the funds available for immediate payment.<sup>134</sup>

However, that statement has since been viewed as having received High Court endorsement. This was most notable in the High Court’s 2010 decision in *Bamford*, which stated:

The effect of the authorities dealing with the phrase “presently entitled” was considered in *Harmer v Commissioner of Taxation*, where it was accepted that a beneficiary would be so entitled if, and only if...[*Harmer* definition stated].<sup>135</sup>

As shown in Table 3 (below), there was a sustained increase in the number of trusts from 1991–92 through to 1997–98.<sup>136</sup> This correlates with the period following the *Harmer* decision.

<sup>129</sup> *ITAA 1936* ss 97 (to the beneficiary), s 99A (to the trustee at the punitive rate). As stated above in Part II and above n 60, the trustee is taxed as the beneficiary’s proxy in some cases.

<sup>130</sup> (1943) 68 CLR 199 (*‘Whiting’*).

<sup>131</sup> (1970) 119 CLR 444 (*‘Taylor’*).

<sup>132</sup> For further discussion of these cases, see Alex Evans, ‘The Evolution of the Meaning for Present Entitlement in Case Law’ (Paper presented at Postgraduate Law Conference, Sydney Law School, 30 October 2013).

<sup>133</sup> (1982) 60 FLR 149 (*‘Totledge’*).

<sup>134</sup> *Harmer* (1991) 173 CLR 264, 271 (citations omitted).

<sup>135</sup> *Bamford* (2010) 240 CLR 481, 505.

<sup>136</sup> See above n 21 for the source of the data.

**Table 3:** Income-year-on-income-year change in the number of trusts from 1991–92 to 1997–98

Between which income tax years	% change in number of trusts (year-on-year)
1991–92 and 1992–93	1.88%
1992–93 and 1993–94	8.31%
1993–94 and 1994–95	9.60%
1994–95 and 1995–96	9.58%
1995–96 and 1996–97	7.39%
1996–97 and 1997–98	6.13%

It is argued that the permissive definition in *Harmer* was appealing to practitioners and those who favoured using trusts because: it was clear and expansive; it was stated in a High Court judgment and so it removed the need to reconcile the statements in *Whiting*, *Taylor* and *Totledge*; and it provided certainty and stability for taxpayers in a complex area of the law. The fact that there has not since been a case directly challenging the substantive meaning of present entitlement reflects how favourably the *Harmer* definition is viewed in practice.<sup>137</sup>

## 2 Unsuccessful Reform Attempts by the Australian Government

A second significant boost to certainty for trusts came when the Coalition (Howard) Government abandoned its initiative to tax trusts as companies (the ‘*Uniform Entity Tax Proposal*’) on 27 February 2001.<sup>138</sup> Table 4 (below) shows that the number of trusts decreased following the announcement of this proposal.<sup>139</sup>

**Table 4:** Income-year-on-income-year change in the number of trusts from 1997–98 to 2001–02

Between which income tax years	% change in number of trusts (year-on-year)
1997–98 and 1998–99	0.49%
1998–99 and 1999–2000	-1.27%
1999–2000 and 2000–01	-0.54%
2000–01 and 2001–02	1.87%

<sup>137</sup> For the refinements of this definition, see above n 59.

<sup>138</sup> *Entity Tax Retraction Media Release*, above n 3.

<sup>139</sup> See above n 21 for the source of the data.

As it was initially announced, the *Uniform Entity Tax Proposal* would have taxed trusts as companies. The rationale for that reform was to create a system so that ‘similar activities, investments and entities’ were taxed similarly (referred to as tax neutrality and also ensuring equity).<sup>140</sup> While this objective is desirable, the proposal has since been criticised for being too focused around an anti-avoidance concern,<sup>141</sup> and for giving rise to other problems, including creating new distortions between the treatment of individuals who owned property directly or were beneficiaries of a trust.<sup>142</sup> It also would not have solved the income-splitting problem, and it would have encouraged deferral of tax.<sup>143</sup>

As the Table 5 (below) shows, there was then a sustained period of increase in the number of trusts between 2002–03 to 2007–08.<sup>144</sup>

**Table 5:** Income-year-on-income-year change in the number of trusts from 2001–02 to 2007–08

Between income tax years	Percentage change in the number of trusts (year-on-year)
2001–02 and 2002–03	3.28%
2002–03 and 2003–04	6.56%
2003–04 and 2004–05	6.26%
2004–05 and 2005–06	6.81%
2005–06 and 2006–07	7.08%
2006–07 and 2007–08	8.26%

The sustained increase over time correlates with the period following the announcement that the *Uniform Entity Tax Proposal* would not be pursued. The reason for this increase was arguably that the abandonment signalled something greater than the failure of the proposal — it provided great certainty going forward for those who favoured using trusts. This was because the process had demonstrated

<sup>140</sup> Australian Government, *Review of Business Taxation: A Tax System Redesigned: More Certain, Equitable and Durable* (1999), Chairman’s Introduction, 2; Section 12 (Distributions) <<http://rbt.treasury.gov.au/publications/paper4/>>. See also Australian Government, ‘A Strong Foundation: Establishing Objectives, Principles and Processes’ (Discussion Paper, Commonwealth of Australia, November 1998) 63–4 [6.11]–[6.14] (‘Ensuring equity’), 75 [6.67]–[6.68] <<http://rbt.treasury.gov.au>>.

<sup>141</sup> See, eg, Slater argued that the *Uniform Entity Tax Proposal* was ‘framed solely as an anti-avoidance measure, rather than structural reform’: Slater, above n 25, 91.

<sup>142</sup> Matthew Marcarian, ‘The Future Taxation of Trusts in Australia – A Proposal’ (2003) 38(5) *Taxation in Australia* 244, 245.

<sup>143</sup> Ken Henry et al, ‘Australia’s Future Tax System: Report to the Treasurer’ (Report, Australia’s Future Tax System Review Panel, December 2009) 85 (‘AFTS Report’). See also Board of Taxation, ‘Taxation of Discretionary Trusts: A Report to the Treasurer and the Minister for Revenue and Assistant Treasurer’ (Commonwealth of Australia, November 2002) 4 [12] <<http://taxboard.gov.au/consultation/taxation-of-discretionary-trusts/>> (‘Board of Taxation’s Discretionary Trust Report’).

<sup>144</sup> See above n 21 for the source of the data.

the power of the National Farmers' Federation and small business lobby in opposing changes in this area.<sup>145</sup> The Howard Government's experience in relation to the proposal showed how difficult reform of the rules for taxing trusts would be both politically and technically.

This certainty was enhanced when political events prevented the Labor (Gillard) Government from undertaking its planned reform of the rules for taxing trusts in 2012.<sup>146</sup> Again this is borne out by the statistics. The number of trusts continued to increase after the 2011–12 income year, but income-year-on-income-year growth has been much slower since (between 2.59% and 3.30%), than in previous periods.<sup>147</sup> Reform proposals by two governments of different parties reintroduced uncertainty because, combined, it signals that reform is more likely.

## VI Why Use a Trust over a Partnership?

As stated in Part II above, Australia applies fairly pure rules to partnerships in the sense that partners are allocated their share of both partnership net income and losses. Despite this, Graph 1 showed that the number of partnerships peaked in 1994–95 and trusts overtook partnerships by number in 2002–03. One question that the existing formal literature has not analysed is: why are trusts favoured over partnerships? The only recent observation was in the Coalition (Abbott) Government's 2015 *Re:Think Tax Discussion Paper*, which stated that 'the reduction in the number of partnerships may reflect the relative decline in the number of entities in the farm sector due to consolidation'.<sup>148</sup> That may have been a contributing factor, but this Part argues that there are two more compelling reasons from an income tax perspective. Those reasons are the following.

### A Characteristics of Trusts

First, some characteristics of trusts and their income tax treatment are particular to trusts. Most significantly, with a trust, it is possible to give different people rights to the income and capital. By comparison, it is fundamental to a partnership that partners have a right to income corresponding with their contributed capital and exposure for future liability.

In the US, the most popular small business structure, the limited liability company ('LLC'), is treated as a partnership for income tax law purposes. There are onerous rules to ensure that any special allocations (that do not correspond with the partner's interest in the partnership) are only respected if they reflect the way in

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<sup>145</sup> *Entity Tax Retraction Media Release*, above n 3. See also the wording of the ALP's 2010 proposal to review the rules for taxing trusts in *ITAA 1936* div 6: *2010 Announcement*, above n 3.

<sup>146</sup> The proposed reform by the Labor (Gillard) Government stalled after the release of the Policy Options Paper in October 2012: Treasury, Australian Government, 'Taxation of Trust Income — Options for Reform' (Policy Options Paper, 24 October 2012). See Alex Evans, 'The "Economic Benefits Model" for Trusts — Fools' Gold?' (2014) 43(3) *Australian Tax Review* 162, 162.

<sup>147</sup> See above n 21 for the source of the data.

<sup>148</sup> *Re:Think Tax Discussion Paper*, above n 34, 107.

which the partners ‘share the economic burden and benefits of those items’<sup>149</sup> (the ‘substantial economic effect restriction’).<sup>150</sup> This restriction has been subject to fairly significant criticism in the US,<sup>151</sup> and it is onerous to administer. However, it is ‘generally considered to be a robust way of protecting the design against the most blatant attempts to avoid or minimise the collective tax liability’.<sup>152</sup> That problem does not exist for the Australian trust, because income tax law respects the trust deed’s allocation to beneficiaries and the division between income and capital beneficiaries.

A corollary of the first point is that, as discussed in Part VA(1) above, in the discretionary trust context, income tax law currently also respects the manner in which trustees appoint income among members of a class of potential beneficiaries. This means that there is greater flexibility in dividing current year income and the corresponding tax liability in discretionary trusts than is possible in the partnership context. Currently, the Australian partnership rules provide very simply for the allocation of net income compared with the US partnership rules.<sup>153</sup> For example, our rules do not give allowance for special allocations and we do not currently have the substantial economic effect restriction. The simplicity of our rules is at least partially attributable to the fact that, due to the decline in the number of partnerships, our partnership rules have not been as contested as the US rules. When it is possible to carry on business through both trusts and partnerships, it should come as no surprise that the statistics clearly show that taxpayers are opting for the vehicle that provides the most flexibility.

## **B      *Application of CGT Rules to Partnerships***

The second reason for using a trust rather than a partnership is that the application of the CGT rules to partnerships was initially very uncertain. After the CGT rules were introduced, from 19 September 1985, it was unclear what the CGT asset was — the partner’s interest in the partnership or the partner’s interests in the partnership’s assets. An ATO interpretive decision released on 22 June 1989 was followed by a series of special rules in 1990 to clarify that capital gains and losses result to the partners individually both when the partnership deals with the partnership assets and when there are changes in the partners’ fractional interests in the partnership.<sup>154</sup> While it is unlikely that this lack of clarity was the sole reason for

<sup>149</sup> George Yin and David Shakow, *Federal Income Tax Project: Taxation of Private Business Enterprises – Reporters’ Study* (The American Law Institute, 1999) 79 (‘ALI Reporters’ Study on Private Business Enterprises’); US Treasury Regulation § 1.704-1(b)(ii)(a).

<sup>150</sup> US Treasury Regulation § 1.704-1(b)(2)(i). See Michael Graetz and Deborah Schenk, *Federal Income Taxation: Policy and Principles* (Foundation Press, 6<sup>th</sup> ed, 2009) 516; Richard Doernberg, Howard Abrams and Don Leatherman, *Federal Income Taxation of Corporations and Partnerships* (Aspen, 4<sup>th</sup> ed, 2009) 476, 572–81, 616–20; *ALI Reporters’ Study on Private Business Enterprises*, above n 149, 388–90.

<sup>151</sup> *ALI Reporters’ Study on Private Business Enterprises*, above n 149, 80–5.

<sup>152</sup> Evans (2016), above n 35, ch 3.

<sup>153</sup> In Australia: *ITAA 1936* pt 3 div 5. In the US: *Internal Revenue Code 1986* 26 USC (1986), sub-ch K (‘IRC 1986’).

<sup>154</sup> The initial ruling was ATO, *Income Tax: Capital Gains: Application to Disposals of Partnership and Partnership Interests*, IT 2540. The rules now include: *ITAA 1997* ss 106-5(1) (capital gain or loss is made by the partners individually), (2) (partner has cost base in their individual interest in the

the move away from partnerships in favour of trusts, it is likely to have provided an additional justification for preferring trusts. Although others have previously expressed that there is ‘uncertainty’ surrounding the application of the CGT rules to trusts and the rules are complex,<sup>155</sup> there are at least clear rules for trusts (CGT ‘E’ events) and, as described in Part VA(2) above, there are currently well-known loopholes that mean that CGT liability does not arise in particular circumstances.

Once taxpayers started using structures involving companies and trusts for all the reasons discussed in Parts IV and V, there was very little to lure them back to partnerships, and changing structures generally triggers a CGT event. If implemented as announced, the ALP’s 2017 *Proposal* would likely have made the partnership more attractive.

## VII Reform and Future Directions

This Part considers future directions and challenges for the income treatment of private trusts.

The heart of the problem with private trusts is that they are taxed using flow-through taxation (that is, taxed as pass-throughs) and they came to be used as a business vehicle before the Australian Government turned its mind to whether this was actually a good idea from a general law or tax policy perspective.

Australian political parties and academic commentators often express polar views about whether the use of trusts is good or bad, with the discussion recently focused on the bad.<sup>156</sup> This article argues that it is not that simple and, for a sustainable solution, the analysis needs to be more nuanced, particularly because: discretionary trusts are used for carrying on small business and small business is currently important to the Australian economy, contributing to both employment and production;<sup>157</sup> and the use of trusts to transfer wealth (that is, trust capital) is an

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partnership), 108-5(2) (definition for CGT asset). For more detailed discussion, see Cooper and Evans, above n 64, [21 000ff]; C J Taylor, *Capital Gains Tax: Business Assets and Entities* (Lawbook, 1994) ch 10.

<sup>155</sup> Cooper and Evans, above n 64, [19 010].

<sup>156</sup> See, eg, Royce Millar and Ben Scheiders, ‘The Tax Minimisation Tool that Nobody Wants to Talk About’, *The Sydney Morning Herald* (online), 6 April 2017 quoting Dale Boccabella; Australian Council of Social Service (‘ACOSS’), ‘Ending Tax Avoidance, Evasion and Money Laundering through Private Trusts’ (ACOSS Policy Briefing, November 2017) <<https://www.acoss.org.au/ending-tax-avoidance-evasion-and-money-laundering-through-private-trusts/>>; David Richardson, ‘Trusts and Tax Avoidance’ (Discussion Paper, The Australia Institute, July 2017) <<http://www.tai.org.au/sites/default/files/P428%20Trusts%20and%20Tax%20Avoidance%20-%20Richardson%20-%20FINAL.pdf>>.

<sup>157</sup> See, eg, Ellis Connolly, David Norman and Tim West, ‘Small Business: An Economic Overview’ (Roundtable Paper, Reserve Bank of Australia, May 2012) 3 <<https://www.rba.gov.au/publications/workshops/other/small-bus-fin-roundtable-2012/pdf/01-overview.pdf>>. Note that, while the number of small business employees increased by 4.3% between 2009 and 2017, the share of private sector employment in selected industries fell from 46% at the end of June 2009 to 44% at the end of June 2017: Geoff Gilfillan, ‘Small Business Sector Contribution to the Australian Economy’ (Parliamentary Library Statistical Snapshot, Parliament of Australia, 15 October 2018) <[https://www.aph.gov.au/About\\_Parliament/Parliamentary\\_Departments/Parliamentary\\_Library/pubs/rp/rp1819/SmallBusinessSector](https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/rp/rp1819/SmallBusinessSector)>. This is consistent with international trends: OECD, ‘OECD Compendium of Productivity Indicators 2017’ (18 May 2017) 66 <<https://www.oecd->

accepted succession practice. Further, income tax law design is complex and designs need to be careful and sophisticated for solutions to be sustainable and robust in the context of modern business practice.

As discussed in Part I above, the *ALP's 2017 Proposal* would have imposed tax at the rate of 30% on distributions made by discretionary trusts to appointees over 18 years of age.<sup>158</sup> The point of the proposal was broadly to produce the same tax result as if a company was used instead of a trust. Functionally, this is a different way of achieving the objects of the *Uniform Entity Tax Proposal*. The heart of the argument, which has now been made by both of the major political parties at different times, appears to be that in the business context, the trust is really a 'disguise', and the taxpayer would have used a company except to minimise or avoid tax.<sup>159</sup> There are several problems with this argument.

## A Business Trusts

A significant feature of the *ALP's 2017 Proposal* was that it excluded farming trusts. This was politically expedient for historic reasons — as discussed above, the National Farmers' Federation mounted such an effective lobby against the *Uniform Entity Tax Proposal* that the Coalition was forced to abandon it.<sup>160</sup> But business trusts were squarely within the *ALP's 2017 Proposal*. This was problematic and the reasons are worth noting for any future reform of this area by either political party.

The *ATO Tax Statistics* analysed in this article show that the trust has been the primary alternative vehicle to a company in Australia since 2002–03. Currently, the only other alternative is the partnership. One key limitation with the current Australian partnership form is that it does not provide partners with limited liability, either legally or functionally. As described in Part V, there are other legitimate non-tax reasons why taxpayers favour trusts. The primary ones are flexibility and asset

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ilibrary.org/economics/oecd-compendium-of-productivity-indicators-2017/labour-productivity-by-firm-size-manufacturing-and-business-services\_pdtvy-2017-graph40-en>.

<sup>158</sup> This rate may not be consistent with the rate that applies to all corporations. While for small corporations, the rate will drop progressively to 25% between now and 2025–26: *Tax Laws Amendment (Enterprise Tax Plan) Act 2017* (Cth), that drop will not currently be extended to all corporations: *Tax Laws Amendment (Enterprise Tax Plan No 2) Bill 2017* (Cth) was negated by the Parliament of Australia, Senate, Committee of the Whole, 22 August 2018.

<sup>159</sup> Taken to its extreme, the legal form of this argument is that the trust is a 'sham': *Sharrment Pty Ltd v Official Trustee in Bankruptcy* (1988) 18 FCR 449, 454. However, in Australia only a narrow conception of sham has been adopted: *Raftland Pty Ltd as trustee of the Raftland Trust v Federal Commissioner of Taxation* (2008) 238 CLR 516, 557 [129]. For literature favouring a broader view, see Miranda Stewart, 'The Judicial Doctrine in Australia' in Edwin Simpson and Miranda Stewart (eds), *Sham Transactions* (Oxford University Press, 2013) 51, 59 onwards (in particular 63 [3.44]); Michael Kirby, 'Of "Sham" and Other Lessons for Australian Revenue Law' (2008) 32(3) *Melbourne University Law Review* 861, 864. For other discussion, see Tony Pagone, 'Sham Trusts' (2012) 41(3) *Australian Tax Review* 119; A H Slater, 'Sham and Substance' (1999) 28(4) *Australian Tax Review* 197; Chris Evans, 'Containing Tax Avoidance: Anti-Avoidance Strategies' [2008] UNSW Law Working Paper Series 40; Glover, 'Shams, Reimbursement Agreements', above n 25.

<sup>160</sup> See above n 3.



protection (which includes group use of assets to ensure that the assets retain as much value over time as possible).<sup>161</sup>

If the tax treatment of trusts becomes unfavourable, experience in the US suggests that taxpayers are likely to demand an alternative vehicle or form taxed as a flow-through that does provide limited liability, particularly for carrying on small business. Others have previously floated the idea of Australia introducing a flow-through company,<sup>162</sup> implicitly with the hope that this would entice taxpayers to shift from a trust back to the corporate form on the basis that that is the most natural vehicle in the private context.

The income tax discussion of a flow-through company in Australia has previously focused on two models based on vehicles in the US – the S Corporation ('S Corp') and the LLC. The S Corp was created as a special vehicle for small business in the late 1950s.<sup>163</sup> The LLC was first recognised in Wyoming in 1977 as the result of lobbying from the oil industry and the form then spread across other states.<sup>164</sup> S Corps are taxed under a special regime *Internal Revenue Code of 1986* 26 USC sub-ch S ('IRC 1986'). LLCs are treated as partnerships for US federal income tax purposes and are taxed under the US partnership rules (*IRC 1986* sub-ch K).<sup>165</sup> US literature has observed that, from a design perspective, sub-ch S is more of a pure flow-through model than sub-ch K.<sup>166</sup> However, the only way US Treasury could achieve such a pure model for the S Corp was by heavily restricting its attributes. For example, originally an S Corp could only have 10 shareholders, it could not have any foreign shareholders and the types of income it could derive were curtailed.<sup>167</sup> Several of these attributes have been relaxed over time. For example,

<sup>161</sup> Brett Freudenberg, 'Advisors' Understanding of Tax Compliance for Choice of Business Form' (2013) 4(1) *Global Review of Accounting and Finance* 1; *RMIT Report*, above n 1, 8.

<sup>162</sup> Institute of Chartered Accountants in Australia ('ICAA'), *Entity Flow-through for SMEs – ICAA Government Submission* (1 July 2008) reproduced by GAA Accounting <<http://www.gaaaccounting.com/entity-flow-through-for-smes-icaa-government-submission>>; Freudenberg (2006), above n 22; ICAA and Deloitte, *Entity Flow-through (EFT) Submission* (10 April 2008); Brett Freudenberg, *Tax Transparent Companies: Striving for Neutrality? An International Comparative Legal Study of Tax Transparent Companies and Their Potential Application for Australian Closely Held Businesses* (PhD, Griffith Business School, 2009) (Freudenberg argued that it was not feasible to introduce a flow-through company due to high administrative costs for taxpayers).

<sup>163</sup> Evans (2016), above n 35, 4.5, citing 104 Congressional Record 388 (President Eisenhower), 389 (daily ed, 13 January 1958); Roberta Mann, 'Subchapter S: Vive le Difference!' (2014) 18(1) *Chapman Law Review* 65, 66; James Eustice and Joel Kuntz, *Federal Income Taxation of S Corporations* (Thomson Reuters, as at 2012) [1.02[3][a]].

<sup>164</sup> Evans (2016), above n 35, 4.5, citing Robert Keatinge, Larry Ribstein, Susan Pace Hamill, Michael L Gravelle and Sharon Connaughton, 'The Limited Liability Company: A Study of the Emerging Entity' (1992) 47 *Business Lawyer* 375, 383. See also Susan Pace Hamill, 'The Story of LLCs: Combining the Best Features of a Flawed Business Tax Structure' in Steven A Bank and Kirk J Stark (eds), *Business Tax Stories: An In-Depth Look at Ten Leading Developments in Corporate and Partnership Taxation* (Foundation Press, 2005) 295. It is noted that Freudenberg considered the LLC form and some dimensions of its income tax treatment in his work, including Freudenberg (2009), above n 162; Freudenberg (2009), above n 22.

<sup>165</sup> Evans (2016), above n 35, citing Doernberg, Abrams and Leatherman, above n 150, 498.

<sup>166</sup> *Ibid* 6, citing Doernberg, Abrams and Leatherman, above n 150, 498.

<sup>167</sup> *Ibid* 4, citing James Eustice and Joel Kuntz, Thomson Reuters, *Federal Income Taxation of S Corporations* (2012) 1.2[5][a][i], 1.02[6][a], 1.03[2][b][i]. The number of shareholders increased to: 25 in 1980; 35 in 1982; 75 in the mid to late 1990s; and 100 in 2005; *IRC 1986* § 1361(b)(1)(A); *ALI Reporters' Study on Private Business Enterprises*, above n 149, 120 (footnote 149); *American*

S Corps can now have up to 100 owners.<sup>168</sup> But the point is that the S Corp was an ongoing tax experiment around the limits of when flow-through treatment could be applied. The problem for advocates of an S Corp style flow-through company in Australia is that, in the US, the S Corp was a timely solution to assist small business in the late 1950s. Creating an Australian equivalent of the S Corp now would not be as attractive as the option taxpayers currently have in a trust. It would be extremely difficult to replicate the extent of flexibility that taxpayers currently enjoy using a trust form in corporate form. This is one of the reasons why the author has previously advocated reforming the income tax rules for trusts, rather than trying to introduce a new vehicle.<sup>169</sup>

A further, thornier problem that is often overlooked by those who advocate for a tax transparent company like the US LLC is that the US partnership rules that are used to tax LLCs have the same pressure points as our current rules for taxing private trusts. As discussed above, the allocation mechanism and the rule used to back-stop it in the US partnership rules (the ‘substantial economic effect restriction’) for special allocations are extremely complicated.<sup>170</sup> Arguing that an LLC style solution would solve the worst of our problems from an income tax perspective is, at best, an incomplete and naïve analysis.

## B *Income Splitting*

As stated in Part I, a key driver behind the *ALP’s 2017 Proposal* was to curtail income splitting. The income-splitting concern is real. But this has been well known for a long time and it is a perennial problem in the private context.

While it appears to have been forgotten, in the 1975 *Asprey Report*, the majority of the Asprey Committee proposed that for family partnerships and inter vivos trusts the Commissioner should

be required to examine the whole of the facts surrounding the setting up of the trust and its operation and control [to determine] whether the shares of income as allocated to beneficiaries [could reasonably be seen as arm’s length] when measured in relation to their beneficial interest in capital and property of the trust and their business and/or professional contributions to the production of the trust income ...<sup>171</sup>

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*Jobs Creation Act of 2004* 26 USC § 232. It is noted that Eustice and Kuntz stated that the number of owners changed to 75 in 1996, while the *ALI Reporters’ Study on Private Business Enterprises* indicated that this happened in 1998.

<sup>168</sup> Evans (2016), above n 35, 4, citing *IRC 1986* § 1361(b)(1)(A); *American Jobs Creation Act of 2004* 26 USC § 232.

<sup>169</sup> Evans (2016), above n 35, chs 1, 5.

<sup>170</sup> Doernberg, Abrams and Leatherman advocated against using the term ‘special allocation’ because it is based on the assumption that partners have a general interest in the partnership: Doernberg, Abrams and Leatherman, above n 150, 570, 572–81, 616–20. US Treasury Regulation § 1.704-1(b)(2)(i); Graetz and Schenk, above n 150, 516; *ALI Reporters’ Study on Private Business Enterprises*, above n 149, 388–90.

<sup>171</sup> *Asprey Report*, above n 82, 150 [11.32].

Where this was not the case, the Committee advocated that the Commissioner tax the allocations ‘at a deterrent rate’.<sup>172</sup> But this proposal was not unanimous. Parsons included a broad and important reservation:<sup>173</sup>

The descriptions given in the chapter of unacceptable ‘income-splitting’ transactions fail to identify any such principle except a notion that a course of action is ‘tax avoidance’, and therefore unacceptable, if it is undertaken solely or primarily for the purpose of reducing income tax liability. In my view such a notion is not a satisfactory explanation nor, where it is adopted as such, is it a workable test of the operation of measures intended to deal with transfers of income.<sup>174</sup>

Further, Parsons noted that the rationale for the measures proposed by the majority appeared to be to prevent transfers of capital, and by extension income derived on gifted capital. However, he also noted that ‘defeat of the principal technique of transfer of income — outright gift of capital — is beyond the limits of effective legal action’.<sup>175</sup> This reservation signals the complexity of the problem of income splitting in trusts and flow-through vehicles. To cure the problem, rather than just shifting it to another vehicle (that is, the partnership), more extensive reform is needed across the tax system. To reform the rules for taxing trusts in the future, consideration should be given to transfers of wealth (that is, capital and income accruing on that capital).

The other problem that appears to be becoming entrenched in Australia, at least politically, is that we seem to be comfortable to allow income splitting in discretionary trusts used by farmers, but not those used by non-farming families or small business. It is very difficult to justify this using the well-worn tax policy criteria of equity, efficiency and simplicity. Therefore, it appears to be politically motivated for the reasons described above. Such concessions are challenging because, once they are in the legislation, history indicates that there is enormous resistance to removing them. For equity reasons, whatever solution a future reform proposal comes up with in relation to income splitting should be applied uniformly across the tax system.

### C *An Alternative to the ALP’s Proposal to Reforming the Rules for Taxing Trusts*

If either major political party wishes to embark on reforming the rules for taxing trusts, there are other ways to resolve the problems raised in the *ALP’s 2017 Proposal*. Key features of a possible design include:<sup>176</sup>

- While the trust would not be the taxpayer, the tax system would recognise the trust as an entity for the purpose of characterising each receipt as being a particular type of income (including dividend income, royalty, interest,

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<sup>172</sup> Ibid.

<sup>173</sup> Ibid 157–60.

<sup>174</sup> Ibid 157.

<sup>175</sup> Ibid 158.

<sup>176</sup> Evans (2016), above n 35, ch 5, especially 178–80 (‘Overview Summary’). This design builds on the elements and arguments outlined in Evans (2019), above n 35.

general business income and exempt income) or a gain, and each outgoing as a deduction, loss or non-deductible, and the trustee would file an informational return.<sup>177</sup>

- A sophisticated allocation mechanism. A key element is that it requires owners to be identified. Owners would be limited to persons who hold an interest in the trust. Appointees of discretionary trusts (colloquially called 'discretionary beneficiaries') would not be treated as owners.
- Amounts that are subject to a discretion or are retained in an income year would be reallocated and taxed to the settlor if the settlor has power to reclaim property and/or any power over any allocation. If that is not applicable (that is, if the settlor is not involved or if the owners or a related party created the vehicle), the amounts would be reallocated between and taxed to the owners according to their share. This sequence would dramatically change the landscape in Australia as it would address the most blatant issues around income splitting.
- Each owner's share is calculated as whatever they are entitled to, of all amounts as they are classified for tax purposes, as a proportion of the whole. This encompasses notional amounts.
- Tax-preferred amounts would be allocated individually. All other amounts would be allocated on an aggregated basis on the argument that the tax treatment of those amounts would not change between owners. All allocated amounts are net (that is, each deduction is apportioned to the item of income to which it relates).
- The design operates on a base-case model, but allows for some variation in owners' interests. However, in variation cases, the owner would be allocated both income and losses relating to their interest.
- Losses would be passed through to owners to the extent of their cost base in their interest in the trust.<sup>178</sup> An owners' cost base could increase by amounts it pays to satisfy the trust's debt.
- The design draws on models from the US income tax system and uses an integrated approach to resolve the problem of dual cost base, which prevents against double taxation and the conferral of double benefits.
- Where the owner is non-resident, the design applies a tentative tax on a gross basis.

<sup>177</sup> Others have discussed this before, but not in advocating for a model for taxing trusts in Australia. Freudenberg referred to recognising the vehicle as an entity for tax purposes as 'entity acknowledgment' in his evaluation of the feasibility of introducing a tax transparent company: Freudenberg (2009), above n 22, 402–6. 'Entity acknowledgement' appears in quotations in Freudenberg's work but it is not attributed to another source.

<sup>178</sup> There is wide support for this approach, see: *IRC 1986* §§ 704(d) (partnerships), 1366(d)(1) (S Corporations). In sub-ch S, this reduction affects both the shareholder's equity and debt basis. See also Graetz and Schenk, above n 150, 516; US House Committee on Ways and Means, *Technical Explanation of the Ways and Means Committee Discussion Draft Provisions to Reform the Taxation of Small Businesses and Pass-through Entities* (12 March 2013) <[http://waysandmeans.house.gov/UploadedFiles/FINAL\\_Sm\\_Bus\\_Passthrough\\_Technical\\_Explanation\\_03\\_12\\_13.pdf](http://waysandmeans.house.gov/UploadedFiles/FINAL_Sm_Bus_Passthrough_Technical_Explanation_03_12_13.pdf)> 47; Brett Freudenberg, *Tax Flow-Through Companies* (CCH, 2011) 86–8; Brett Freudenberg, 'Losing my Losses: Are the Loss Restriction Rules Applying to Australia's Tax Transparent Companies Adequate?' (2008) 23(2) *Australian Tax Forum* 125, 136. Some countries apply this technique to limited partnerships: Easson and Thuronyi, above n 42, 937.

Such a design goes further and addresses other, harder problems that the *ALP's 2017 Proposal* did not raise, such as the problem of dual cost base, and the notoriously difficult allocation issues encountered in the US partnership tax rules described in Parts VIA and VIIA above.

In addition to considering another way to reform the rules for taxing trusts, it would be valuable for Australia to consider the alternative forms that are used in the private context for carrying on business in other countries and to fully appreciate their income tax treatment. This could build on initial contributions by others,<sup>179</sup> and would make clear the best alternative form. Treasury could then consult with small business regarding that form. This is the most logical way forward for sustainable change in this area. This author's proposal, outlined above, was designed to be broadly applicable to any form used in the private context for carrying on business (that is, its application is not limited to the trust form). Consequently, if Australia does ultimately introduce a new vehicle/form for this context, the design outlined above could easily be adapted.

## VIII Conclusion

In 2002–03 the trust became the favoured alternative vehicle in Australia. While there has been a growing understanding of the popularity and pervasiveness of the trust form in Australia, this article filled the gap in the extant literature by clearly articulating: the income tax settings that prompted the movement towards trusts, both pre and post-imputation; and the reasons why trusts continue to offer a comparative advantage over the partnership in Australia. The explanations were supported by statistical data.

While the ALP correctly identified an income-splitting concern with trusts in its 2017 proposal, this article argued that the ALP's fix was limited and short-sighted, and it was likely to make the partnership form more attractive and then push the income-splitting problem into partnerships. A more comprehensive solution is required to solve the income-splitting problem. Further, the other alternative form to a corporation in Australia is the partnership. In the US, a key alternative vehicle, the LLC, is generally taxed as a partnership. The US rules for taxing partnerships that are designed to prevent income splitting are very complex and onerous to administer. It is naïve for Australia to think that the partnership will be a simple answer to the trust problem in the private context irrespective of which major political party embarks on reform of this area in the future.

This author suggests that Australia pursues a two-pronged strategy in the future. First, although it is very difficult politically, it would be valuable to reform the rules for taxing trusts. Part VII of this article contained a high level summary of the key features of a possible design. Second, Australia should consider the

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<sup>179</sup> That body of work includes the following. Freudenberg considered select dimensions of alternative forms in selected countries (the LLC and S Corp in the US, the limited liability partnership in the UK and the Loss Attribution Qualifying Company in New Zealand): Freudenberg (2009), above n 22; Freudenberg (2011), above n 178. Stewart considered the limited partnership form in Miranda Stewart, 'Towards Flow Through Taxation of Limited Partnerships: It's Time to Repeal Division 5A' (2003) 32(3) *Australian Tax Review* 171.

alternative non-corporate vehicles/forms used in a range of countries and their tax treatment as this may aid the selection of an alternative form that meets taxpayer needs and resolves the issues the ALP identified as well as other hard technical ones.

# *Before the High Court*

## Discharged Contracts and *Quantum Meruit*: *Mann v Paterson Constructions Pty Ltd*

John Eldridge\* and Timothy Pilkington†

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### *Abstract*

Should a claimant be entitled to maintain a claim for restitution in respect of work carried out under a contract that is subsequently discharged for breach or repudiation? Should the claimant instead be limited to a contractual claim for damages? If a claim for restitution is maintainable in these circumstances, should the contract price operate as a ceiling upon the sum recoverable? In *Mann v Paterson Constructions Pty Ltd* the High Court of Australia will be presented with an opportunity to consider these questions. The principal object of this column is to outline the different ways in which the relationship between damages and restitution may be understood in this setting.

## **I Introduction**

The obligation to pay damages for loss of bargain is a secondary obligation that arises from the failure to fulfil a primary performance obligation under a contract.<sup>1</sup> At the time the secondary obligation to pay damages arises, it is an unconditional obligation and thus survives discharge of the contract.<sup>2</sup> Where a contract is discharged by the acceptance of an act of repudiation, the right to damages unconditionally accrues when the repudiation is accepted.<sup>3</sup>

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We are grateful to Elise Bant, Jessica Hudson, Andrew Stewart and the anonymous reviewer for their comments. The usual caveat applies.

<sup>1</sup> *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827, 849 (Lord Diplock).

<sup>2</sup> See, eg, *Ogle v Comboyuro Investments Pty Ltd* (1976) 136 CLR 444, 451 (Barwick CJ); *Berger & Co Inc v Gill & Duffus SA (No 2)* [1984] AC 382, 390 (Lord Diplock). For a discussion of unconditionally accrued rights, see Timothy Pilkington, 'Advance Payments and the Border of Contract and Restitution: *McDonald v Dennys Lascelles* Revisited' in John Eldridge and Timothy Pilkington (eds), *Sir Owen Dixon's Legacy* (Federation Press, forthcoming).

<sup>3</sup> *Johnstone v Milling* (1886) 16 QBD 460, 472–3 (Bowen LJ); *Heyman v Darwins Ltd* [1942] AC 356, 382 (Lord Wright); *Huppert v Stock Options of Australia Pty Ltd* (1965) 112 CLR 414, 426 (Kitto J). In contrast, an unconditionally accrued right to damages for an actual breach may arise before discharge.

In some cases, the application of these principles may give rise to difficult questions as to the relationship between the law of contract and unjust enrichment.<sup>4</sup> Suppose, for instance, C performs work under a contract with D and D repudiates the contract prior to C earning an unconditionally accrued right under the contract to be paid for its work.<sup>5</sup> In such a case, C might be thought to be entitled to ‘elect’ between a claim for damages for loss of bargain and a *quantum meruit* for the fair market value of the work performed.<sup>6</sup> Although the existence of such a remedial choice may initially seem unremarkable, it is capable of producing outcomes that might invite objection. A claimant may be able to recover a sum upon a *quantum meruit* that exceeds the contract price because the quantum of a claim for restitution for work or services is ordinarily determined by reference to the fair market value of the performance conferred, and the concept of ‘fair market value’ has not been understood as invariably consistent with the contract price.<sup>7</sup>

Should a claimant be entitled to maintain a claim for restitution in respect of work or services performed under a contract that is subsequently discharged for breach or repudiation if, at the time of discharge, there is not an unconditionally accrued contractual right to payment for the work or services? Should the claimant instead be limited to a contractual claim for damages for loss of bargain? If a claim for restitution is maintainable in such circumstances, should the contract price operate as a ceiling upon the amount recoverable? In *Mann v Paterson Constructions Pty Ltd*,<sup>8</sup> the High Court of Australia will have an opportunity to consider these questions.<sup>9</sup> Though they have been the subject of considerable judicial and academic consideration, their proper resolution remains the subject of debate. As will be seen, some of these questions are obscured by the lingering shadow of quasi-contract, which, while formally relegated to history, continues to exert an indirect influence over the modern law.<sup>10</sup>

<sup>4</sup> We use the expression ‘unjust enrichment’ throughout to refer to a category of situations in which restitution is available: *Equuscorp Pty Ltd v Haxton* (2012) 246 CLR 498, 516 [30] (French CJ, Crennan and Kiefel JJ) (‘*Equuscorp*’).

<sup>5</sup> Of course, where an entitlement to payment has accrued unconditionally prior to discharge, an action for debt lies for its recovery: see *Young v Queensland Trustees Ltd* (1956) 99 CLR 560, 567 (Dixon CJ, McTiernan and Taylor JJ).

<sup>6</sup> The idea that a claimant is faced with an ‘election’ in such a case is reflected in much of the case law: see *Chandler Bros Ltd v Boswell* [1936] 3 All ER 179, 186 (Greer LJ); *Automatic Fire Sprinklers Pty Ltd v Watson* (1946) 72 CLR 435, 462 (Starke J). The language of ‘election’ is also seen in academic writing, see, eg, N C Seddon and R A Bigwood, *Cheshire & Fifoot: Law of Contract* (LexisNexis, 11<sup>th</sup> ed, 2017) 1305. However, the term ‘election’ is not entirely apt to describe the choice a claimant has in such a case: see J W Carter, ‘Discharged Contracts: Claims for Restitution’ (1997) 11(2) *Journal of Contract Law* 130. This point is discussed further below.

<sup>7</sup> See, eg, *Sopov v Kane Constructions Pty Ltd* (No 2) (2009) 24 VR 510, 518–9 [26]–[28] (Maxwell P, Kellam JA and Whelan AJA) (‘*Sopov* (No 2)’).

<sup>8</sup> High Court of Australia, Case No M197/2018.

<sup>9</sup> The appeal also raises questions, not discussed here, as to the interpretation and application of the *Domestic Building Contracts Act 1995* (Vic) s 38.

<sup>10</sup> Under the quasi-contractual conception of restitutionary liability, the obligation to make restitution was thought to rest upon an ‘implied’ contractual promise. As to the development of this understanding of restitutionary liability, see David Ibbetson, *A Historical Introduction to the Law of Obligations* (Oxford University Press, 1999) ch 14. For a brief overview of its gradual abandonment, see Graham Virgo, *The Principles of the Law of Restitution* (Oxford University Press, 3<sup>rd</sup> ed, 2015) 45–8.



It is not intended here to offer a definitive answer to each of the questions set out above or to examine all of the issues relevant to their determination. Rather, the object of the brief discussion that follows is to outline the different ways in which the High Court may characterise the relationship between damages and *quantum meruit*, and to dispel a number of misconceptions that have emerged in the course of the relevant debates.

## II Facts and Procedural History

The appeal in *Mann v Paterson Constructions* arises from a dispute in respect of a residential building contract. The appellants ('the Manns') entered into a standard-form contract with the respondent ('the builder') for the construction of two units.<sup>11</sup> The parties' relationship broke down when the project was at an advanced stage of completion.<sup>12</sup> The Manns purported to terminate the contract and to exclude the builder from the worksite.<sup>13</sup> Each party accused the other of having repudiated the contract.<sup>14</sup>

The builder commenced proceedings against the Manns in the Victorian Civil and Administrative Tribunal. The Manns responded with a counterclaim. The Tribunal found that the Manns had repudiated the contract.<sup>15</sup> It further held that the builder was entitled to recover upon a *quantum meruit* for work performed prior to discharge.<sup>16</sup> In arriving at the latter conclusion, the Tribunal relied upon the decision of the Victorian Court of Appeal in *Sopov (No 2)*.<sup>17</sup>

Justice Cavanough granted an application for leave to appeal from the Tribunal's decision and allowed the appeal for the limited purpose of addressing a mathematical error in the Tribunal's orders.<sup>18</sup> The appeal was otherwise dismissed.

The Victorian Court of Appeal granted an application for leave to appeal from the decision of Cavanough J in respect of three of the four grounds upon which the Manns relied.<sup>19</sup> The appeal was dismissed.<sup>20</sup> Significantly, the Court of Appeal refused the application for leave to appeal in respect of the Manns' second ground of appeal, which concerned the availability of a *quantum meruit*.<sup>21</sup> In arriving at this aspect of its decision, the Court made it clear that any departure from the rule that a *quantum meruit* is available where a contract is discharged for breach or repudiation was a step that could be taken only by the High Court of Australia.<sup>22</sup>

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<sup>11</sup> *Mann v Paterson Constructions Pty Ltd* [2018] VSC 119 (19 March 2018), [1].

<sup>12</sup> *Ibid* [2].

<sup>13</sup> *Ibid*.

<sup>14</sup> *Ibid*.

<sup>15</sup> *Paterson Constructions Pty Ltd v Mann* [2016] VCAT 2100 (12 December 2016), [469]–[518].

<sup>16</sup> *Ibid*.

<sup>17</sup> *Sopov (No 2)* (2009) 24 VR 510.

<sup>18</sup> *Mann v Paterson Constructions Pty Ltd* [2018] VSC 119 (19 March 2018), [84]–[86].

<sup>19</sup> *Mann v Paterson Constructions Pty Ltd* [2018] VSCA 231 (12 September 2018), [150] (Kyrou, McLeish and Hargrave JJA).

<sup>20</sup> *Ibid*.

<sup>21</sup> *Ibid*.

<sup>22</sup> *Ibid* [95]–[97].

### III Three Approaches

There are at least three possible approaches to the relationship between damages and a *quantum meruit* in cases exemplified by *Mann v Paterson Constructions*. The first is to maintain that no such choice is available, and that the plaintiff is limited to an award of damages. The second is that such a choice is available, and that the amount recovered upon a *quantum meruit* may exceed the sum to which the innocent party would be entitled to in damages. The third approach recognises a *quantum meruit* as being maintainable, but would have the contract price operate, at least in most instances, as a ceiling upon the amount claimable.<sup>23</sup> Each approach merits consideration in turn.

#### A The Primacy of Contract

The preponderance of judicial and academic opinion favours the view that restitutionary rights are subsidiary to those arising from contract.<sup>24</sup> Though that view might be traceable in part to the lingering influence of quasi-contract, it is nonetheless susceptible of justification on a number of bases.<sup>25</sup> The first rests upon a respect for the voluntary allocation of risk between parties, consistent with individual autonomy.<sup>26</sup> The second turns upon a concern for transactional security; that is, the desire to ensure that parties are confident about the integrity of their bargains.<sup>27</sup> The subsidiarity of restitution to contract was acknowledged by the High Court of Australia in *Lumbers v Cook Builders* where, in rejecting a builders' claim for restitution, the Court said that 'if allowed, [such a claim] would redistribute not only the risks but also the rights and obligations for which provision was made by the contract the Lumbers made with Sons'.<sup>28</sup>

An additional reason why contractual rights might be understood as, or give the appearance of being, primary follows from an interpretation of restitution as concerned with reversing benefits where consent to the transfer of the benefit is defective. As Smith has observed,<sup>29</sup> the situations to which Lord Mansfield referred in *Moses v Macferlan*, namely: 'money paid by mistake; or upon a consideration which happens to fail; or for money got through imposition, (express, or implied); or extortion; or oppression; or an undue advantage taken of the plaintiff's situation,

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<sup>23</sup> Edelman and Bant suggest that although the contract price should generally operate as a ceiling, this might not be a blanket rule: see James Edelman and Elise Bant, *Unjust Enrichment* (Hart Publishing, 2<sup>nd</sup> ed, 2016) 84.

<sup>24</sup> For a discussion of the subsidiarity of unjust enrichment, see Ross Grantham and Charles Rickett, 'On the Subsidiarity of Unjust Enrichment' (2001) 117(Apr) *Law Quarterly Review* 273.

<sup>25</sup> It is not difficult to see why the fictions of quasi-contract necessitated an acceptance of the subsidiarity of restitutionary liability: where a matter was governed by an effective contract, there could be no room for the implication of a promise dealing with that same matter.

<sup>26</sup> *Lumbers v W Cook Builders Pty Ltd (in liq)* (2008) 232 CLR 635, 664 [80] ('*Lumbers v Cook Builders*'); *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827, 848 (Lord Diplock); Grantham and Rickett, above n 24, 293.

<sup>27</sup> *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313, 388 (Lord Mustill).

<sup>28</sup> (2008) 232 CLR 635, 664 [80] (Gummow, Hayne, Crennan and Kiefel JJ).

<sup>29</sup> Lionel Smith, 'Unjust Enrichment: Big or Small?' in Simone Degeling and James Edelman (eds) *Unjust Enrichment in Commercial Law* (Lawbook, Thomson Reuters, 2008) 36–7.

contrary to laws made for the protections of person under those circumstances’,<sup>30</sup> all justify restitution substantially on the basis that the claimant’s consent was defective in some way. Thus understood, there is no need for restitution where the agreed contractual basis for the transfer is satisfied or there is provision in the parties’ contract for what is to occur should the basis for the transfer fail. This idea may be seen as having led to a characterisation of restitution as ‘gap-filling’ or supplementary to contract.

Although Australian law has not generally understood restitution in terms of correcting normatively defective transfers of value as it is in England,<sup>31</sup> recognition has been given to restitution as fulfilling a supplementary or gap-filling role. In *Pavey & Matthews Pty Ltd v Paul*, Deane J said that ‘it is the very fact that there is no genuine agreement ... that provides occasion for ... the imposition ... of the obligation to make restitution’.<sup>32</sup> Similarly, in *Roxborough v Rothmans of Pall Mall Australia Ltd*, Gummow J spoke of restitution for a total failure of consideration as ‘illustrative of the gap-filling and auxiliary role of restitutionary remedies’ that operate in the absence of contract and ‘do not let matters lie where they would fall if the carriage of risk between the parties were left entirely within the limits of their contract’.<sup>33</sup> In this respect, Gummow J understood there to be an analogy between restitution and equity insofar as both fulfil a corrective role of ameliorating the harshness of other doctrines.<sup>34</sup>

The perceived subsidiary or supplementary function of restitution to contract has led certain commentators to argue that there should not be a choice available between damages and a *quantum meruit* where a contract is discharged for breach or repudiation. In the view of these commentators, the recognition of such a choice is incompatible with an approach to restitution as fulfilling a gap-filling role or one that respects the normative primacy of contract.<sup>35</sup> Havelock, for example, reasons that in respect of damages for loss of bargain, the parties’ contract defines their rights and obligations,<sup>36</sup> in the sense that the damages are an unconditionally accrued secondary obligation whose purpose is to put the innocent party, so far as money can do so, in the position they would have been in had the contract been performed.<sup>37</sup> To allow for a *quantum meruit* would ‘subvert the voluntary allocation of risk’<sup>38</sup> because it is measured by the fair market value of the work or services and not the price the parties agreed.

<sup>30</sup> *Moses v Macferlan* (1760) 2 Burr 1005, 1012.

<sup>31</sup> *Investment Trust Companies v Revenue and Customs Commissioners* [2018] AC 275, 295 [42] (Lord Reed JSC).

<sup>32</sup> *Pavey & Matthews Pty Ltd v Paul* (1987) 162 CLR 221, 256.

<sup>33</sup> (2001) 208 CLR 516, 545 [75].

<sup>34</sup> *Ibid.*

<sup>35</sup> Rohan Havelock, ‘A Taxonomic Approach to *Quantum Meruit*’ (2016) 132(Jul) *Law Quarterly Review* 470, 481; Peter Birks, *An Introduction to the Law of Restitution* (Oxford Clarendon Press, 1991) 47; Jack Beatson, ‘The Temptation of Elegance: Concurrence of Restitutionary and Contractual Claims’ in William Swadling and Gareth Jones (eds), *The Search for Principle: Essays in Honour of Lord Goff of Chieveley* (Oxford University Press, 1999) 151–2.

<sup>36</sup> Havelock, above n 35, 481; *Moschi v Lep Air Services Ltd* [1973] AC 331, 350 (Lord Diplock).

<sup>37</sup> *Robinson v Harman* (1848) 1 Exch 850, 855 (Parke B).

<sup>38</sup> Havelock, above n 35, 481.

It is, however, important to observe that any rejection of the availability of a *quantum meruit* in such circumstances would create an exception to the general rule that an innocent party has a prima facie right to recover benefits upon discharge for breach where there has been a total failure of consideration.<sup>39</sup> There are two reasons why the general rule's application in respect of work or services can be seen as controversial. The first is that unlike money or property, work or services cannot be returned. As Stevens explains, what the law reverses is the performance itself as rendered by C and accepted by D.<sup>40</sup> Second, restitution for work or services has traditionally been awarded to the amount of the fair market value for the work or services performed. This means the beneficiary of the work or services may be required to pay to the claimant a sum, to reverse the performance rendered, that is greater than that they agreed to pay under their contract.

If one accepts restitution as subsidiary or supplementary to contract, the question that arises is how, in cases such as *Mann v Paterson Constructions*, best to account for those ideas.<sup>41</sup> Should restitution upon a total failure of consideration for work or services be treated as an exception to the general availability of restitution for a total failure of consideration after discharge? Or should the law's adoption of a blanket rule that the value of what the defendant has received in cases of work or services is the fair market value, or its understanding of how the fair market value is determined, be refined?

## B Concurrent Claims

Although courts and commentators have routinely described a claimant as being faced with an 'election' between damages and a *quantum meruit*, this expression is somewhat misleading. As Carter has observed:

Under the modern law, where a breach occurs, damages are always available, and the decision to exercise a right of discharge does not operate to divest the promisee of the right to make the claim. ... Since the plaintiff does not give up its right to contract damages, either by making the claim for restitution or on receiving judgment for the return of money paid or for reasonable remuneration, damages can always be sought following discharge.<sup>42</sup>

It is thus preferable to speak in terms of the existence of 'concurrent' claims in this setting.<sup>43</sup>

Arguments in support of the concurrent availability of damages and a *quantum meruit* have generally rested upon three contentions. The first is that there is historical support for the concurrent recognition of both remedies. As Bailey

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<sup>39</sup> *Giles v Edwards* (1797) 7 TR 181; *Rowland v Divall* [1923] 2 KB 500. This is not to say this is the only type of situation where a *quantum meruit* is available.

<sup>40</sup> Robert Stevens, 'The Unjust Enrichment Disaster' (2018) 134(Oct) *Law Quarterly Review* 574, 580.

<sup>41</sup> In addition, ideas of 'negation' and 'coherence' are also relevant in this context. For reasons of space, a full discussion of those ideas is not possible here.

<sup>42</sup> Carter, above n 6, 141–2. See further J W Carter, *Carter's Breach of Contract* (LexisNexis, 2<sup>nd</sup> ed, 2018) 652.

<sup>43</sup> Though the claims may aptly be described as concurrent, it must of course be noted that the usual rule against double recovery applies.

points out,<sup>44</sup> the origins of the availability of the concurrent *quantum meruit* remedy are generally traced to two 19<sup>th</sup>-century cases: *Planché v Colburn*<sup>45</sup> and *De Bernardy v Harding*.<sup>46</sup>

In *Planché*, the plaintiff was engaged by the defendant publisher to research and write a book. The defendant repudiated the contract before the manuscript was delivered. The plaintiff's claim for a *quantum meruit* succeeded. Chief Justice Tindal held:

when a special contract is in existence and open, the Plaintiff cannot sue on a *quantum meruit*: part of the question here, therefore, was, whether the contract did exist or not. It distinctly appeared that the work was finally abandoned; and the jury found that no new contract had been entered into. Under these circumstances the Plaintiff ought not to lose the fruit of his labour ...<sup>47</sup>

In *De Bernardy*, the defendant engaged the plaintiff to sell tickets abroad for the viewing of the Duke of Wellington's funeral procession. The claimant incurred expense in organising accommodation for the purchasers of tickets and on advertising. However, before any tickets had been sold, the defendant repudiated the contract. The plaintiff claimed a *quantum meruit* for the work he had performed. He was met with a defence that there was a contract between the parties. Baron Alderson held that if one party has 'absolutely refused to perform' or has rendered themselves incapable of performing their part of the contract, the other party has 'either to sue for a breach of it, or to rescind the contract and sue on a *quantum meruit* for the work actually done'.<sup>48</sup>

In the early 20<sup>th</sup> century, courts generally continued to adhere to the idea that a claimant could choose between damages and a *quantum meruit*.<sup>49</sup> In *Lodder v Slowey*,<sup>50</sup> a subcontractor was found to be entitled to a claim for a *quantum meruit* against the head contractor following termination. It was said the subcontractor 'was in the circumstances entitled to treat the contract as at an end and to sue on a *quantum meruit* for work and labour done and materials supplied'.<sup>51</sup> In *Chandler Bros Ltd v Boswell*, Greer LJ considered it 'long well settled' that an innocent party 'is entitled, if he so choose, to claim damages or claim on *quantum meruit* basis'.<sup>52</sup> Such sentiments were also present in Australia.<sup>53</sup> For example, in *Horton v Jones (No 2)* Jordan CJ said that if one party to a contract 'renders to the other some but not all the services which have to be performed' before they are entitled to receive payment under the contract, and the other wrongfully repudiates thereby preventing the

<sup>44</sup> Julian Bailey, 'Repudiation, Termination and *Quantum Meruit*' (2006) 22 *Construction Law Journal* 217, 220.

<sup>45</sup> (1831) 131 ER 305 ('*Planché*').

<sup>46</sup> (1853) 155 ER 1586 ('*De Bernardy*').

<sup>47</sup> *Planché* (1831) 131 ER 305, 306.

<sup>48</sup> *De Bernardy* (1853) 155 ER 1586, 1587.

<sup>49</sup> See *Heyman v Darwins Ltd* [1942] AC 356, 397–8 (Lord Porter); *Elkington v Wandsworth Corp* (1924) 41 TLR 76; *George Trollope & Sons v Caplan* [1936] 2 KB 382, 390 (Greer LJ); *Thomas v Hammersmith BC* [1938] 3 All ER 201; *Luxor (Eastbourne) Ltd v Cooper* [1941] AC 108, 141 (Lord Wright).

<sup>50</sup> [1904] AC 442.

<sup>51</sup> *Ibid* 451 (Lord Davey).

<sup>52</sup> [1936] 3 All ER 179, 186.

<sup>53</sup> *Segur v Franklin* (1934) 34 SR (NSW) 67, 72 (Jordan CJ).

innocent party 'from earning the stipulated remuneration, the former may treat the contract as at an end and then sue for a *quantum meruit* for the services actually rendered'.<sup>54</sup>

Two observations should be made in respect of the abovementioned line of authorities that have continued to be relied upon by Australian intermediate appellate courts.<sup>55</sup> First, many of these cases appear to proceed upon the false assumption that where a contract is discharged as a result of an accepted repudiation, the contract is rescinded *ab initio* and, therefore, damages are not available.<sup>56</sup> Second, they place repeated reliance upon *Planché*. However, as Havelock points out, nowhere in that case is it suggested that the claimant had the ability to elect between damages and a *quantum meruit*.<sup>57</sup>

The second argument is that there is nothing unusual about concurrent remedies arising from distinct grounds of legal claims and liabilities. One may, for example, generally pursue concurrent remedies in contract and tort,<sup>58</sup> and tort and unjust enrichment.<sup>59</sup> This sort of argument was made by Meagher JA in *Renard Constructions (ME) Pty Ltd v Minister for Public Works*:

There is nothing anomalous in the notion that two different remedies proceeding on entirely different principles, might yield different results. Nor is there anything anomalous in the fact that either remedy may yield a higher monetary figure than the other. Nor is there anything anomalous in the prospect that a figure arrived at on a *quantum meruit* might exceed, or even far exceed, the profit which would have been made if the contract had been fully performed.<sup>60</sup>

It is true that concurrent remedies are available throughout the law of obligations. However, it is an error to suppose that, in and of itself, such an observation supports the proposition that the same should apply, by analogy, in respect of contract and unjust enrichment. Only by examining the reasons that support concurrent remedies in, for example, contract and tort and then considering if they apply to contract and unjust enrichment is such an approach informative.<sup>61</sup>

The third argument is that to allow a *quantum meruit* does not undermine the contractual allocation of risk. The builder, in its written submissions in *Mann v Paterson Constructions Pty Ltd*, says:

Insofar as the contractual allocation of risk was undermined in this case, it was undermined by the fact of the owners' repudiation; not by the remedies available to the builder upon accepting that repudiation. ... The law sufficiently respects party autonomy by confining claims in quantum meruit

<sup>54</sup> (1939) 39 SR (NSW) 305, 319 (Jordan CJ).

<sup>55</sup> *Iezzi Constructions Pty Ltd v Watkins Pacific (Qld) Pty Ltd* [1995] 2 Qd R 350, 361 (McPherson JA).

<sup>56</sup> For a discussion of the emergence of this rule, see Steven Lurie, 'Towards a Unified Theory of Breach: Tracing the History of the Rule that Rescission Ab Initio is Not a Remedy for Breach of Contract' (2003) 19(3) *Journal of Contract Law* 250.

<sup>57</sup> Havelock, above n 35, 480.

<sup>58</sup> *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145.

<sup>59</sup> *Attorney-General v Guardian Newspapers Ltd (No 2)* [1990] 1 AC 109.

<sup>60</sup> (1992) 26 NSWLR 234, 277.

<sup>61</sup> Charlie Webb, *Reason and Restitution: A Theory of Unjust Enrichment* (Oxford University Press, 2015) 40–8.

to those services in fact requested by the defendant. And insofar as the availability of quantum meruit in cases of repudiatory breach may dissuade some defendants from repudiating their contracts, then it serves ... to uphold, not to undermine, the contractual bargain.<sup>62</sup>

In short, this argument contends that the parties' autonomy is respected because a *quantum meruit* is confined to services requested by a defendant and because an award of a *quantum meruit* where the contract is repudiated may have a deterrent effect. Both of those propositions may be accepted for argument's sake. Neither, however, says anything about why a *quantum meruit* that exceeds the damages to which a claimant is entitled in contract does not undermine the parties' autonomy.

### C *Harmonisation*

A final approach is to reject the primacy of damages in contract, but to hold that the contract price operates as a ceiling on the amount that can be claimed upon a *quantum meruit*. There are a number of bases upon which to reach such a conclusion.

The distinguishing feature of the law of restitution has, in Australia, broadly been understood in terms of allowing the recovery by one person of a benefit transferred to another where retention of the benefit would be unconscionable.<sup>63</sup> Insofar as a *quantum meruit* is a restitutionary remedy, its primary object must be understood in such terms. If restitution is concerned with the recovery of benefits, a question that follows is how one measures the benefit a defendant has retained. One approach to this issue has been the notion of 'subjective devaluation', according to which the existence and extent of a defendant's benefit depends upon the subjective value attributed to it by the defendant. A further approach, advocated by Edelman and Bant, is that value is determined by an objective measure of the value of the benefit chosen to a reasonable person in the position of the defendant.<sup>64</sup> In other words, 'objective' value is to be qualified by the defendant's position.

An award of a *quantum meruit* and contract damages could conceivably be brought into alignment through reliance upon the concept of subjective devaluation; that is, that the contract price reflects the subjective value and thus the benefit on the part of the beneficiary of the work or services. Edelman and Bant are also of the view that, on their preferred analysis, it is possible to reconcile both remedies. They explain that '[i]n the case of a simple contract involving the performance of a service for a price, the award of restitution should never exceed the contract price because that was the objective price at which the service was chosen'.<sup>65</sup>

<sup>62</sup> Paterson Constructions Pty Ltd, 'Submissions of the Respondent' in *Mann v Paterson Constructions Pty Ltd*, Case No M197/2018, 1 March 2019, [21]–[22].

<sup>63</sup> See, eg, *Roxborough v Rothmans of Pall Mall Australia Ltd* (2001) 208 CLR 516, 543–51 [70]–[89] (Gummow J); *Equuscorp* (2012) 246 CLR 498, 517 [32] (French CJ, Crennan and Kiefel JJ); *Australian Financial Services and Leasing Pty Ltd v Hills Industries Ltd* (2014) 253 CLR 560, 568 [1] (French CJ), 597 [81] (Hayne, Crennan, Kiefel, Bell and Keane JJ).

<sup>64</sup> Edelman and Bant, above n 23, 83.

<sup>65</sup> *Ibid* 84.

In Australia, unjust enrichment is not a freestanding criterion for the imposition of legal liability.<sup>66</sup> As the High Court said in *Australian Financial Services and Leasing Pty Ltd v Hills Industries Ltd*, ‘unjust enrichment is not the basis of restitutionary relief in Australian law’;<sup>67</sup> the enquiry is instead conducted by reference to equitable principles.<sup>68</sup> It follows that the sum that a defendant must make in restitution to a claimant cannot conclusively be determined by reference to the extent of the benefit the defendant has received. Rather, one must consider the extent to which it would be against conscience for a defendant to retain a particular benefit. This directs attention to a further way in which damages and a *quantum meruit* may be harmonised under the Australian understanding of restitution. That is, where a defendant has received some benefit through performance of a contract, conscience may dictate that only the value which the contracting parties have subjectively attributed to the bargained for work or services operates as a ceiling on the amount that a claimant may receive in restitution.<sup>69</sup>

## IV Conclusion

*Mann v Paterson Constructions* raises interesting and difficult questions concerning the relationship between contract and unjust enrichment. The preceding discussion has examined three approaches available to the High Court. In making its choice between those three alternatives, the Court will do much to clarify the operation of *quantum meruit* claims in circumstances where the relevant works or services are performed under a contract.

Of equal interest will be the analytic framework that the Court adopts in dealing with the appeal. There remain questions as to how equitable principles, which have been favoured by the Court in the restitutionary context, operate in respect of restitution for work or services and how notions such as ‘unconscionable retention’ are to be applied.

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<sup>66</sup> *Equuscorp* (2012) 246 CLR 498, 516 [30] (French CJ, Crennan and Kiefel JJ); *Lampson (Australia) Pty Ltd v Fortescue Metals Group Ltd (No 3)* [2014] WASC 162 (7 May 2014), [50] (Edelman J).

<sup>67</sup> (2014) 253 CLR 560, 596 [78] (Hayne, Crennan, Kiefel, Bell and Keane JJ).

<sup>68</sup> *Ibid* 568 [1] (French CJ), 592–6 [65]–[76] (Hayne, Crennan, Kiefel, Bell and Keane JJ).

<sup>69</sup> An example of an Australian case that may illustrate this approach is *Ford v Perpetual Trustees Victoria Ltd* (2009) 75 NSWLR 42.



# Case Note

## *Hossain v Minister for Immigration and Border Protection*: A Material Change to the Fabric of Jurisdictional Error?

Courtney Raad\*

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### *Abstract*

In *Hossain v Minister for Immigration and Border Protection* (2018) 92 ALJR 780, the High Court of Australia unanimously endorsed a pragmatic approach to jurisdictional error. This case note argues that the decision, which introduces a threshold of materiality not quite in line with earlier judicial authority, occasions a less-than-desirable reformulation of the concept. It argues that the Court's reliance on factual circumstances extends beyond the established principles of statutory interpretation, in relation to context and precedent, and administrative law, in relation to the constitutionally significant legality/merits distinction. The case note argues that the dissenting judgment of Mortimer J in the Federal Court of Australia decision in *Minister for Immigration and Border Protection v Hossain* (2017) 252 FCR 31 is preferable as it avoids the departures from principle inherent in the High Court's reasoning and ultimately carries fewer problematic implications for individuals attempting to challenge administrative decisions.

## I Introduction

In *Hossain v Minister for Immigration and Border Protection*,<sup>1</sup> the High Court of Australia unanimously endorsed a pragmatic approach to jurisdictional error by building a requirement of materiality into a concept that has 'long eluded definition'.<sup>2</sup> This case note compares the three judgments handed down by the Court with the dissenting judgment of Mortimer J in the Full Court of the Federal Court of Australia.<sup>3</sup> It argues that the approach adopted by the High Court, which relies on an analysis of factual circumstances, extends beyond the established principles of statutory interpretation and administrative law. The case note concludes that Mortimer J handled the difficulties presented by the concept of jurisdictional error in a manner that avoided departures from principle.

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<sup>1</sup> (2018) 92 ALJR 780 ('*Hossain*').

<sup>2</sup> Chief Justice James Spigelman, 'The Centrality of Jurisdictional Error' (2010) 21(2) *Public Law Review* 77, 84.

<sup>3</sup> *Minister for Immigration and Border Protection v Hossain* (2017) 252 FCR 31, 41–57 [35]–[101] ('*Hossain* (FCAFC)').

In Part II, this case note identifies the issues before the High Court in *Hossain*. Part III examines the judgments of the High Court in *Hossain* and Mortimer J in *Hossain (FCAFC)* against established interpretative principles in relation to context and precedent. In Part IV, the case note analyses those judgments against established principles of administrative law in relation to the constitutionally significant legality/merits distinction.

## II The High Court Decision in *Hossain*

*Hossain* concerned two criteria that the Administrative Appeals Tribunal was required to consider in deciding whether or not to grant a partner visa under s 65 of the *Migration Act 1958* (Cth) ('*Migration Act*'). First, the application was required to be validly made within 28 days of the applicant ceasing to hold a previous visa 'unless the Minister [was] satisfied that there [were] compelling reasons for not applying' that criterion.<sup>4</sup> Second, the applicant was required not to have outstanding debts to the Commonwealth, 'unless the Minister [was] satisfied that appropriate arrangements [had] been made for payment'.<sup>5</sup> The Tribunal refused to grant the visa on the basis of non-satisfaction of both criteria. The error was attached to the first, in that the Tribunal had assessed whether there were compelling reasons at the time the application was made, rather than at the time the Tribunal made its decision.<sup>6</sup> As the Tribunal had misunderstood and misapplied the Regulation, the error was premised on an incorrect interpretation of the statute.

The determination of whether the error was jurisdictional, as opposed to a non-jurisdictional error of law, was critical because of the privative clause contained in s 474 of the *Migration Act*.<sup>7</sup> That section attempts to exclude judicial review of migration decisions by providing that decisions made under the Act are final and conclusive;<sup>8</sup> not susceptible to review by any court,<sup>9</sup> and not subject to the constitutional writs that function as judicial review remedies.<sup>10</sup> Privative clauses cannot oust the original jurisdiction of the High Court, entrenched in s 75(v) of the *Australian Constitution*, to review administrative decisions affected by jurisdictional error.<sup>11</sup>

The High Court's determination that the error was non-jurisdictional meant that the privative clause was operative. As the Tribunal's decision was final, conclusive, and not susceptible to judicial review remedies, it was upheld.<sup>12</sup> This conclusion was reached through a method of analysis that departed, at times, from established understandings of statutory interpretation and the legality/merits distinction integral to administrative law. The identified departures will be considered in turn.

<sup>4</sup> *Migration Regulations 1994* (Cth) sch 2 cl 820.211(2)(d)(ii), sch 3 criterion 3001.

<sup>5</sup> *Ibid* sch 2 cl 820.223(1)(a), sch 4 criterion 4004.

<sup>6</sup> *Hossain* (2018) 92 ALJR 780, 785 [10] n 5 (Kiefel CJ, Gageler and Keane JJ).

<sup>7</sup> *Ibid* 793–4 [65] (Edelman J).

<sup>8</sup> *Migration Act 1958* (Cth) s 474(1)(a).

<sup>9</sup> *Ibid* s 474(1)(b).

<sup>10</sup> *Ibid* s 474(1)(c).

<sup>11</sup> *Plaintiff S157/2002 v Commonwealth* (2003) 211 CLR 476 ('*Plaintiff S157/2002*').

<sup>12</sup> *Hossain* (2018) 92 ALJR 780, 789 [38] (Kiefel CJ, Gageler and Keane JJ), 798 [39] (Nettle J), 797 [80] (Edelman J).

### III Principles of Statutory Interpretation: Context and Precedent

#### A *The Understanding before Hossain*

Section 65 of the *Migration Act* has historically been regarded as a statutory precondition in the form of a subjective jurisdictional fact. The decision-maker is required to possess a state of satisfaction before the power and obligation to grant a visa arises.<sup>13</sup> The state of satisfaction must be formed reasonably and on a correct understanding of the law.<sup>14</sup> The duty imposed on the decision-maker under s 65 has been described as

binary: the Minister is to do one or other of two mutually exclusive legally operative acts — to grant the visa under s 65(1)(a), or to refuse to grant the visa under s 65(1)(b) — depending on the existence of one or other of two mutually exclusive states of affairs (or ‘jurisdictional facts’) — the Minister’s satisfaction of the matters set out in each of the sub-paragraphs of s 65(1)(a), or the Minister’s non-satisfaction of one or more of those matters.<sup>15</sup>

In the context of statutory preconditions, the process of discerning what facts,<sup>16</sup> opinions, procedural steps or judgments are jurisdictional,<sup>17</sup> and, in turn, what errors are jurisdictional, has long been regarded as an exercise in statutory interpretation.<sup>18</sup> Bateman and McDonald argue that the ‘statutory approach’ became dominant over the last 40 years,<sup>19</sup> culminating in the ‘cementing of legislative purpose as the ultimate reference point for the functional consequences of unlawful administrative action’.<sup>20</sup> The seminal authority on that approach is expressed in the joint judgment of McHugh, Gummow, Kirby and Hayne JJ in *Project Blue Sky v Australian Broadcasting Authority*:

A better test for determining the issue of validity is to ask whether it was a purpose of the legislation that an act done in breach of the provision should be invalid. This has been the preferred approach of courts in this country in recent years, particularly in New South Wales. In determining the question of

<sup>13</sup> See, eg, *Minister for Immigration and Multicultural Affairs v Eshetu* (1999) 197 CLR 611, 651 (‘Eshetu’); *Minister for Immigration and Citizenship v SZMDS* (2010) 240 CLR 611, 620–21 (Gummow ACJ and Kiefel J), 643–4, 648 (Crennan and Bell JJ); *Plaintiff M70/2011 v Minister for Immigration and Citizenship* (2011) 244 CLR 144, 179–80 (French CJ), 194–5 (Gummow, Hayne, Crennan and Bell JJ); *Wei v Minister for Immigration and Border Protection* (2015) 257 CLR 22, 35 (Gageler and Keane JJ) (‘Wei’).

<sup>14</sup> *Eshetu* (1999) 197 CLR 611, 651–4 (Gummow J), quoting *R v Connell*; *Ex parte Hetton Bellbird Collieries Ltd* (1944) 69 CLR 407, 430 and citing *Buck v Bavone* (1976) 135 CLR 110, 118–9 (Gibbs J).

<sup>15</sup> *Plaintiff S297/2013 v Minister for Immigration and Border Protection* (2014) 255 CLR 179, 188–9 [34] (Crennan, Bell, Gageler and Keane JJ) (citations omitted).

<sup>16</sup> *Timbarra Protection Inc v Ross Mining NL* (1999) 46 NSWLR 55, 64.

<sup>17</sup> Spigelman, above n 2, 85.

<sup>18</sup> See, eg, Chief Justice Robert French AC, ‘Statutory Interpretation and Rationality in Administrative Law’ (Speech delivered at the Australian Institute of Administrative Law National Lecture, Canberra, 23 July 2015) published in (2015) 82 (Nov) *Australian Institute of Administrative Law* (‘AIAL’) *Forum* 1.

<sup>19</sup> Will Bateman and Leighton McDonald, ‘The Normative Structure of Australian Administrative Law’ (2017) 45(2) *Federal Law Review* 153.

<sup>20</sup> *Ibid* 164.

purpose, regard must be had to ‘the language of the relevant provision and the scope and object of the whole statute’.<sup>21</sup>

The ‘statutory approach’ marks a rejection of absolute propositions as to what constitutes jurisdictional error,<sup>22</sup> in favour of an inquiry into the subject matter and specific statutory context.<sup>23</sup> The central concept is legislative *intention*: whether it was a statutory purpose that an error would render a decision invalid.<sup>24</sup> This analysis is consistent with the aim of interpretation: to ascertain the intention manifested by the words used by the legislature.<sup>25</sup>

Accepting the centrality of statutory interpretation in the process of identifying jurisdictional requirements and, in turn, jurisdictional errors, it is important to recognise the limits of the interpretative principles that have developed both within and outside of administrative law. Legislative intention may be discerned by an examination of the statute’s text, context and purpose,<sup>26</sup> having regard only to ‘extrinsic materials to which reference might properly be made’.<sup>27</sup> These principles are an aspect of the common law.<sup>28</sup> The modern common law approach,<sup>29</sup> expounded in *CIC Insurance Ltd v Bankstown Football Club Ltd*,<sup>30</sup> considers context in its widest sense. It includes the existing state of the law and the mischief that, by legitimate means, one may discern the statute was intended to remedy.<sup>31</sup> Judicial pronouncements on context have, so far, stopped short of suggesting that factual circumstances influence constructional choice.

## B A Shift in Understanding: The High Court’s Reasoning

In *Hossain*, despite acknowledging that the task was a constructional one,<sup>32</sup> the High Court considered factual circumstances to assess whether the identified statutory breach was material to the Tribunal’s decision. In determining whether the error was jurisdictional, the inquiry extended beyond the statutory text and purpose, and beyond the conventional understanding of context.

<sup>21</sup> (1998) 194 CLR 355, 390–1 [93] (*‘Project Blue Sky’*), quoting *Tasker v Fullwood* [1978] 1 NSWLR 20, 24.

<sup>22</sup> *Kirk v Industrial Court (NSW)* (2010) 239 CLR 531, 573–4 [71]–[73] (*‘Kirk’*), signifying a refusal to ‘mark the metes and bounds of jurisdictional error’ and a disavowal of the ‘rigid taxonomy’ expressed in *Craig v South Australia* (1995) 184 CLR 163 (*‘Craig’*).

<sup>23</sup> *Area Concrete Pumping Pty Ltd v Inspector Childs* (2012) 223 IR 86, 108. The *Project Blue Sky* approach has been applied repeatedly since: see, eg, *Plaintiff S157/2002* (2003) 211 CLR 476, 488–9 (Gleeson CJ); *Re Minister for Immigration and Multicultural and Indigenous Affairs; Ex parte Palme* (2003) 216 CLR 212, 225, 227.

<sup>24</sup> French, above n 18, 6.

<sup>25</sup> See, eg, *Saeed v Minister for Immigration and Citizenship* (2010) 241 CLR 252, 264–5 (French CJ, Gummow, Hayne, Crennan and Kiefel JJ); *Wik Peoples v Queensland* (1996) 187 CLR 1, 168–9 (Gummow J); *River Wear Commissioners v Adamson* [1877] 2 App Cas 743, 763 (Lord Blackburn).

<sup>26</sup> *Project Blue Sky* (1998) 194 CLR 355, 384 [78].

<sup>27</sup> *FAI Insurances Ltd v Winneke* (1982) 151 CLR 342, 409 (Brennan J).

<sup>28</sup> French, above n 18, 5.

<sup>29</sup> Westlaw, *Laws of Australia* (at 15 April 2013) 25 Interpretation and Use of Legal Sources, ‘25.1 Australian Domestic Laws’ [25.1.790].

<sup>30</sup> (1997) 187 CLR 384 (*‘CIC Insurance’*).

<sup>31</sup> *Ibid* 408 (Brennan CJ, Dawson, Toohey and Gummow JJ).

<sup>32</sup> *Hossain* (2018) 92 ALJR 780, 787–8 [27]–[28] (Kiefel CJ, Gageler and Keane JJ), 793 [64], 794–5 [67] (Edelman J).

The majority judgment of Kiefel CJ, Gageler and Keane JJ endorsed an interpretative presumption that the statute incorporates a threshold of materiality.<sup>33</sup> Non-compliance with a statutory term will not meet the threshold if, in the circumstances in which the decision was made, compliance could have made no difference to the decision.<sup>34</sup> The Tribunal did breach the implied condition attached to s 65 by misconstruing and misapplying the 28-day criterion. However, its non-satisfaction as to the debt criterion meant that the breach could not have made a difference to the decision in fact made.<sup>35</sup> Put differently, although the majority acknowledged that the state of satisfaction was not based ‘on a correct understanding and application of the law’,<sup>36</sup> because of the factual circumstances, an error that otherwise would have gone to jurisdiction was regarded as non-jurisdictional.

Justice Edelman acknowledged that construction does not depend solely on the text, and that statutes are construed in light of the ‘principles and history of judicial review’.<sup>37</sup> His Honour referred to the common law ‘principle’ that the consequences intended by Parliament to follow an error will usually depend on the gravity of that error.<sup>38</sup> It is questionable whether this is, in fact, a principle, as opposed to a piecing together of judicial authorities that briefly mention, but do not explain, the role of ‘gravity’. Citing *Project Blue Sky*, his Honour framed the question as: ‘which breaches of a provision does the legislation, either expressly or, more commonly, impliedly, treat as depriving the decision maker of power?’.<sup>39</sup> Justice Edelman stated that it is unlikely the legislature would have intended that an immaterial error would render a decision invalid.<sup>40</sup> His Honour explained that an error will not usually be material, and thus will not ‘affect’ the exercise of power,<sup>41</sup> unless there is a possibility that the error could have altered the decision. Generally, this means that an error is not material unless it has deprived the applicant of ‘the possibility of a successful outcome’.<sup>42</sup> This, according to his Honour, is ‘the usual implication that an immaterial error will not invalidate a decision made under [s 65]’,<sup>43</sup> where materiality is assessed against the existing facts before the Tribunal.<sup>44</sup>

Justice Nettle substantially agreed with the reasons of Edelman J,<sup>45</sup> but explained circumstances that depart from the ‘general’ rule, where an error might be jurisdictional despite not depriving a party of the possibility of a successful outcome.<sup>46</sup>

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<sup>33</sup> Ibid 788 [29].

<sup>34</sup> Ibid 788 [30].

<sup>35</sup> Ibid 789 [35].

<sup>36</sup> Ibid 789 [34].

<sup>37</sup> Ibid 793 [64].

<sup>38</sup> Ibid.

<sup>39</sup> Ibid 794 [67].

<sup>40</sup> Ibid 794–5 [67].

<sup>41</sup> Ibid 795 [71], relying on *Minister for Immigration and Multicultural Affairs v Yusuf* (2001) 206 CLR 323, 351 [82] in response to the Minister’s submission that the error must ‘affect’ the decision to be jurisdictional in nature.

<sup>42</sup> *Hossain* (2018) 92 ALJR 780, 795–6 [72].

<sup>43</sup> Ibid 796 [76].

<sup>44</sup> Ibid 796–7 [78].

<sup>45</sup> Ibid 789 [39].

<sup>46</sup> Ibid 789 [40].

In arriving at these conclusions, the High Court referred to specific statements in *Minister for Aboriginal Affairs v Peko-Wallsend Ltd*,<sup>47</sup> *Project Blue Sky*,<sup>48</sup> *Minister for Immigration and Citizenship v SZIZO*,<sup>49</sup> *Kirk*,<sup>50</sup> and *Wei*.<sup>51</sup> Although these cases did broaden the considerations that the court may have regard to, arguably, the reasoning in *Hossain* extends their reach. The trajectory of considering factual circumstances, and its limits, may be charted as follows. In *Peko-Wallsend*, Mason J suggested in the context of a failure to consider a mandatory relevant consideration that '[a] factor might be so insignificant that the failure to take it into account could not have materially affected the decision'.<sup>52</sup> *Peko-Wallsend* related to a discretion, whereas *Hossain* concerned a jurisdictional fact. Given that the case law has drawn a distinction between the two kinds of statutory creatures, it is difficult to accept an extension of *Peko-Wallsend* in the absence of an express judicial statement as to why it should be applied in a different context.

In *Project Blue Sky*, the High Court considered the public inconvenience that would result if non-compliance with a statutory term rendered a decision invalid. Members of the public should be in a position to order their affairs on the basis of apparently valid decisions.<sup>53</sup> The Court was concerned with the expense, inconvenience and loss of investor confidence that would follow a finding that a decision was legally ineffective.<sup>54</sup> Public inconvenience does not relate to the particular consequences of the particular breach, but to inconvenience that follows a particular interpretation and inconvenience that Parliament could not have intended. The inquiry remains premised on objective intention, as ascertained by the mechanisms of the statutory scheme and the way in which interests are *necessarily* affected. That is, it is concerned with the inevitable effects on certain groups of people as opposed to the specific effects on individuals appearing before the court. The public inconvenience test has not come to prominence in recent years,<sup>55</sup> and the courts that have engaged with it have placed it within, and not apart from, the conventional interpretative task.<sup>56</sup> Inconvenience is relevant when it assists the court in arriving at the meaning intended by Parliament.<sup>57</sup> Once that meaning is discerned, it sets precedent.

In *SZIZO*, the High Court found that there was no legislative intention that any departure from procedural steps would result in invalidity 'without consideration of the extent and consequences of the departure'.<sup>58</sup> The Court went on to say:

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<sup>47</sup> (1986) 162 CLR 24 ('*Peko-Wallsend*').

<sup>48</sup> (1998) 194 CLR 355.

<sup>49</sup> (2009) 238 CLR 627 ('*SZIZO*').

<sup>50</sup> *Kirk* (2010) 239 CLR 531.

<sup>51</sup> (2015) 257 CLR 22.

<sup>52</sup> *Peko-Wallsend* (1986) 162 CLR 24, 40.

<sup>53</sup> *Project Blue Sky* (1998) 194 CLR 355, 392 [97] (McHugh, Gummow, Kirby and Hayne JJ).

<sup>54</sup> *Ibid* 392 [98].

<sup>55</sup> Moreover, the three cases that did refer to public inconvenience were at State level: see *Barro Group Pty Ltd v Redland Shire Council* [2010] 2 Qd R 206; *Minister Administering Crown Lands Act 1989 v New South Wales Aboriginal Land Council* [2018] NSWLEC 26 (8 March 2018); *Yarri Mining Pty Ltd v Eaglefield Holdings Pty Ltd* [2009] WASC 125 (14 May 2009).

<sup>56</sup> See Graeme Hill, 'Applying *Project Blue Sky* — When Does Breach of a Statutory Requirement Affect the Validity of an Administrative Decision?' (2015) 80 (May) *AIAL Forum* 54, 74 n 98.

<sup>57</sup> *CIC Insurance* (1997) 187 CLR 384, 408 (Brennan CJ, Dawson, Toohey and Gummow JJ).

<sup>58</sup> *SZIZO* (2009) 238 CLR 627, 640 [35].

The respondents acknowledge that they suffered no injustice by reason of the Tribunal's omission and they do not take issue with the Full Court's characterisation of the result in the circumstances as being 'rather absurd'. The admitted absurdity of the outcome is against acceptance of the conclusion that the legislature intended that invalidity be the consequence of departure from any of the procedural steps leading up to the hearing.<sup>59</sup>

Read in context, the extracted sentence is not quite aligned with the analysis offered in *Hossain*. It remains contingent on statutory interpretation, with the conventional focus on purpose and legislative intention. This is consistent with the Court's conclusion that, as the purpose of the provision was to facilitate a fair hearing, the legislature would not have intended that a breach that did not amount to a denial of procedural fairness would invalidate a decision. Relevantly, procedural requirements are often regarded as non-jurisdictional.<sup>60</sup> On this analysis, the direct connection between purpose, intention, and the circumstances of the breach is different to the implied or presumed threshold of materiality endorsed in *Hossain*.

In *Kirk*, the High Court introduced the assessment of 'gravity' by quoting Jaffe's 'opinion',<sup>61</sup> that 'the word "jurisdiction" is not a metaphysical absolute but simply expresses the gravity of the error'.<sup>62</sup> The Court did not explain to what extent Jaffe's 'opinion' should form part of the Australian understanding of jurisdictional error, if at all. It is difficult to accept that this singular reference grounds what Edelman J identified as a 'principle' or 'common restriction' in *Hossain*.<sup>63</sup>

*Wei* was heard by a three-person bench of the High Court. The majority, Gageler and Keane JJ, stated that jurisdictional error 'consists of a *material breach* of an express or implied condition of the valid exercise of a decision-making power conferred by [the *Migration Act*]'.<sup>64</sup> The notion of 'material breach' is different to the notion of materiality proffered in *Hossain*. It focuses on the particular non-compliance with the statutory requirement and considers the extent of the breach in relation to that requirement. It does not concern how material the error was to the final decision. This is a subtle but essential distinction.

In the cases preceding *Hossain*, references to materiality or gravity were directed to the operation of the statutory scheme as opposed to the wider factual scenario. If *Hossain* represents an extension of what the court can consider, or a novel use of materiality, the extension is problematic. It cannot be reconciled with two key aspects of statutory interpretation: that the wide context does not include the specific facts at hand; and that the rules of precedent apply to interpreted provisions.<sup>65</sup>

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<sup>59</sup> Ibid (citations omitted).

<sup>60</sup> *Plaintiff S157/2002* (2003) 211 CLR 476, 504, 506 (Gaudron, McHugh, Gummow, Kirby and Hayne JJ); *Project Blue Sky* (1998) 194 CLR 355, 389–90 [92].

<sup>61</sup> *Kirk* (2010) 239 CLR 531, 570–71 [64].

<sup>62</sup> Ibid, quoting Louis L Jaffe, 'Judicial Review: Constitutional and Jurisdictional Fact' (1957) 70(6) *Harvard Law Review* 953, 963.

<sup>63</sup> *Hossain* (2018) 92 ALJR 780, 793–4 [64]–[65].

<sup>64</sup> *Wei* (2015) 257 CLR 22, 32 [23] (emphasis added).

<sup>65</sup> *Laws of Australia*, above n 29, '25.4 Judicial Statements' [25.4.260]. See also *McNamara v Consumer Trader and Tenancy Tribunal* (2005) 221 CLR 646, 661; *R v London Transport Executive; Ex parte Greater London Council* [1983] QB 484, 490–1; *Walker Corporation Pty Ltd v Sydney Harbour Foreshore Authority* (2008) 233 CLR 259, 270.

### C *The Preferred Understanding: Justice Mortimer's Reasoning*

Dissenting in the Full Court of the Federal Court, and finding that the matter should have been remitted to the Tribunal for reconsideration, Mortimer J adopted a reasoning process that avoided potential inconsistencies with the established principles of statutory interpretation.

Justice Mortimer began by acknowledging that whether or not an error is jurisdictional depends on the proper construction of the statutory power in accordance with the principles set out in *Project Blue Sky*.<sup>66</sup> Although her Honour saw materiality as a proper consideration, on her view, materiality or gravity, in the sense described by Jaffe,<sup>67</sup> went to *how* the decision-maker was required to and *in fact did* discharge the statutory task.<sup>68</sup> Her Honour's analysis accords with the line of authority considered above. Gravity and materiality relate to the nature of the error relative to the power under consideration, such that where an error is made, the decision-maker's jurisdiction is 'constructively unexercised'.<sup>69</sup>

If the High Court, in *Hossain* and in earlier cases, has consistently treated jurisdictional error as a conclusion arrived at after an exercise in construction,<sup>70</sup> that conclusion would conventionally hold precedent value. The Court's reasoning might now lead to the result that in one circumstance, an error will be non-jurisdictional, while in another, the same error will be jurisdictional. This could undermine the certainty attached to the precedent effect of interpreted statutes, particularly so in cases that relate to established jurisdictional facts. While flexibility is generally desirable, in this sense it carries 'the risk of uncertainty and administrative inconvenience'.<sup>71</sup> Uncertainty is problematic for potential litigants, particularly those faced with a privative clause, when assessing the threshold question of whether an administrative decision can be challenged.

Justice Mortimer did not accept that 'the very same error — misunderstanding the proper construction and operation of a visa criterion — can be jurisdictional in one case and non-jurisdictional in another'.<sup>72</sup> Instead, her Honour outlined what she preferred as the correct approach, namely:

to accept an error of this kind is jurisdictional and then to ask whether there is utility in the grant of relief to an applicant, because of a second basis for the decision on review. The answer to that question will depend on the circumstances of each case.<sup>73</sup>

Justice Mortimer found that if the matter was remitted to the Tribunal, the debt criterion would no longer be an issue given that, at the time of the Court proceedings,

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<sup>66</sup> *Hossain (FCAFC)* (2017) 252 FCR 31, 46 [57].

<sup>67</sup> *Ibid* 48–9 [65].

<sup>68</sup> *Ibid*.

<sup>69</sup> *Ibid* 49 [65].

<sup>70</sup> *Ibid* 46 [57]; *Hossain* (2018) 92 ALJR 780, 787–9 [27]–[28] (Kiefel CJ, Gageler and Keane JJ); *Kirk* (2010) 239 CLR 531, 570–71 [64], 574 [73].

<sup>71</sup> Stephen Gageler SC, 'Impact of Migration Law on the Development of Australian Administrative Law' (2010) 17(2) *Australian Journal of Administrative Law* 92, 104.

<sup>72</sup> *Hossain (FCAFC)* (2017) 252 FCR 31, 49 [67].

<sup>73</sup> *Ibid* [70].



Mr Hossain had repaid the Commonwealth debt.<sup>74</sup> Thus, looking forward to a potential re-examination by the Tribunal, there was utility in granting relief. On this approach, the factual circumstances are considered after the statute has been interpreted, when the utility question is at hand. This means that the precedent effect of an interpreted provision is not clouded by fact-specific considerations and the wide context identified in *CIC Insurance*<sup>75</sup> is not extended beyond proper limits.

## IV Principles of Administrative Law: The Legality/Merits Distinction

### A *The Understanding before Hossain*

The process whereby the Court, in the face of a privative clause, accepts an error, but labels it as non-jurisdictional, necessarily involves some form of deference to the administrator. Arguably, the High Court's decision in *Hossain* facilitates a pragmatic fact-based deference unsupported by Australian authority. The notion of deference has implications for the constitutionally significant legality/merits distinction.

In an influential article, Justice Ronald Sackville identified the twin pillars of administrative law: first, that courts are not concerned with the merits of administrative decisions, but only with their legality; and second, that because the courts are responsible for declaring the law, they must bear the exclusive responsibility of performing that task.<sup>76</sup> The judgment of Brennan J in *Attorney-General (NSW) v Quin*<sup>77</sup> might be seen as the seminal authority for Sackville's statements of principle. An essential characteristic of the judicature is that it declares and enforces the law which determines the limits of administrative power.<sup>78</sup> In performing that task, the court is not to balance competing policy considerations or inquire into the merits of administrative decisions. This is an instance of the constitutional separation of powers and the rule of law,<sup>79</sup> infringement of which will put the legitimacy of the courts at risk.<sup>80</sup> Justice Gageler described the distinction as follows: 'To the judges the law; to the others the merits'.<sup>81</sup>

The legality/merits distinction, and the judgment of Brennan J in *Quin*, informed the High Court's treatment of the doctrine that emerged from the judgment of Stevens J in the United States ('US') Supreme Court case of *Chevron USA Inc v*

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<sup>74</sup> Ibid 56–7 [100].

<sup>75</sup> (1997) 187 CLR 384.

<sup>76</sup> Justice Ronald Sackville, 'The Limits of Judicial Review of Executive Action — Some Comparisons between Australia and the United States' (2000) 28(2) *Federal Law Review* 315, 319–23. See also Stephen Gageler SC, 'The Legitimate Scope of Judicial Review: The Prequel' (2005) 26(3) *Australian Bar Review* 303, 304.

<sup>77</sup> (1990) 170 CLR 1, 35–6 ('*Quin*').

<sup>78</sup> Ibid, citing *Marbury v Madison* (1803) 5 US (1 Cranch) 137, 177 (Marshall CJ).

<sup>79</sup> Sir Anthony Mason, 'Judicial Review: A View from Constitutional and Other Perspectives' (2000) 28(2) *Federal Law Review* 331, 337.

<sup>80</sup> *Quin* (1990) 170 CLR 1, 35–6 (Brennan J).

<sup>81</sup> Gageler, above n 71, 104.

*Natural Resources Defense Council Inc.*<sup>82</sup> The *Chevron* doctrine allows the judiciary to defer to agency interpretations where a statute is silent or ambiguous with respect to a specific issue.<sup>83</sup> The question for the US court is not whether the interpretation is correct, but whether it is reasonable.<sup>84</sup> *Chevron* deference has been justified on the basis of the repository's fact-finding and policy-making competence, its electoral accountability, and the implication that Congress, in drafting the statute in ambiguous terms, intended to leave the interpretative task to the administrator.<sup>85</sup>

In *Corporation of the City of Enfield v Development Assessment Commission*,<sup>86</sup> the High Court of Australia rejected *Chevron* deference. Whether it did so explicitly or only implicitly,<sup>87</sup> what is clear is that 'the Court regarded the doctrine as amounting to an abdication of the judicial responsibility to declare and enforce the law'.<sup>88</sup> First, the Court found that the *Chevron* doctrine, 'even on its own terms',<sup>89</sup> addressed competing interpretations of ambiguous statutory provisions. It did not concern the issue before the Court, which involved fact-finding of objective jurisdictional facts.<sup>90</sup> The Court acknowledged that, even in the US, it was unsettled as to whether the doctrine applied to agency interpretations of jurisdiction-defining provisions.<sup>91</sup> Second, the Court explained that the doctrine may have undesirable consequences, in that the decision-maker may choose to adopt one of many competing reasonable interpretations to fit the facts to the desired result, transforming legal issues into policy issues, abdicating judicial interpretative responsibility, and insulating decisions from judicial scrutiny.<sup>92</sup> Finally, the Court found that *Chevron* deference was inconsistent with basic principles of Australian administrative law, such as the legality/merits distinction discussed by Brennan J in *Quin*.<sup>93</sup>

The High Court has, however, accepted what Justice Gageler terms another kind of deference in the form of 'respectful regard for the judgment or opinion of ... an expert [administrator]'.<sup>94</sup> On questions of fact and usage, the Court has attached weight to the opinion of administrators.<sup>95</sup> This development has, however, been described as a 'far cry' from building a notion of *Chevron* deference into Australian judicial review.<sup>96</sup> Instead, it appears to be more analogous to what Justice Gageler

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<sup>82</sup> (1984) 467 US 837 ('*Chevron*').

<sup>83</sup> Ibid 842–4.

<sup>84</sup> Ibid 843.

<sup>85</sup> Cass R Sunstein, 'Law and Administration after *Chevron*' (1990) 90(8) *Columbia Law Review* 2071.

<sup>86</sup> (2000) 199 CLR 135 ('*Enfield*').

<sup>87</sup> Compare *Woolworths Ltd v Pallas Newco Pty Ltd* (2004) 61 NSWLR 707, 712 [16] (Spigelman CJ); *Contra* Mason, above n 79, 339.

<sup>88</sup> Mason, above n 79, 339.

<sup>89</sup> *Enfield* (2000) 199 CLR 135, 151 [40].

<sup>90</sup> Ibid.

<sup>91</sup> Ibid 151–2 [41].

<sup>92</sup> Ibid 152 [41]–[42].

<sup>93</sup> Ibid 152–4 [43]–[44].

<sup>94</sup> Justice Stephen Gageler, 'Deference' (2015) 22(3) *Australian Journal of Administrative Law* 151, 152.

<sup>95</sup> See *R v Williams; Ex parte Australian Building Construction Employees' & Builders Labourers' Federation* (1982) 153 CLR 402, 411; *Eshetu* (1999) 197 CLR 611, 655 (Gummow J); *Enfield* (2000) 199 CLR 135, 154–5 [45]–[48].

<sup>96</sup> Peter Cane and Leighton McDonald, *Principles of Administrative Law* (Oxford University Press, 2<sup>nd</sup> ed, 2013) 157.

identifies as ‘*Skidmore* deference’, emerging from the US Supreme Court case of *Skidmore v Swift & Co.*<sup>97</sup> *Skidmore* deference is different to *Chevron* deference because it involves a court giving weight to a question of interpretation that, on the statute’s proper construction, is made a question for the court, rather than the administrator.<sup>98</sup> The judiciary retains interpretative authority.

## B *A Shift in Understanding: The High Court’s Reasoning*

The High Court’s approach in *Hossain* might blur the constitutionally significant legality/merits distinction. In practical effect, the question of materiality facilitates a pragmatic fact-based deference. The administrator’s misapplication or incorrect interpretation of a statutory test will be permitted to stand if the court, after inquiring into the factual circumstances, determines that the breach is immaterial to the decision made. The dangers of this approach are two-fold: not only could it amount to an abdication of judicial responsibility in the manner warned of in *Enfield*,<sup>99</sup> but it could also allow the judiciary to impinge on the executive role. In practical effect, the administrator might decide questions of law,<sup>100</sup> and the judiciary, when assessing materiality, might impermissibly inquire into the merits of the administrative decision. Against the Australian constitutional context, the rationale underpinning *Chevron* deference, and the rationale required to underpin *Hossain*’s pragmatic deference, is not available to the Australian court.

*Hossain* represents a kind of deference not quite contemplated in *Chevron*.<sup>101</sup> Although *Enfield* concerned an objective jurisdictional fact, and *Hossain* concerned a subjective jurisdictional fact, the framework of *Hossain* is certainly closer to the form of deference contemplated and rejected in *Enfield* than the kind endorsed in *Chevron*. This is supported by the High Court’s own reasoning in *Enfield*, whereby a jurisdictional fact was described as ‘a criterion, satisfaction of which mandates a particular outcome’,<sup>102</sup> the precise terminology that has been used to describe s 65. In *Enfield*, Gaudron J stated:

Once is it appreciated that it is the rule of law that requires the courts to grant whatever remedies are available and appropriate to ensure that those possessed of executive and administrative powers exercise them only in accordance with the laws which govern their exercise, *it follows that there is very limited scope for the notion of ‘judicial deference’ with respect to findings by an administrative body of jurisdictional facts.*<sup>103</sup>

<sup>97</sup> 323 US 134, 140 (1944).

<sup>98</sup> Gageler, above n 94, 153.

<sup>99</sup> (2000) 199 CLR 135, 152 [41] (Gleeson CJ, Gummow, Kirby and Hayne JJ), 158 [60] (Gaudron J).

<sup>100</sup> As interpretative questions are questions of law: see *May v Military Rehabilitation and Compensation Commission* (2015) 233 FCR 397, overturned on appeal, but not on that point.

<sup>101</sup> See, eg, *Crowell v Benson* 285 US 22, 56–7 (1932).

<sup>102</sup> *Enfield* (2000) 199 CLR 135, 148 [28]. See also Aronson and Groves comparing deference to administrative determinations of the law with administrative findings of jurisdictional facts: Mark Aronson and Matthew Groves, *Judicial Review of Administrative Action* (Lawbook, 6<sup>th</sup> ed, 2017) 200.

<sup>103</sup> *Enfield* (2000) 199 CLR 135, 158 [59] (emphasis added).

Allars calls this an accountability test, or an additional screening mechanism when jurisdictional facts are subject to judicial review.<sup>104</sup> If *Hossain* is an extension of *Chevron* deference, the extension is problematic. The rationale underpinning the US courts' acceptance of the *Chevron* doctrine is not present within the current Australian context. Although regard is had to the administrator's expertise, Australian courts have not made references to electoral accountability. In addition, there is no indication that the Australian courts have ever, overtly at least, treated vague statutory terminology as a reason for recognising that parliaments have allocated interpretative authority to administrators.

Perhaps more fundamentally, Australia's separation of powers doctrine has been described as more rigid than the US model.<sup>105</sup> The constitutional separation of powers is integral to Australian administrative law. The current understanding of the relationship between the branches of government is addressed in the High Court's unanimous endorsement of Lord Diplock's statement that

Parliament can, of course, if it so desires, confer upon administrative tribunals or authorities power to decide questions of law as well as questions of fact or of administrative policy; but this requires clear words, for the presumption is that where a decision-making power is conferred on a tribunal or authority that is not a court of law, Parliament did not intend to do so.<sup>106</sup>

In *Craig*, the Court went on to say that:

The position is, of course, a fortiori in this country where constitutional limitations arising from the doctrine of the separation of judicial and executive powers may preclude legislative competence to confer judicial power upon an administrative tribunal.<sup>107</sup>

The presumption is that Parliament did not intend to confer interpretative authority on administrative decision-makers. Even so, Parliament's expression of intention is constrained by the constitutional separation of powers. It is difficult to reconcile these principles with the interpretative *presumption*, and not an express Parliamentary statement, endorsed by the judgments in *Hossain*: that the statute incorporates a threshold of materiality in the event of a breach, and jurisdictional error generally only arises when the threshold is met.<sup>108</sup> Against the constitutional context, the reasons handed down by the High Court do not disclose a rationale as to why a pragmatic fact-based deference is necessary or even justified.

Justice Gaudron's rejection of deference in *Enfield*, on the basis of the rule of law,<sup>109</sup> connects to the general judicial reluctance to decline to grant relief after finding that an error has occurred. It has long been recognised that a court may, depending on the circumstances of the case, exercise a discretion to refuse a remedy.

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<sup>104</sup> Margaret Allars, 'Chevron in Australia: A Duplicious Rejection?' (2002) 54(2) *Administrative Law Review* 569, 587–90.

<sup>105</sup> Spigelman, above n 2, 83; Bradley Selway QC, 'The Principle Behind Common Law Judicial Review of Administrative Action — The Search Continues' (2002) 30(2) *Federal Law Review* 217, 233.

<sup>106</sup> *Craig* (1995) 184 CLR 163, 179, quoting *In re Racial Communications Ltd* [1981] AC 374, 383. See also Sackville, above n 76, 330.

<sup>107</sup> *Craig* (1995) 184 CLR 163, 179.

<sup>108</sup> *Hossain* (2018) 92 ALJR 780, 788 [29] (Kiefel CJ, Gageler and Keane JJ), 796 [76] (Edelman J), 789 [39] (Nettle J).

<sup>109</sup> *Enfield* (2000) 199 CLR 135, 157–8.

In *Re Refugee Tribunal; Ex parte Aala*, the High Court quoted Gaudron J in support of the proposition that the discretion to refuse a remedy for a trivial breach of the rules of procedural fairness is not exercised lightly.<sup>110</sup> A remedy will only be denied where adherence to the rules of procedural fairness could not possibly have altered the final decision.<sup>111</sup> The standard is high,<sup>112</sup> such that the mere appearance that the decision would have been the same is insufficient.<sup>113</sup> The high standard protects against an impermissible judicial inquiry into the merits of the decision.

### C *The Preferred Understanding: Justice Mortimer's Reasoning*

The reasoning adopted by Mortimer J in the Federal Court avoids some difficulties attached to the legality/merits distinction. It is true that, in exercising the discretion to refuse relief, a court might allow a decision involving an incorrect agency interpretation to stand. However, in reaching that conclusion, the court, and not the administrator, has performed the interpretative task. On Mortimer J's approach, a court may characterise particular errors as either jurisdictional or non-jurisdictional in every case, according to established principles and without regard to differing factual scenarios, and then impose a separate discretionary test for whether a remedy should not be granted. In so doing, the court acknowledges that the agency's misapplication of the statutory term goes to jurisdiction, but the analysis is divided into 'two separate questions': whether jurisdiction was exceeded, and whether a remedy should not issue.<sup>114</sup> This methodology is consistent with the established discretions to refuse remedies, including the trivial breach discretion.<sup>115</sup> The first question, within which the interpretative task is entirely contained, is non-flexible.<sup>116</sup> Facts are only considered within the second, and more flexible, question of discretion.

The High Court's determination in *Hossain* indicates that the materiality threshold carries a lower standard than that attached to the established discretions. As a result, there is now a greater possibility that no remedy will issue for what would, on application of established interpretative principles and without regard to factual circumstances, amount to a jurisdictional error. If the standard is not high, the process of deciding whether compliance with a statutory condition could have resulted in a different decision, or whether a party has been deprived of the possibility of a successful outcome, might encourage an inquiry into the merits of the decision. Justice Mortimer was aware of this possibility. Her Honour stated that

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<sup>110</sup> (2000) 204 CLR 82, 107–8 (Gaudron and Gummow JJ), 89 (Gleeson CJ) ('*Aala*'). See also 136–7 (Kirby J).

<sup>111</sup> *Ibid* 109.

<sup>112</sup> *Ibid* 88–9 (Gleeson CJ), 109, 117 (Gaudron and Gummow JJ), 130–1 (Kirby J); *Stead v State Government Insurance Commission* (1986) 161 CLR 141, 147.

<sup>113</sup> Cane and McDonald, above n 96, 107–8.

<sup>114</sup> *Aala* (2000) 204 CLR 82, 106–7 (Gaudron and Gummow JJ), 89 (Gleeson CJ), quoted in *Hossain (FCAFC)* (2017) 252 FCR 31, 55–6 [96].

<sup>115</sup> For example, if there has been delay, waiver of rights or collateral motives: see *Aala* (2000) 204 CLR 82, 136–7 (Kirby J).

<sup>116</sup> Akin to the non-flexible threshold question of whether a statute conditions an exercise of power upon observance of the principles of natural justice. Here, flexibility also arises in the second, circumstance-specific question: *Kioa v West* (1985) 159 CLR 550, 612 (Brennan J).

‘the Court must be astute not to descend into merits review by endorsing what it considers to be the “inevitable” outcome given the reasoning of the Tribunal, which reasoning is affected by error’.<sup>117</sup>

Justice Mortimer offered an ‘alternative analysis’ of the facts of *Hossain*, on the basis of the materiality submission ultimately accepted.<sup>118</sup> Comparison of her Honour’s analysis against that of the High Court indicates a potential blurring of the legality/merits distinction by the High Court. The Court treated the two bases for the Tribunal’s decision as separate and independent — an error in relation to one criterion could not have affected the Tribunal’s exercise of its review power or its approach to the other criterion.<sup>119</sup>

Justice Mortimer, however, identified that both criteria contain discretionary elements. A discretion is attached to what constitutes ‘compelling reasons’<sup>120</sup> and ‘appropriate arrangements’.<sup>121</sup> The Tribunal also has a discretion to decide when it will make its decision, including at what point the debt criterion should be met,<sup>122</sup> acknowledging that circumstances may change during the course of the review.<sup>123</sup> Justice Mortimer was not convinced that if the meaning of ‘compelling reasons’ was correctly understood the conclusion reached in relation to either the 28-day criterion or the debt criterion would certainly have been the same.<sup>124</sup> In relation to ‘compelling reasons’, there may have been matters in the material that would have caused the Tribunal to reconsider its approach to the respondent’s circumstances.<sup>125</sup>

In relation to ‘appropriate arrangements’, the Tribunal, in maintaining an open and persuadable mind, might have exercised its discretion to delay the making of its decision so as to give the respondent time to satisfy the criterion.<sup>126</sup> The majority of the High Court correctly labelled this as ‘conjecture’.<sup>127</sup> The point is not, however, that the discretion would necessarily have been exercised and that more time would have been given. Rather, Mortimer J’s reasoning suggests that the mere possibility of the discretion being exercised means the outcome was not strictly inevitable. In deciding that the decision would have been the same, notwithstanding the discretionary elements of the statutory tests and the discussion of Mortimer J, the High Court appears to have broadened the circumstances in which a remedy will be refused and applied a lower standard than that which, for the purposes of the rule of law, is attached to the usual discretion to refuse a remedy. A lower standard increases the likelihood that an applicant who proves the existence of error will, nevertheless, be denied a remedy.

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<sup>117</sup> *Hossain* (FCAFC) (2017) 252 FCR 31, 50 [72].

<sup>118</sup> *Ibid* 49–55 [71]–[95].

<sup>119</sup> *Hossain* (2018) 92 ALJR 780, 789–90 [41] (Nettle J), 790 [44] (Edelman J).

<sup>120</sup> See above n 4 and accompanying text.

<sup>121</sup> See above n 5 and accompanying text.

<sup>122</sup> *Hossain* (FCAFC) (2017) 252 FCR 31, 50 [72].

<sup>123</sup> *Ibid* 51–2 [77].

<sup>124</sup> *Ibid* 50 [72].

<sup>125</sup> *Ibid* 51 [75].

<sup>126</sup> *Ibid* 51–2 [77].

<sup>127</sup> *Hossain* (2018) 92 ALJR 780, 789 [36] (Kiefel CJ, Gageler and Keane JJ).

As Edelman J stated, the consideration of materiality ‘looks backwards to whether the error would have made any difference to the result’.<sup>128</sup> Although looking backwards might be justified pragmatically, it puts the judiciary in the position of the decision-maker, where there is a risk of entering into the merits of the decision. According to Mortimer J’s approach, the discretion to refuse relief involves a higher threshold, and the judiciary will not, through speculation, readily assert that the decision would have been the same. Whether there will be utility in remitter ‘will depend on the particular visa criteria in issue, the state of the evidence *before the Court*, and the decision-maker’s reasons’.<sup>129</sup> The test of utility looks forward, to whether it is worth putting the question before the Tribunal again. It retains flexibility while avoiding the constitutional implications associated with the High Court’s reasoning.

## V Conclusion

In *Hossain*, the High Court of Australia faced a difficult task. Jurisdictional error consists of ‘undefined, probably undefinable content’,<sup>130</sup> and, as the majority in *Hossain* quoted, ‘new formulas attempting to rephrase the old are not likely to be more helpful than the old’.<sup>131</sup> This case note has argued that the threshold of materiality is one such formula. It is unhelpful because it conflicts with the established principles of statutory interpretation, in terms of contextual considerations and precedent. It also conflicts with the established principles of administrative law, in terms of the constitutionally significant legality/merits distinction. The solution offered by Mortimer J is preferable, as it differentiates between an exercise in construction and an exercise in the discretion to refuse relief. It is a standard solution: consistent with the authority on materiality and gravity, consistent with the principles of statutory interpretation, and consistent with the twin pillars of administrative law.

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<sup>128</sup> Ibid 796 [74].

<sup>129</sup> *Hossain (FCAFC)* (2017) 252 FCR 31, 56–7 [100] (emphasis added).

<sup>130</sup> Justice Mark Leeming, ‘The Riddle of Jurisdictional Error’ (2014) 38(2) *Australian Bar Review* 139, 150, quoting Chief Justice James Spigelman, ‘Public Law and the Executive’ (2010) 34(1) *Australian Bar Review* 10, 17.

<sup>131</sup> *Hossain* (2018) 92 ALJR 780, 786 [17] (Kiefel CJ, Gageler and Keane JJ), quoting *Universal Camera Corporation v National Labor Relations Board*, 340 US 474, 489 (1951).





# Review Essay

## *Are Human Rights Enough (in Australia)?*

*Not Enough: Human Rights in an Unequal World*  
by Samuel Moyn (2018), Belknap Press, 296 pp,  
ISBN 9780674737563

Dylan Lino\*

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### *Abstract*

This essay reviews Samuel Moyn's recent book *Not Enough: Human Rights in an Unequal World* and explores its resonance with Australian political experience. It argues that the politics of bills of rights in Australia bear out one of Moyn's central theses: that within global politics since the 1970s, a concern for human rights has partly displaced concerns about material inequality. Understanding this history should challenge progressive Australian lawyers to rethink the privileged standing that the bill-of-rights cause possesses within their aspirations for law reform, and encourage advocacy for projects that seek to counter material inequality.

## **I Introduction**

Progressive-minded Australians love human rights, progressive-minded Australian lawyers especially so. One of their dominant legal projects over the past 50 years has been to better institutionalise human rights protections in domestic law. Most prominent and glamorous among their causes has been the unrealised endeavour to create a national bill of rights, whether constitutionally or legislatively enshrined.<sup>1</sup> It is a source of considerable frustration and embarrassment for left-of-centre Australians, and particularly for the lawyers among us, that (as the standard refrain goes) 'Australia is now the only Western democracy without a national Human Rights Act or bill of rights'.<sup>2</sup> Despite the numerous advances made towards more

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<sup>1</sup> Andrew Byrnes, Hilary Charlesworth and Gabrielle McKinnon, *Bills of Rights in Australia: History, Politics and Law* (UNSW Press, 2009).

<sup>2</sup> Morry Bailes, President of the Law Council of Australia, quoted in Law Council of Australia, '70 Years after *Universal Declaration of Human Rights*, Australia Has Unfinished Business' (Media Release, 10 December 2018) <<https://www.lawcouncil.asn.au/media/media-releases/70-years-after-universal-declaration-of-human-rights-australia-has-unfinished-business>>.

fully protecting human rights from state incursions in Australia, further extending that project remains one of the highest goals for law reform among progressive Australians.

For those in this camp, and I count myself among them, Samuel Moyn's brilliant and provocative new book, *Not Enough: Human Rights in an Unequal World*,<sup>3</sup> should prompt some hard reflection. Over the past decade, Moyn, a professor of history and a professor of law at Yale University, has emerged as one of the most influential historians of human rights, prompting academics and advocates alike to revisit their often pietistic assumptions about the origins and politics of human rights. *Not Enough* is a worthy extension of this iconoclasm. Both a work of intellectual and legal history and an incisive political intervention, *Not Enough* documents the historical relationship between human rights and distributive justice, particularly the pursuit of material equality. The story is not a happy one. In Moyn's persuasive telling, human rights were peripheral to the greatest modern feats of egalitarian redistribution, especially the erection of welfare states, and they have been powerless against the reversal of those feats in the age of neoliberalism since the 1970s. *Not Enough* demonstrates that, in their congenital neglect of material inequality, human rights are fundamentally incomplete as a program of social justice.

*Not Enough* has a special resonance with Australia, one that I seek to bring out in this essay. I start by reviewing *Not Enough* and situating it against Moyn's prior work on human rights. I then turn to Australia, focusing on the history of progressive advocacy for a bill of rights. In extending Moyn's analysis to Australia, I want not only to demonstrate the robustness of Moyn's historical conclusions, but also to bring his critique of human rights closer to home for an Australian legal audience. I argue that, roughly since the 1970s, the bill-of-rights cause has captured the legal imagination of Australian progressives and their commitment to egalitarian redistribution has waned, even as material inequality has expanded as a result of neoliberal reforms. For progressive lawyers, who have so often led efforts to better protect human rights, understanding this history should challenge us — not to abandon human rights, but to go beyond them: to expand our imaginative horizons, enlarge our political ambitions and redirect some of our energies in pursuit of the neglected ideal of egalitarian redistribution.

## II Inequality and the Failures of Human Rights

The story that Moyn tells in *Not Enough* is one in which human rights have been marginal in past achievements of egalitarian distribution and virtually impotent in challenging their more recent reversals. The most successful visions for reducing material equality, Moyn argues, have been those grounded in the Welfare State and socialism, even as those egalitarian visions were frequently entangled with imperialism, authoritarianism, racism, sexism and other forms of domination. After experiencing a heyday for three decades after World War II, the fortunes of the Welfare State and socialism declined, replaced from the 1970s by a highly unequal

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<sup>3</sup> Samuel Moyn, *Not Enough: Human Rights in an Unequal World* (Belknap Press, 2018).

age whose political economy has been neoliberal and whose political morality has been human rights. Certainly, Moyn acknowledges that among the commendable successes of human rights is their role in challenging status inequalities based on gender, race, sexual orientation and other grounds — a major improvement on the exclusionary Welfare State.<sup>4</sup> But his central conclusion is that human rights have failed to provide a political language or institutional repertoire for contesting unequal distribution and, as a result, ‘have been a powerless companion of market fundamentalism’.<sup>5</sup>

In *Not Enough*, Moyn builds upon his earlier field-defining histories of human rights, most notably 2010’s *The Last Utopia*.<sup>6</sup> There, Moyn undermined prevailing genealogies of human rights that posited their deep origins and celebrated their historical unfolding as the steady march of progress. Human rights as we know them today — as ‘an agenda for improving the world, and bringing about a new one in which the dignity of each individual will enjoy secure international protection’<sup>7</sup> — did not originate in Christian natural law or the Enlightenment or even in response to the horrors of World War II. Rather, according to Moyn, the internationalist human rights program only emerged to global prominence in the 1970s.<sup>8</sup> And it did so not through some inevitable triumph of universal justice, but primarily because other more ambitious and globally dominant programs for human emancipation — especially communism and anti-colonial nationalism — collapsed under the weight of ignominy.<sup>9</sup> As these once-ascendant utopian programs shed supporters and accumulated critics, the seemingly purer, more minimalist vision of justice represented by human rights was left standing as the ‘last utopia’.<sup>10</sup>

There are strong continuities between *The Last Utopia* and *Not Enough*. Both are first and foremost works of history, underpinned by a critical impulse to contest the sanctified status of human rights as the pinnacle of progressive politics. In *Not Enough*, as in *The Last Utopia*, the 1970s remains the critical turning point for the global rise of human rights, with Moyn maintaining that human rights occupied a fairly minimal place in law and politics globally prior to the 1970s.<sup>11</sup> And Moyn persists in seeing the principal reason for the ascendance of human rights since then as the decline of rival utopian agendas, socialist and anti-colonial projects most notably.<sup>12</sup>

But there are also divergences. The most obvious is *Not Enough*’s narrowing of thematic focus to the relationship between human rights and distributive justice. In practice, this new orientation sees Moyn focus more on economic and social rights and situate human rights primarily within the explanatory context of political

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<sup>4</sup> Ibid 3, 9, 10, 176, 202–6.

<sup>5</sup> Ibid 216.

<sup>6</sup> Samuel Moyn, *The Last Utopia: Human Rights in History* (Belknap Press, 2010). See also Samuel Moyn, *Christian Human Rights* (University of Pennsylvania Press, 2015); Samuel Moyn, *Human Rights and the Uses of History* (Verso, 2014).

<sup>7</sup> Moyn, *The Last Utopia*, above n 6, 1.

<sup>8</sup> Ibid 1–8.

<sup>9</sup> Ibid 3–5, 7–8, chs 3–4.

<sup>10</sup> Ibid.

<sup>11</sup> Moyn, *Not Enough*, above n 3, xi.

<sup>12</sup> Ibid.

economy.<sup>13</sup> Another major difference between *Not Enough* and *The Last Utopia* is in temporal scope. Where the earlier book had ended the story ‘on the brink of 1980, precisely when it began to seem interesting’,<sup>14</sup> *Not Enough* extends the timeframe to the present. The expanded narrative arc is integral to Moyn’s project, enabling him to puzzle over how the age of human rights, commencing in the 1970s, has also coincided with the ascendancy of neoliberalism and exploding material inequality.

More subtly, Moyn has relaxed his insistence on seeing human rights as an international program sitting beyond and directed against the State. That insistence had given *The Last Utopia* so much of its drama, allowing Moyn to discount the human rights credentials of political projects from the French Revolution through to decolonisation movements, since they turned to the State rather than the international sphere as the guarantor of rights.<sup>15</sup> In *Not Enough*, Moyn himself now looks to rights guaranteed by states as part of the history of human rights. To borrow one of Moyn’s conceptual distinctions, he now acknowledges that the *substantive content* of human rights may be old, while maintaining that the 1970s were the crucial moment when human rights rose to an international (rather than statist) *scale* and attained global ideological *salience*.<sup>16</sup>

Informing Moyn’s historical analysis is a theoretical distinction between sufficiency and equality in the politics of redistribution:

Sufficiency concerns how far an individual is *from having nothing* and how well she is doing *in relation to some minimum of provision* of the good things in life. Equality concerns how far individuals are *from one another* in the portion of those good things they get.<sup>17</sup>

According to Moyn, when human rights have cared about material distribution at all, they have been concerned with sufficiency — meeting a subsistence minimum, as through most economic and social rights — while letting hierarchy run rampant.<sup>18</sup> But for Moyn, the idea that everyone should simply have enough is not enough: ‘Not merely a floor of protection against insufficiency is required, but also a ceiling on inequality’.<sup>19</sup> And he doubts whether human rights themselves can be successfully repurposed to undertake this pressing task.<sup>20</sup>

Alongside its upfront theoretical framework, *Not Enough* also wears a political program on its sleeve: to make material equality a political priority again and, insofar as human rights unnecessarily detract from that goal, to lessen our fixation on them. Moyn’s work on human rights has always been refreshingly open, some historians would say heretical, in using history for contemporary political ends. As Moyn has emphasised elsewhere, ‘arguments about history ... can never do other than serve the present, since they are inevitably motivated by its chronologically

<sup>13</sup> See especially Moyn, *Not Enough*, above n 3, x, 6, 8, 175.

<sup>14</sup> *Ibid* x.

<sup>15</sup> Moyn, *The Last Utopia*, above n 6, chs 1, 3.

<sup>16</sup> Samuel Moyn, ‘Substance, Scale, and Salience: The Recent Historiography of Human Rights’ (2012) 8 *Annual Review of Law and Social Science* 123.

<sup>17</sup> Moyn, *Not Enough*, above n 3, 3 (emphasis in original).

<sup>18</sup> *Ibid* 2–3, ch 7.

<sup>19</sup> *Ibid* 4.

<sup>20</sup> *Ibid* 218–19.

temporary and thematically narrow concerns'.<sup>21</sup> The political motivation underpinning *The Last Utopia* was a general dissatisfaction with the achievements of human rights: they were, at best, an unimpressive vision of global justice falsely masquerading as apolitical, and, at worst, a compromised program entangled in questionable practices of foreign intervention. It was a potent critique that destabilised the moral and political authority of human rights, without suggesting any alternative program to supplement or replace them. In *Not Enough*, Moyn's history likewise serves a critical project, this time revealing that when it comes to challenging unequal distribution, human rights have not been up to the task and probably never will be. But now Moyn forthrightly proclaims an alternative program to supplement human rights: a capaciously defined socialism, ideally international in scope, to reverse the material inequality that is neoliberalism's calling card.

*Not Enough* provides a history of the relationship between human rights and redistribution that is both sweeping and compelling. The book's first half explores national and international projects for achieving distributive justice up to the 1970s and the place of human rights within them. In essence, Moyn's argument is that political movements, especially those that produced the Welfare State, once took egalitarian redistribution much more seriously, and that human rights were peripheral in those movements.<sup>22</sup> Attentive to the injustices present in earlier egalitarian projects, Moyn substantiates his thesis with wide-ranging chapters that trace the development of the Welfare State, the unrecognised welfarist origins of the *Universal Declaration of Human Rights*,<sup>23</sup> and the postcolonial mobilisations that culminated in demands for a New International Economic Order in the 1970s.<sup>24</sup>

Where the book's first part shows how human rights were peripheral to projects of egalitarian redistribution up through the 1970s, the second part persuasively shows how egalitarian redistribution has been peripheral to human rights projects from the 1970s onwards, even as material inequality has grown. The penultimate chapter is the pivotal one, offering a synoptic view of the mutual ascent of human rights and neoliberalism — and, just as importantly, the decline of socialism.<sup>25</sup> While Moyn emphasises that human rights and neoliberalism arose from different conditions in different places, a recurring explanatory factor is the diminishing power and prestige of the socialist left in local and global settings, which opened up political space for the emergence of human rights and neoliberalism alike. Moyn convincingly concludes that human rights have since comfortably cohabited with neoliberalism primarily because they 'had no commitment on their own to material equality'.<sup>26</sup>

In *Not Enough*, Moyn has supplied another riveting and powerful critical history of human rights whose central thesis is difficult to deny. For progressives, *Not Enough* stands as a bracing indictment of the ways in which our growing concern for human rights has dovetailed with a growing neglect of the scourge of material

<sup>21</sup> Moyn, *Human Rights and the Uses of History*, above n 6, xii–xiii.

<sup>22</sup> Moyn, *Not Enough*, above n 3, chs 1–4.

<sup>23</sup> GA Res 217A (III), UN GAOR, UN Doc A/810 (10 December 1948).

<sup>24</sup> Moyn, *Not Enough*, above n 3, chs 1–4.

<sup>25</sup> *Ibid* ch 7.

<sup>26</sup> *Ibid* 193.

inequality. This realisation should not lead to a disregard of the fundamental importance of human rights for progressive politics. That crucial point sometimes gets lost in *Not Enough*, as the weight of the analysis chronicles human rights' redistributive shortcomings. Certainly, Moyn concedes the successes of human rights in bringing global scrutiny to state repression and combating the status inequality of women and other marginalised social groups, but the praise is damning in its faintness.<sup>27</sup> But while Moyn's analysis of the achievements of human rights in *Not Enough* is unduly truncated and ungenerous, he acknowledges their necessity: human rights, though not enough themselves, are a vital part of a progressive agenda.<sup>28</sup> And asking for more nuance and balance is in some sense to miss the point. *Not Enough* is not simply a history but a polemic, designed to provoke progressives into re-evaluating their political priorities in an age of inequality. In that goal, the book succeeds admirably.

### III Australian Affinities

The rest of this essay sketches some ways in which the Australian experience fits into Moyn's narrative. My focus will be on one particularly prominent domestic manifestation of human rights politics: progressive advocacy for a bill of rights. I will also focus mainly on the policies of the Australian Labor Party ('ALP'), the politically dominant institutional form of the Australian left for over a century. I argue that the ALP's commitment to a bill of rights properly began only in the 1970s, at the same time as its commitment to socialism declined, soon to be transformed into the neoliberal Labor agenda of the 1980s and after. In the decades since, an era of widening inequality underpinned by neoliberal policies, the legal imagination of progressives has often fixated on a bill of rights as the zenith of law reform, while egalitarian redistribution has slipped down the progressive agenda.

The starting point is that the ALP once cared much more about egalitarian redistribution than it does today, although in ways that remained profoundly exclusionary for many. As a social-democratic workers' party, the ALP was, from its inception in the 1890s, broadly committed to using state power for reducing economic exploitation and socioeconomic inequality — it supported a reformist, state-centred and modest socialism.<sup>29</sup> From 1921, the Party's national platform incorporated a 'socialist objective' that, extending earlier commitments, enshrined as the Party's ultimate goal '[t]he Socialisation of Industry, Production, Distribution and Exchange'.<sup>30</sup> At its foundations, the labour movement's vision of social justice was, like other political programs of the time, inextricably entangled with other forms of exploitation and inequality: in particular, the violent expropriation of lands and resources from Aboriginal peoples, the ongoing subordination of women and

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<sup>27</sup> Ibid 175, 202–6.

<sup>28</sup> Ibid xii, 10, 220.

<sup>29</sup> Graham Maddox and Tim Battin, 'Australian Labor and the Socialist Tradition' (1991) 26(2) *Australian Journal of Political Science* 181.

<sup>30</sup> Australian Labor Party, *Official Report of Proceedings of the Ninth Commonwealth Conference* (Labor Call, 1921) iii. See further L F Crisp, *The Australian Federal Labour Party 1901–1951* (Longmans, Green and Co, 1955) ch 14.

the discriminatory exclusion and regulation of non-white immigration.<sup>31</sup> Into the 20<sup>th</sup> century's second half, the labour movement pursued an egalitarianism whose primary beneficiaries were intended to be white, settler, male workers.

In the pursuit of this program, the ALP saw little place for constitutional rights enforced by the courts against the political branches. Labor generally did not diverge from the British orthodoxy on the protection of individual rights: rights received adequate protection through parliamentary sovereignty and the rule of law.<sup>32</sup> While progressive movements in Australia have often used the language of rights, until the 1970s they typically saw influence over governments and parliaments, not judicial supremacy, as the ultimate means of protecting their interests.<sup>33</sup>

Indeed, at the heart of the ALP's social and economic program for decades was a constitutional reform agenda very different from a bill of rights. Throughout much of its existence, Labor's central constitutional goal was not to impose *limits* on the political branches through judicially enforceable rights protections. Instead, the goal was to *expand* governmental power, especially at the national level, in order to manage and regulate the national economy in the name of civilising capitalism. Put differently, Labor's animating constitutional struggle was to overcome the barriers that federalism put in the way of nationwide socialist and redistributive policies.<sup>34</sup> Labor's problem was that whereas realising its program demanded the extensive use of state power, ideally at the national level, the federal *Constitution* imposed significant limits on state power, especially at the national level. By 1919, the ALP platform included a plan for constitutional amendments to give the Federal Parliament unfettered legislative power, to replace the states with Commonwealth-subordinated provinces and to abolish the Senate.<sup>35</sup> These or like platform commitments remained until the 1970s.<sup>36</sup>

Despite some dalliances with constitutional rights by Labor in the 1940s and 1950s, the Party's overriding constitutional objective remained expanding federal power in the name of a redistributive agenda.<sup>37</sup> Labor's periods in power until 1950 were marked by constitutional reform efforts, almost all unsuccessful, to extend federal power as the necessary precursor to fulfilling the Party's socialist and

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<sup>31</sup> See, eg, Symposium, 'Who Are Our Enemies? Racism and the Working Class in Australia' (1978) 35 *Labour History* xi; Edna Ryan and Anne Conlon, *Gentle Invaders: Australian Women at Work* (Penguin, 2<sup>nd</sup> ed, 1989).

<sup>32</sup> Brian Galligan, 'Australia's Rejection of a Bill of Rights' (1990) 28(3) *Journal of Commonwealth and Comparative Politics* 344, 345–8; Haig Patapan, 'Competing Visions of Liberalism: Theoretical Underpinnings of the Bill of Rights Debate in Australia' (1997) 21(2) *Melbourne University Law Review* 497, 508–11.

<sup>33</sup> See, eg, Bain Attwood and Andrew Markus (eds), *The Struggle for Aboriginal Rights: A Documentary History* (Allen & Unwin, 1999); Marilyn Lake, *Getting Equal: The History of Australian Feminism* (Allen & Unwin, 1999); James Waghorne and Stuart Macintyre, *Liberty: A History of Civil Liberties in Australia* (UNSW Press, 2011).

<sup>34</sup> Brian Galligan and David Mardiste, 'Labor's Reconciliation with Federalism' (1992) 27(1) *Australian Journal of Political Science* 71.

<sup>35</sup> Crisp, above n 30, 240–2.

<sup>36</sup> Galligan and Mardiste, above n 34, 81–3.

<sup>37</sup> Ibid 76; Galligan, above n 32, 348–50.

redistributive goals.<sup>38</sup> Typically, Labor governments sought new powers to regulate various fields of the economy, such as corporations, employment and industrial relations, trade and commerce, monopolies, and prices and rents. Labor's most substantial efforts along these lines occurred throughout the 1940s, as it sought new federal powers to pursue post-war reconstruction through centralised economic planning, an expanded Welfare State and selective nationalisation of industry.<sup>39</sup> The necessity of constitutional reform was underscored as the High Court of Australia obstructed various parts of Labor's program, primarily on federalism grounds: its pharmaceutical benefits scheme (twice); its first foray into nationalisation, in the field of interstate airlines; its effort to institute greater public controls over private banking; and its resulting attempt at bank nationalisation.<sup>40</sup>

By the 1970s, when Labor came back to power federally after 23 years in the wilderness, the Party under Gough Whitlam's leadership had adopted a 'revisionist' program that entailed a moderation or rejection of its past racial and gender chauvinism alongside a downgrading of its socialist commitments.<sup>41</sup> The ALP reversed its lifelong support for the White Australia policy, officially embraced multiculturalism, took on the cause of Aboriginal land rights and advocated equality for women.<sup>42</sup> But although the Whitlam Government belatedly introduced aspects of the Welfare State such as a universal health insurance scheme, Labor had also relaxed its grander ambitions to civilise capitalism, particularly through central planning and nationalisation.<sup>43</sup> While all of these policy changes were responses to post-war social, economic and political developments, they also reflected the changing composition and base of the ALP itself, which had moved from its working-class and trade-union foundations to become more middle class.<sup>44</sup>

The ALP's revisionist program saw the Party's constitutional priorities shift away from constitutional amendments to expand federal power and towards a bill of rights, a cause first properly embraced by the Whitlam Government. On the one hand, since Labor had begun to dilute its more expansive goals for social and economic reform, Labor had become less committed than in the past to enlarging federal power, especially through constitutional amendment.<sup>45</sup> On the other hand, a bill of rights fitted in with the agendas of new social movements seeking protection of their rights, while also reflecting Labor's reorientation towards 'reformist causes, quality-of-life issues and the concerns of Labor's increasingly "white-collar" and

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<sup>38</sup> Crisp, above n 30, ch 11.

<sup>39</sup> Ibid 252–5; Stuart Macintyre, *Australia's Boldest Experiment: War and Reconstruction in the 1940s* (NewSouth, 2015) 137–42, 254–8.

<sup>40</sup> Brian Galligan, *Politics of the High Court: A Study of the Judicial Branch of Government in Australia* (University of Queensland Press, 1987) ch 4.

<sup>41</sup> Frank Bongiorno, 'Origins of the Present Crisis? Fabianism, Intellectuals and the Making of the Whitlam Government' in Jenny Hocking and Colleen Lewis (eds), *It's Time Again: Whitlam and Modern Labor* (Circa, 2003) 311.

<sup>42</sup> See generally Jenny Hocking, *Gough Whitlam: The Biography* (Miegunyah Press, 2008–12).

<sup>43</sup> On the modesty of Whitlam's health insurance scheme, see Anne-Marie Boxall and James A Gillespie, *Making Medicare: The Politics of Universal Health Care in Australia* (UNSW Press, 2013) ch 2.

<sup>44</sup> Bongiorno, above n 41; Andrew Scott, *Fading Loyalties: The Australian Labor Party and the Working Class* (Pluto Press, 1991).

<sup>45</sup> Galligan and Mardiste, above n 34.



middle-class constituency'.<sup>46</sup> From the outset, Labor's emphasis was on protecting civil and political rights, rather than economic and social rights.

Fittingly, given the ALP's middle-class reorientation, its turn to a bill of rights was pioneered from the mid-1960s by a cadre of newly influential lawyer-politicians, most notably Whitlam and Lionel Murphy.<sup>47</sup> As Whitlam's Attorney-General, Murphy tried in 1973 to introduce an ambitious legislative bill of rights that sought to bind the parliaments and executives at both Commonwealth and state levels.<sup>48</sup> Murphy also sought to progress a constitutional bill of rights at the 1973 Constitutional Convention. Both initiatives failed due to strong conservative opposition.<sup>49</sup>

When Labor was returned to power federally in 1983, it recommenced the push for a bill of rights, while also dramatically restructuring the Australian economy along recognisably neoliberal lines.<sup>50</sup> During its 13 years in government, Labor pursued a raft of pro-market reforms in line with international trends, even as it maintained a commitment to social protection and a socially progressive agenda.<sup>51</sup> Key reforms included taming union power and suppressing wages (with union collaboration), increasing the economy's exposure to international market forces, reining in taxation and spending, and subjecting government departments and services to economic rationalism and privatisation.<sup>52</sup>

Through the 1980s, the bill-of-rights cause, no threat to Labor's neoliberal reforms, was pressed by the Hawke Government, with the initial impetus coming from another lawyer-politician and Murphy acolyte, Attorney-General Gareth Evans. Labor tried, yet again, to pass a legislated bill of rights, but the initiative was sunk in 1986 through determined conservative opposition.<sup>53</sup> By referendum held in 1988, Labor also sought to extend three existing federal constitutional guarantees to the states: trial by jury, freedom of religion and just-terms compensation for government acquisitions of property. Amidst fierce conservative criticism, the referendum was rejected by almost 70 per cent of voters.<sup>54</sup>

While Labor's resolve to institute a national bill of rights has never again matched that of the 1970s and 1980s, the bill-of-rights cause has since assumed an exalted status in the legal imagination of Australian progressives and been advanced in other ways. From the 1990s, with political efforts at establishing a bill of rights faltering, progressive lawyers and judges pursued new avenues for protecting

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<sup>46</sup> Galligan, above n 32, 353.

<sup>47</sup> Ibid 352–7.

<sup>48</sup> Human Rights Bill 1973 (Cth).

<sup>49</sup> Galligan, above n 32, 357–8.

<sup>50</sup> For the coincidence of bills of rights and neoliberalism elsewhere, see Ran Hirschl, *Towards Juristocracy: The Origins and Consequences of the New Constitutionalism* (Harvard University Press, 2004) ch 3.

<sup>51</sup> Elizabeth Humphreys, *How Labour Built Neoliberalism: Australia's Accord, the Labour Movement and the Neoliberal Project* (Brill, 2018).

<sup>52</sup> See, eg, Stephen Bell, *Ungoverning the Economy: The Political Economy of Australian Economic Policy* (Oxford University Press, 1997).

<sup>53</sup> Galligan, above n 32, 359–62.

<sup>54</sup> Ibid 363–4.

constitutional rights in the courts.<sup>55</sup> Their achievements have included the development of a jurisprudence on implied constitutional rights,<sup>56</sup> the adoption of an increasingly rights-protective orientation in the jurisprudence on judicial power,<sup>57</sup> and the development of a quasi-constitutional ‘common law bill of rights’ through a rights-protective approach to statutory interpretation.<sup>58</sup>

Outside the courts, advances in the protection of human rights have also been made through legislation. During Labor’s 11 years out of power federally from 1996, the bill-of-rights cause was taken up by two subnational Labor governments, with the Australian Capital Territory (2004)<sup>59</sup> and Victoria (2006)<sup>60</sup> enacting Australia’s first statutory bills of rights.<sup>61</sup> Queensland followed suit in 2019.<sup>62</sup> After the Rudd Labor Government was installed in 2007, it initiated a National Human Rights Consultation into legislating a national bill of rights.<sup>63</sup> Unwilling to spend its dwindling political capital on the issue, the Rudd Government resisted the Inquiry’s recommendation of a statutory bill of rights. But it did establish a new Human Rights Framework, at the centre of which was a statutory regime for parliamentary scrutiny of legislative compliance with human rights.<sup>64</sup>

And yet, as the bill-of-rights cause has cemented its place as the pinnacle of progressive legal reform in Australia, economic inequality has widened under the auspices of the neoliberal economic reforms begun by Labor in the 1980s and since consolidated and extended. From around the 1980s, the distribution of income and wealth in Australia has become more and more unequal, as it has in many other parts of the world.<sup>65</sup> Although the causes of this growing inequality are multiple, neoliberal reforms have played a pivotal role.<sup>66</sup> But while the various efforts to extend the constitutional protection of human rights over the period of neoliberal predominance have had a range of important, often praiseworthy effects, challenging material inequality has not been one of them. The most fundamental reason, as Moyn makes clear, is that challenging material inequality is simply not part of the human rights program.

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<sup>55</sup> Dan Meagher, ‘The Judicial Evolution (or Counter-Revolution) of Fundamental Rights Protection in Australia’ (2017) 42(1) *Alternative Law Journal* 9.

<sup>56</sup> George Williams and David Hume, *Human Rights under the Australian Constitution* (Oxford University Press, 2<sup>nd</sup> ed, 2013) chs 5–6.

<sup>57</sup> *Ibid* ch 9.

<sup>58</sup> James Spigelman, *Statutory Interpretation and Human Rights* (University of Queensland Press, 2008) ch 1. See further Meagher, above n 55.

<sup>59</sup> *Human Rights Act 2004* (ACT).

<sup>60</sup> *Charter of Human Rights and Responsibilities Act 2006* (Vic).

<sup>61</sup> Byrnes, Charlesworth and McKinnon, above n 1, chs 4–5.

<sup>62</sup> *Human Rights Act 2019* (Qld).

<sup>63</sup> Human Rights Consultation Committee, *Report*, National Human Rights Consultation (2009).

<sup>64</sup> Adam Fletcher, *Australia’s Human Rights Scrutiny Regime: Democratic Masterstroke or Mere Window Dressing?* (Melbourne University Press, 2018).

<sup>65</sup> Andrew Leigh, *Battlers and Billionaires: The Story of Inequality in Australia* (Redback, 2013) ch 3.

<sup>66</sup> Frank Stilwell, ‘Inequality and Neoliberal Economic “Reforms” in Australia’ in Damien Cahill and Phillip Toner (eds), *Wrong Way: How Privatisation and Economic Reform Backfired* (La Trobe University Press in conjunction with Black Inc, 2018) 257.

## IV Conclusion

From the beginning of Australian progressives' embrace of a bill of rights, lawyers of all stripes — those in politics, legal practice, judicial service and academia — have been at the vanguard, frequently seeing constitutional protections for human rights as the highpoint of progressive legal change. *Not Enough* poses a strident and necessary challenge to this legal project, and to the sanctified place that human rights occupy within progressive politics more generally. When we reflect on the history of human rights in Australia, and especially on progressive advocacy for human rights protections, we can see 'how partial our activism has become' in its disregard for egalitarian redistribution.<sup>67</sup> That partiality is something that must be rectified. As Moyn sharply concludes, 'for those activists and lawyers who have inherited the world's stock of idealism in our day, there ought to be some shame in succeeding only amid the ruins of materially egalitarian aspiration'.<sup>68</sup>

The point is not to abandon human rights, but to put human rights in their proper place: as necessary, but insufficient, for the achievement of social justice. Human rights become a problem when they crowd our vision, limit our ambitions and exhaust our energies for social transformation. For a more complete vision of social justice, we must once more make room in our imaginations and our advocacy for projects that seek to counter the blight of material inequality. For Australia's progressive lawyers, this means rethinking the privileged standing that the bill-of-rights cause possesses within our aspirations for law reform. It means understanding how law is responsible for constituting the basic distribution of economic wealth, power and opportunity. And it means imagining and advancing legal institutions that, instead of tolerating or abetting economic hierarchy, are committed to undoing it.

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<sup>67</sup> Moyn, *Not Enough*, above n 3, 10.

<sup>68</sup> *Ibid* 217.

