

## DWORKIN'S JURISPRUDENCE AND *HOSPITAL PRODUCTS*: PRINCIPLES, POLICIES AND FIDUCIARY DUTIES

ASHLEY BLACK\*

### I. INTRODUCTION

The imposition of fiduciary duties in commercial relationships raises difficult questions of equitable doctrine and of legal policy, which received the consideration of the High Court in *Hospital Products Ltd v. United States Surgical Corporation*.<sup>1</sup>

The decision in *Hospital Products* represents an archetypally "hard case": where there was no clearly established rule of law to cover the facts of the case; where there was doubt as to the application of fiduciary principles to the kind of relationship at issue, that of a distributorship established by agreement between parties dealing at arm's length and in a commercial setting; and where McLelland J. at first instance,<sup>2</sup> the New South Wales Court of Appeal<sup>3</sup> and the High Court each took different views of the law. The case is central to a developing Australian approach to the law of fiduciary duties.<sup>4</sup> The decision provides a useful test of the explanatory value of

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\*B.A., (Hons), LL.B. (Hons) (Syd.), Solicitor of the Supreme Court of New South Wales.

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- 1 (1984) 156 CLR 41, (1984) 55 ALR 417. The decision is noted by C.C. Hodgekiss, (1985) 59 *ALJ* 670; B.D. Gordon & R.B. Plimer, "The Hospital Products Case" (1985) *A Bus L Rev* 68; A. O'Connell, "Damages for cloning medical supplies" (1985) *L Inst J* 228; and is discussed at greater length in R.P. Austin, "Commerce and Equity — Fiduciary duty and Constructive trust" (1986) 6 *Ox J of Leg Studies* 444.
- 2 [1982] 2 NSWLR 766.
- 3 [1983] 2 NSWLR 157.
- 4 The recent cases which define this approach include *Chan v. Zacharia* (1983) 154 CLR 178; *Moorgate Tobacco Co. Ltd v. Philip Morris Ltd* (1984) 56 ALR 193, (1985) 59 ALJR 77; and *United Dominions Corporation Ltd v. Brian Pty Ltd* (1985) 60 ALR 741, (1985) 59 ALJR 676.

Dworkin's "Rights Thesis" in hard cases. It has the advantage that it lies outside the fields of public law, constitutional law and actions in negligence to which Dworkin most commonly refers.<sup>5</sup> In such fields policy issues are generally closer to the surface of the reasoning of the courts than in contractual and equitable matters.

The facts of the *Hospital Products* litigation need only briefly be reviewed here. The dispute arose from the conduct of Blackman and Hospital Products International ("HPI"), which had been granted the Australian distributorship for the surgical stapling instruments and disposable stapling cartridges manufactured by United States Surgical Corporation ("USSC"), for which Blackman had previously been a distributor in New York. Blackman undertook to use his best efforts to build up a market in Australia for USSC products and not to deal in other products at the expense of those of USSC, although those undertakings were not embodied in a formal written contract. It was argued that Blackman and HPI had been in breach of contract and in breach of fiduciary duty by "reverse engineering" USSC products, allowing HPI to set up in Australia initially to the exclusion of USSC, and ultimately to enter the American market in competition with USSC. USSC sought damages for breach of contract, and sought a remedy in constructive trust over the assets of Hospital Products Ltd ("HPL"), the successor to HPI.

In the Supreme Court of New South Wales, McLelland J. held that HPI's breach of fiduciary duty had been established. McLelland J. found that the contract contained an implied term that Blackman would not do anything inimical to the market for USSC products in Australia. The Court of Appeal agreed on this point. McLelland J. further held that HPI was a fiduciary to USSC in respect of the market for USSC products in Australia.<sup>6</sup> His Honour identified the breach of fiduciary duty as HPI's having secretly developed a manufacturing capacity by reverse engineering USSC's products "with a view to appropriating for itself at the expense of USSC the whole or a substantial part of the Australian market for USSC products", and in HPI's having deferred orders for USSC products so as to fill those orders with products which it had repacked or manufactured.<sup>7</sup> McLelland J., however, denied USSC a remedy in constructive trust where the property obtained by HPI was not "property the obtaining or pursuing of which was or ought to have been in all the circumstances an incident of the relevant fiduciary duty".<sup>8</sup> His

5 For an illustration in the field of public law, see Dworkin's account of the "Snail Darter Case", *Tennessee Valley Authority v. Hill* 437 US 153 (1978), discussed in R. Dworkin, *Law's Empire*, (1986) 20-23; in constitutional law, *Brown v. Board of Education of Topeka* 347 US 483 (1953), discussed *Law's Empire* 29-30; in negligence, *McLoughlin v. O'Brian* [1983] 1 AC 410, discussed *Law's Empire* 23-29; and in the area of economic loss, *Spartan Steel and Alloys Ltd v. Martin and Co.* [1973] 1 QB 27, discussed in R. Dworkin, *Taking Rights Seriously* (1981) 83-85.

6 Note 2 *supra*, 812.

7 *Ibid.* These findings were approved by the NSW Court of Appeal, note 3 *supra*, 209.

8 Note 2 *supra*, 813.

Honour allowed USSC, at its election, an account of profits as against HPI and Blackman — to be calculated over the period of HPI’s “headstart” in the Australian market<sup>9</sup> — or equitable compensation as against HPI and Blackman, or damages for breach of contract against HPI.

The New South Wales Court of Appeal confirmed the finding of McLelland J. that a breach of fiduciary duty had been established. The Court of Appeal observed that the existence of a “best efforts” obligation upon Blackman and HPI and of an obligation to carry on the distributorship “for the benefit of both parties” distinguished the dealings of USSC and HPI from the typical manufacturer-distributor relationship,<sup>10</sup> and held that the contract contained an implied term that Blackman would do nothing inimical to USSC’s market in Australia. The Court held that the entire business of HPI at the date of termination of the Australian distributorship represented a benefit gained in breach of fiduciary duty.<sup>11</sup> The Court further held that the assets and goodwill of HPL, which had acquired HPI’s assets with notice of USSC’s claim, were held on constructive trust for USSC.<sup>12</sup>

The High Court unanimously declined to find an implied term in the contract that HPI would not damage the market for USSC products in Australia.<sup>13</sup> The Court, Gibbs C.J. dissenting, found that the distributorship contract contained a “best efforts” undertaking as an express term,<sup>14</sup> while Gibbs C.J., Wilson and Dawson JJ. found an equivalent undertaking to be implied by law under section 2-306(2) of the *Uniform Commercial Code* (US).<sup>15</sup>

The majority (Gibbs C.J., Wilson, Deane, Dawson JJ.) further held that the distributorship did not impose fiduciary obligations upon HPI. Gibbs C.J., Wilson and Dawson JJ. held that USSC was restricted to relief at common law for breach of contract. Mason J. found a breach of fiduciary duty as to USSC’s product goodwill to have been established, allowing the imposition of a limited constructive trust in favour of USSC over the gains from the breach.<sup>16</sup> Deane J. would have granted equitable relief on a wider equitable principle denying the retention of benefits gained in breach of contractual, legal or equitable obligations to another, as “appropriate to the particular circumstances of the case rather than as arising from a breach of some fiduciary duty flowing from an identified fiduciary relationship”.<sup>17</sup> Both

9 *Id.*, 815.

10 Note 3 *supra*, 198.

11 *Id.*, 225-226.

12 *Id.*, 249, 258. The Court excluded from the constructive trust any assets of HPL prior to its acquisition of HPI.

13 Note 1 *supra*, 65-66 *per* Gibbs C.J., 117 *per* Wilson J., 121 *per* Deane J., 138, 141 *per* Dawson J.

14 *Id.*, 90 *per* Mason J., 117 *per* Wilson J., 120 *per* Deane J., 138 *per* Dawson J., 62 *per* Gibbs C.J.

15 *Id.*, 65 *per* Gibbs C.J., 117 *per* Wilson J., 138 *per* Dawson J.

16 *Id.*, 101. See text accompanying note 100 *infra*.

17 Note 1 *supra*, 124-125. Lehane notes that the wider equitable principles upon which his Honour relied are “bound to start more than a few hares before the principles are finally revealed”, J.R.F. Lehané, “Fiduciaries in a Commercial Context” in P.D. Finn (ed.) *Essays in Equity* (1985) 102. Some indication of the direction of his Honour’s reasoning may be found in *Chan v. Zacharia*, note 4 *supra*, 201, 204-205.

Mason and Deane JJ. would have restored the order of McLelland J. allowing USSC a constructive trust for the "headstart" period during which HPI was selling its products on the Australian market.<sup>18</sup>

## II. HARD CASES AND LEGAL THEORY: DWORKIN, HART AND LEGAL POSITIVISM

The intention here is to utilise Dworkin's account of judicial reasoning in "hard cases" as a framework for analysing the decision in *Hospital Products*, and at the same time to use the close analysis of a specific case to identify the limitations of Dworkin's account as an explanatory model. To the extent that Dworkin's theory of law describes the courts' approach in hard cases, it must be tested by application to those cases which cannot be resolved by the application of an established legal rule to the proven facts.<sup>19</sup> The "hard case" may arise from indeterminacy of the appropriate legal rule or from conflict between the applicable rules or principles. It will require the court to reach "beyond the holdings of past cases and beyond the literal import of established legal rules."<sup>20</sup> *Hospital Products* was in this sense a hard case, where the difficulty arose from an indeterminacy of the applicable rule — that in certain circumstances a fiduciary duty would arise — and in particular from an uncertainty as to the range of cases in which this rule would apply.

Dworkin's account of the legal resolution of hard cases draws upon his criticism of the "positivist" theory of law attributed to H.L.A. Hart.<sup>21</sup> In Hart's account, the duty of the judge is to apply the established rules of law wherever available. Hart allows that there will exist some cases where the law has no determined application under any established rule. Such cases are in Hart's view the result of the nature of language and of an inevitable "indeterminacy of aim" in establishing legal standards.<sup>22</sup>

Dworkin suggests that it follows from the positivist assertion that legal rights and duties are established by legal rules that, where no rule applies, there are no pre-existing rights and duties to be enforced by the court.<sup>23</sup> Hart allows that in such cases the judge has a "discretion", although that discretion must be exercised according to the generally accepted rules of the legal system, and is limited by the obligation to "deploy some acceptable general principle as a reasoned basis for decision".<sup>24</sup> For Hart, the judge in a

18 Note 1 *supra*, 112 *per* Mason J., 124 *per* Deane J.

19 N. MacCormick, "Taking the 'Rights Thesis' Seriously" in N. MacCormick, *Legal Right and Social Democracy: Essays in Legal and Political Philosophy* (1982) 131.

20 D. Lyons, "Principles, Positivism and Legal Theory" (1977) 87 *Yale LJ* 415, 427; *id.*, 141.

21 H.L.A. Hart, *The Concept of Law* (1961).

22 *Id.*, 119-120, 125; E. P. Soper, "Legal Theory and the Obligation of a Judge: The Hart/Dworkin Dispute" (1977) 75 *Mich L Rev* 473, 476.

23 Dworkin, *Taking Rights Seriously*, note 5 *supra*, 17; *Law's Empire*, note 5 *supra*, 115, 117, 129.

24 Note 21 *supra*, 200; N. MacCormick, *H.L.A. Hart* (1981) 126. Dworkin describes the elements of this model in *Law's Empire*, note 5 *supra*, 8-9.

hard case decides the case by judicially legislating a new rule or modifying an old rule, engaging in a “creative or legislative activity” in reaching a “choice between open alternatives” on whatever grounds seem to him appropriate.<sup>25</sup>

In treating the issue of judicial discretion, Dworkin identifies two weak senses of “discretion”, founded in the fact that a court’s decision may be both controversial — requiring the use of judgment rather than the application of mechanical rules — and final. For Dworkin, the judge retains a “weak” discretion, available where “no social rule unambiguously requires a particular legal decision”, and requiring the exercise of “initiative and judgment beyond the application of a settled rule”. The discretion is limited, in Dworkin’s view, since the result reached is defined by the principles underlying the rules the application of which is in issue. In each case, there exists a decision to which the parties are entitled, which is dictated by legal principles<sup>26</sup> binding the court and operating as an external standard for decision.<sup>27</sup> Dworkin refers to a third and “strong” sense of discretion, where the judge’s decision is not controlled by authoritative standards.<sup>28</sup> Dworkin interprets Hart’s theory as having the effect that in hard cases and in the absence of applicable rules the judge has a “strong discretion” in that he may reach a discretionary judgment founded in extra-legal standards.<sup>29</sup> Dworkin criticises such a view as wrongly characterising the nature and extent of judicial discretion.

Dworkin argues that there is a single correct legal result in any hard case:<sup>30</sup> in determining that result, however, the judge cannot rely on existing legal rules which *ex hypothesi* are unclear. Dworkin asserts that the absence of clear rules does not entitle the judge to rely upon a free discretion in reaching his decision.<sup>31</sup> Rather a litigant has pre-existing rights which determine that

25 Note 21 *supra*, 125, 131.

26 Dworkin *Taking Rights Seriously*, note 5 *supra*, 81, 279-290, 363; R. Dworkin, “A Reply by Ronald Dworkin” in M. Cohen (ed.) *Ronald Dworkin and Contemporary Jurisprudence* (1983) 278; B. S. Bix, “Dancing in the Dark: The Philosophical Moves of Ronald Dworkin” (1986) 23 *Harv. J. Legis* 307, 317; J.M. Steiner, “Judicial Discretion and the Concept of Law” (1976) 35 *Camb LJ* 135, 144, 147; Soper, note 22 *supra*, 473, 478-479.

27 K. Greenawalt, “Discretion and Judicial Decision: The Elusive Quest for the Fetters that Bind Judges” (1975) 75 *Colum L Rev* 359, 360, 361; “Note: Dworkin’s Rights Thesis” (1976) 74 *Mich L Rev* 1167, 1169; Soper, note 22 *supra*, 479.

28 Dworkin, *Taking Rights Seriously*, note 5 *supra*, 105-130; Bix, note 26 *supra*, 320; N. B. Reynolds, “Dworkin as Quixote” (1975) 123 *U Pa L Rev* 574, 575.

29 Sartorius develops a similar account of Hart’s theory in “Social Policy and Judicial Legislation” (1971) 8 *Am Philosophical Socy Q* 151, 152.

30 Dworkin’s claim raises issues of considerable philosophical difficulty. MacCormick rejects such a view with respect to “pure practical disagreements” between judges, which he suggests may arise in the law although the judge has considered the applicable principles and analogies, and the issues of the coherence and consistency of the law, and of formal justice: N. MacCormick, *Legal Reasoning and Legal Theory* (1978). Haakonssen argues that it is not philosophically demonstrable that no right answer exists where the legal system does not provide only a limited number of possible results available through consequentialist reasoning. This has the result that Dworkin’s argument is not logically falsifiable, rather than that it is proven: K. Haakonssen “The Limits of Reason and the Infinity of Argument” (1981) 87 *Archiv fur Rechts-und Sozialphilosophie* 491, 500.

31 W. Sadurski, *Giving Desert its Due: Social Justice and Legal Theory* (1985) 45.

correct answer and which must be respected by the court although in conflict with social goals: these rights are to be determined by the judge's identification of the applicable legal principles.

Thus on Dworkin's most recent account of his model, termed "Law as Integrity", the law "contains not only the narrow explicit content of [past] decisions but also, more broadly, the scheme of principles necessary to justify them", while

rights and responsibilities flow from past decisions and so count as legal, not just when they are explicit in these decisions but also when they follow from the principles of personal and political morality the explicit decisions presuppose by way of justification.<sup>32</sup>

On this account, the "judge who accepts integrity will think that the law it defines set out genuine rights litigants have to a decision before him".<sup>33</sup> The principles establishing the "right answer" to a case can be identified by the judge's looking to a general justifying theory of the law at a given stage in its development, to "the soundest theory of law that can be provided as a justification for the explicit substantive and institutional rules of the jurisdiction in question."<sup>34</sup> Dworkin argues that the judge ought to adopt an interpretation of the law in a particular area which meets a minimum standard of "fit" with previous decisions<sup>35</sup> and is at the same time their best justification within the judge's "political morality".<sup>36</sup> Ultimately, the judge must determine what the "background morality" of the legal system requires, by attempting to construct "the best justification [he] can find, in principles of political morality, for the structure as a whole".<sup>37</sup> The judge will therefore

decide hard cases by trying to find, in some coherent set of principles about people's rights and duties, the best constructive interpretation of the political structure and legal doctrine of their community.<sup>38</sup>

In Dworkin's model, legal principles may therefore be founded upon argument by analogy, an assessment of the coherence of competing approaches, or upon "institutional fit", looking to the institutional history of the jurisdiction.<sup>39</sup> Dworkin illustrates the development of such wider theory

32 Dworkin, *Law's Empire*, note 5 *supra*, 227, 96.

33 *Id.*, 218.

34 Dworkin, *Taking Rights Seriously*, note 5 *supra*, 66; "Note: Dworkin's Rights Thesis", note 27 *supra*, 1184; K.J. Kress, "Legal Reasoning and Coherence Theories: Dworkin's Rights Thesis, Retroactivity, and the Linear Order of Decisions" (1984) 72 *Calif L Rev* 369, 377-378.

35 Dworkin, "A Reply by Ronald Dworkin", note 26 *supra*, 271-275; R. Dworkin, "'Natural' Law Revisited" (1982) 34 *U Fla L Rev* 165, 170; Dworkin, *Law's Empire*, note 5 *supra*, 239, 255. For the application of this model to the doctrine of precedent, see text accompanying note 154, *infra*.

36 R. Dworkin, *A Matter of Principle* (1985); Dworkin, *Law's Empire*, note 5 *supra*, 255-256; Bix, note 26 *supra*, 318, 319.

37 Dworkin, "'Natural' Law Revisited", note 35 *supra*, 165; Dworkin, *Law's Empire*, note 5 *supra*, vii, 106, 152; note 31 *supra*, 45.

38 Dworkin, *Law's Empire*, note 5 *supra*, 255-256.

39 Kress, note 34 *supra*, 383. MacCormick's account, like Dworkin's, allows the judge access to a wide range of relevant considerations, in recognising that a judge may address the question of the "best" or "most desirable" outcome of his decision, given accepted social values with respect to the particular area. Subject to the difficulties of definition in Dworkin's account of "policy" noted below, MacCormick's account allows a wider role for policy reasoning in determining that "most desirable" outcome. MacCormick, note 30 *supra*; Haakonssen, note 30 *supra*, 500.

of law by the practice of his ideal judge Hercules, who will consider each case and statute relating to the case before him in determining the theory which provides the best justification for past State actions, although he recognises that in practice judges may only achieve Hercules' approach in part.<sup>40</sup>

That courts look to principles in hard cases ought not to be in doubt. However, it may be argued that — even where in hard cases no legal rule is immediately applicable — courts generally use principle indirectly, in the evaluation of legal rules which may be relevant by analogy, and in determining the scope of an existing rule or its appropriate application in a novel situation.<sup>41</sup> For Dworkin, the application of an existing rule to a novel context involves no “strong” judicial discretion,<sup>42</sup> since the extension is implicit in the principles underlying the rule in the analogous case, and such principles are binding on the court. Dworkin's argument here fails to allow that when deciding a novel or difficult case a range of lines of authority may be available to the court as potential analogies. It is only once the court has identified a particular line of authority as most closely analogous to the circumstances of the case before it, that the principles expressed within that line of authority have binding force. Arguably the process of recognising an analogy and reasoning from it in a fresh situation itself reaches beyond the principle from which the analogy begins.

### III. FIDUCIARY DUTIES IN THE MANUFACTURER-DISTRIBUTOR RELATIONSHIP

The question for the High Court in *Hospital Products* required consideration of the legal status of the manufacturer-distributor relationship, and more specifically whether such a relationship could be categorised as fiduciary in quality. For Finn, fiduciary duties are founded in particular circumstances: each fiduciary duty “itself defines the type of relationship to which it applies”, and sets “its own standard of acceptable conduct from the fiduciary to whom it applies.”<sup>43</sup> The corollary of this approach is that fiduciary duties arise not from the legal status of the parties' relationship, but from the nature of the obligations undertaken.<sup>44</sup> On this approach, the essential question for the Courts in *Hospital Products* was whether Blackman and HPI had undertaken obligations such as to attract fiduciary duties.

At first instance, McLelland J. had surveyed American case law as to the relationship between manufacturers and distributors, concluding that the

40 Dworkin, *Taking Rights Seriously*, note 5 *supra*, 239-254, 265; Bix, note 26 *supra*, 320.

41 R.S. Bell, “Understanding the Model of Rules: Toward a Reconciliation of Dworkin and Positivism” (1971-1972) 81 *Yale L J* 912, 942-943; MacCormick, note 30 *supra*, 245; Soper, note 22 *supra*, 489.

42 In the sense defined above, text accompanying note 28 *supra*.

43 P.D. Finn, *The Law of Fiduciaries* (1977) 4, 78.

44 *Id.*, 1-5.

dealings between a manufacturer and his distributor “are not of a kind from which fiduciary duties necessarily arise”, although allowing that “such relationships are capable in particular circumstances of giving rise to fiduciary duties on the part of the distributor”.<sup>45</sup>

The Court of Appeal rejected a “category” approach to the manufacturer-distributor relationship, looking rather to the features of the dealings between USSC and HPL. HPL had argued that “the characteristics of the [manufacturer-distributor] relationship are inimical to the finding that it is a fiduciary one”, since the distributor has a separate business and goodwill, since “he deals with his manufacturer at arm’s length”, and since the interest of manufacturer and distributor are opposed in areas such as setting the cost of the product to the distributor and his sale prices.<sup>46</sup>

The Court of Appeal however held that the relationship between USSC and HPI could be distinguished by the terms of the distributorship agreement from the “ordinary run of distribution agreements in which ... the distributor has great liberty to consult his own interest and to prefer them to those of his supplier”,<sup>47</sup> observing further that “there may be occasions in the most conventional of distribution agreements where the distributor’s freedom to consult his own interest encounters limitations.”<sup>48</sup> Thus, the Court noted, to argue that a distributorship of this nature could not establish a fiduciary relationship

overlooks the necessity to examine the agreement in order to ascertain precisely what its incidents were, and to do so in the light of the circumstances in which the agreement was formed and the relationship between the parties which then existed.<sup>49</sup>

The High Court looked to the extent to which the particular features of the dealings between USSC and HPI were consistent with the traditional categories of fiduciary obligation founded in the acceptance by one party of a responsibility for the welfare of another. The majority characterised the relationship between USSC and HPI as that of a distributorship entered into at arm’s length.

Counsel for USSC had argued, relying principally on American authorities, that a distributor may owe fiduciary duties to his manufacturer, qualifying the argument by allowing that “[i]t is not suggested that all distributors are fiduciaries”.<sup>50</sup> Gibbs C.J. observed that such cases were of little value as precedents on the specific facts of *Hospital Products*, since even where they held the distributor to be a “fiduciary” they did not establish “duties of the kind sought to be enforced against HPI”.<sup>51</sup> His Honour further observed that

45 Note 2 *supra*, 810.

46 Note 3 *supra*, 203.

47 *Id.*, 197, 203.

48 *Id.*, 204.

49 *Id.*, 203.

50 Note 1 *supra*, 49. The American cases on which counsel relied included *Flexitized Inc. v. National Flexitized Corp.* (1964) 335 F (2d) 774; *Distillerie Flli Ramazotti SPA v. Banfi Products Corp.* (1966) 276 NYS (2d) 413; *Sapery v. Atlantic Plastics Inc.* (1958) 258 F (2d) 793.

51 Note 1 *supra*, 75.



the nature of the relationship between Blackman and USSC was not such that conflicts of interest were necessarily to be resolved in favour of USSC. It followed, on the reasoning of Gibbs C.J., that both the “no conflict” and “no profit” rules consequent upon a fiduciary relationship could have no application.<sup>52</sup> Dawson J. similarly remarked that “[b]y its very nature a distributorship agreement does not ordinarily give rise to a relationship in which any conflict between duty and interest must be eliminated”, observing that although “the parties have the common aim of exploiting a market”, nonetheless “it is assumed that the distributor will pursue his own economic interest”.<sup>53</sup>

Mason J. described the characteristic elements of a distributorship agreement as including the distributor’s right “to make decisions in its own interests, subject to such restrictions on its power to do so as may be imposed by the contract”. His Honour observed that a distributorship was not normally carried on as a “joint venture” and for the “common benefit” of the parties, and concluded that HPI’s status as exclusive distributor did not “provide a basis for finding that HPI promised to carry on its business for and on behalf of the parties jointly or for their common benefit”.<sup>54</sup> Mason J. found that, absent “the suggested promise to carry on the business for the common benefit of the parties” and “the implied term that HPI would do nothing inimical to USSC’s interests” on which the Court of Appeal had relied, HPI could not be held a fiduciary to USSC in a comprehensive sense, since its ability to act in some matters in its own interests was “inconsistent with the existence of a general fiduciary relationship”.<sup>55</sup>

Deane J. concluded that “[t]he relationship between a manufacturer and a distributor is not, in itself, ordinarily a fiduciary one even in a case where the distributor enjoys sole rights of distribution in a particular area”.<sup>56</sup> His Honour however qualified his conclusion to allow that a restricted fiduciary duty may arise with respect to particular matters within the scope of a distributorship, observing that

the continuing relationship of manufacturer and distributor might well provide a context in which it would be easier to imply an undertaking by one party to act as a fiduciary in relation to a particular matter than would be the case if that relationship did not exist.<sup>57</sup>

It is noteworthy that Deane J. adopted closely analogous reasoning in *Moorgate Tobacco Co. Ltd v. Philip Morris Ltd*,<sup>58</sup> decided a little less than a month after *Hospital Products*. His Honour there observed that a licensing agreement — although in a commercial setting — might give rise to fiduciary

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52 *Id.*, 143.

53 *Id.*, 143, 144.

54 *Id.*, 93, 94.

55 *Id.*, 97, 98.

56 *Id.*, 122.

57 *Id.*, 123.

58 Note 4 *supra*, 207. See M. Blakeney, “The Demise of Unfair Competition in Australia: *Moorgate Tobacco Co. Ltd v. Philip Morris Ltd and Another (No 2)*” (1985) 59 *ALJ* 366, 369.

obligations, but found on the facts that no such obligations had arisen. His Honour again remarked that a "continuing relationship between the parties under the agreements" would make it more likely that an undertaking by one party to act on behalf of the other might arise.

It might be argued that the High Court's reasoning is in practical effect indistinguishable from a category approach to the identification of a fiduciary relationship, having the result that the relationship between manufacturer and distributor is of its nature not fiduciary. The better view, it is submitted, is that the majority's reasoning merely recognises that in commercial circumstances the dealings of manufacturer and distributor typically lack the obligation to pursue the common interest of the parties which might render a relationship fiduciary. As a generalisation as to fact, this is unexceptionable, and is consistent with Lehane's observation that in most cases commercial relationships "do not, as a matter of fact, satisfy the criteria ... which lead courts to characterise a relationship between private parties as fiduciary", where each party acts and is accepted as acting in its own interest.<sup>59</sup> So limited a holding may be difficult, however, to reconcile with the breadth of their Honours' observations as to the nature of commercial relationships and the inappropriateness of equity for their regulation, which will be considered below.

If, by contrast, the majority's reasoning forecloses the possibility of *any* manufacturer-distributor relationship giving rise to fiduciary obligations as a matter of law, then it is of doubtful consistency with a commitment to determining the existence of fiduciary duties upon the circumstances of the case, and in consequence of the incidents of a relationship.

#### IV. PRINCIPLES AND THE RIGHT ANSWER: THE FIDUCIARY PRINCIPLE

For Dworkin, then, judicial decisions in "hard cases" must be based on the relevant legal principles. In distinguishing his account from that of Hart, Dworkin identifies the different application of "rules" and "principles". In Dworkin's account a legal "rule" is either valid and applicable to a particular situation, in which case it determines the legal result, or it is wholly inapplicable, and only one rule may govern a particular situation.<sup>60</sup> By contrast, Dworkin argues that both principles and policies have a "dimension of weight":<sup>61</sup> they do not determine a particular result, and two competing principles having different weights may both apply to the one situation.<sup>62</sup> Dworkin suggests that the positivist must deny principles the status of legal

<sup>59</sup> Lehane, note 17 *supra*, 104.

<sup>60</sup> Dworkin, *Taking Rights Seriously*, note 5 *supra*, 24.

<sup>61</sup> *Id.*, 26.

<sup>62</sup> *Ibid.*; Kress, note 34 *supra*, 376; J. Stone, "From Principles to Principles" (1981) 97 *Law Q Rev* 224, 231; Soper, note 22 *supra*, 478; Greenawalt, note 27 *supra*, 360.

rules since they are too indeterminate to be validated by the rule of recognition, being subject to “the persuasive force of various sorts of precedent, the relation of all these to contemporary moral practices, and hosts of other such standards.”<sup>63</sup> Dworkin criticises positivism as overemphasising rules at the expense of principles arguing that a principle is legally relevant to the extent that it is “one which officials must take into account ... as a consideration inclining in one direction or another”.<sup>64</sup>

Dworkin accepts that there may be situations where two recognised principles are each in their terms applicable to a case, and have directly opposite legal results. For Dworkin, this raises no substantial difficulty since the balancing of the weight of the competing principles, in the context of the facts and looking to the relative desirability of application of the competing principles,<sup>65</sup> will define the correct result. It may be argued that in reaching this assessment the courts often look to the “policy” consequences – in the lawyer’s sense of policy, although not in Dworkin’s – of giving a principle predominant weight.

The judgments in *Hospital Products* arguably turn upon the weight of two competing principles:<sup>66</sup> on the one hand, equity’s commitment to holding the fiduciary to his undertaking to act in the interests of his beneficiary, and on the other hand the principle – formulated in its widest terms under the rubric “freedom of contract” – that the parties to a contract ought to be able to define and limit their obligations in their dealings with each other by the terms of their contract. Unger formulates this dichotomy in terms of competing social attitudes, pointing to an oscillation in contract law between “an ideal of strict altruism in a confined range of situations and a tolerance for unrestrained self-interest in the great majority of contracts”, while observing that “[t]he higher standard of solidarity – the one that gives primacy to the other party’s interests – is necessarily exceptional.”<sup>67</sup>

The fiduciary relationship demands a substantially higher standard of care for the interests of the beneficiary, of “altruism” in Unger’s terms, than does a non-fiduciary commercial dealing. The equitable principles of fiduciary obligation and the contractual principle of the parties’ ability to define their mutual obligations and of the need for commercial certainty may thus be treated as competing principles.

On the one hand, then, it is a fundamental equitable principle, founded in notions of good conscience, and expressed in the doctrine of the “fiduciary”

63 Dworkin, *Taking Rights Seriously*, note 5 *supra*, 40; note 20 *supra*, 424.

64 Dworkin, *Taking Rights Seriously*, note 5 *supra*, 26, 283.

65 MacCormick, note 30 *supra*, 169, 173.

66 Dworkin distinguishes “competing” from “contradictory” principles, observing that where principles compete, “[t]here is no incoherence in recognizing both as principles”. He argues that in such competition, coherence “require[s] some nonarbitrary scheme of priority or weighting or accommodation between the two, a scheme that reflects their respective sources in a deeper level of political morality”: Dworkin, *Law’s Empire*, note 5 *supra*, 269.

67 R.M. Unger, “The Critical Legal Studies Movement” (1983) 96 *Harv L Rev* 561, 641.

relationship, that a person who has the power to affect the interests of another<sup>68</sup> and who has undertaken "to act in the interest of another person" ought to be held to that undertaking.<sup>69</sup> Arguably, the vulnerability of the beneficiary provides the common element in recognised fiduciary relationships, where the fiduciary has a better opportunity to take advantage of his beneficiary than within arm's length dealings.<sup>70</sup> As Shepherd recognises, the vulnerability of the beneficiary need not predate the creation of a fiduciary relationship, but may itself result from that relationship.<sup>71</sup> The fiduciary principle has, at least in part, a "prophylactic" operation, seeking to prevent fiduciaries taking advantage of the vulnerability of their beneficiaries, and at the same time operating to support a relatively high standard of proper conduct in fiduciary dealings.<sup>72</sup>

Such a principle in its various forms echoes through the judgments in *Hospital Products*. The High Court recognised that the definition of the fiduciary relationship was a matter of difficulty, and depended upon the purpose for which such definition was required.<sup>73</sup> The judgments refer to the fiduciary's undertaking "to act in relation to a particular matter in the interests of another",<sup>74</sup> to the "representative" status consequent upon such undertaking<sup>75</sup> and the beneficiary's expectation that the fiduciary will act in accordance with that undertaking,<sup>76</sup> and to the entrusting of the fiduciary "with the power to affect those interests in a legal or practical sense".<sup>77</sup>

At first instance McLelland J. referred to the vulnerability of "those whose interests are entrusted to the power of another, to abuse of that power" as justifying a "special protective rule" in equity. His Honour's reasoning in this respect is consistent with that of the High Court.<sup>78</sup> The Court of Appeal emphasised that "[i]t is that undertaking and the consequential relegation of [the fiduciary's] interest to [the beneficiary's] which creates the trust or

68 The power to affect the interests of another is not in itself sufficient to establish a fiduciary relationship: J.C. Shepherd, *The Law of Fiduciaries* (1981) 87; Austin, note 1 *supra*, 4.

69 A. Scott, "The Fiduciary Principle" (1949) 37 *Calif L Rev* 539, 540; L.S. Sealy, "Some Principles of Fiduciary Obligations" [1963] *Camb L J* 119, 122. The significance of an "undertaking to act for or on behalf of another in some particular matter or matters" finds support in Finn, note 43 *supra*, 201. Finn's formulation was, however, qualified by Gibbs C.J. in *Hospital Products*, note 1 *supra*, 71-72.

70 R.P. Austin, "Fiduciary Accountability for Business Opportunities" in P.D. Finn (ed.) *Equity and Commercial Relationships* (1987), 141, 178. E.J. Weinrib, "The Fiduciary Obligation" (1975) 25 *U Toronto L J* 1, 5; note 1 *supra*, 97 *per* Mason J.

71 J.C. Shepherd, "Towards a Unified Concept of Fiduciary Relationships" (1981) 97 *Law Q Rev* 51, 69.

72 *Bray v. Ford* [1896] AC 44, 51-52 *per* Lord Herschell; *Meinhard v. Salmon* (1928) 229 N.Y. SUPP (2d) 345, 464 *per* Cardozo J.; Austin, note 70 *supra*, 177, 179; Weinrib, note 70 *supra*, 3, 6.

73 Note 1 *supra*, 69 *per* Gibbs C.J.; 96 *per* Mason J., 141-142 *per* Dawson J.; Austin, note 1 *supra*, 4-5.

74 Note 2 *supra*, 810 *per* McLelland J.; note 3 *supra*, 205, 208 (Court of Appeal).

75 Note 3 *supra*, 208 (Court of Appeal); note 1 *supra*, 454 *per* Mason J.

76 Note 3 *supra*, 207-208 (Court of Appeal).

77 Note 2 *supra*, 810 *per* McLelland J.; note 3 *supra*, 207-208 (Court of Appeal).

78 Note 2 *supra*, 811 *per* McLelland J.; note 1 *supra*, 68-69, 72 *per* Gibbs C.J.; 97 *per* Mason J.; 142, *per* Dawson J.

confidence which marks the fiduciary relationship”.<sup>79</sup> While in the High Court Mason J. emphasised the fiduciary’s undertaking and the beneficiary’s vulnerability as the common elements in fiduciary relationships:

The critical feature of these relationships is that the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power of discretion which will affect the interests of that other person in a legal or practical sense. The relationship between the parties is therefore one which gives the fiduciary a special opportunity to exercise the power or discretion to the detriment of that other person who is accordingly vulnerable to abuse by the fiduciary of his position.<sup>80</sup>

The Court of Appeal further allowed that a fiduciary relationship might exist although the fiduciary is entitled to look to his own interest in particular matters. In the High Court, Mason J. similarly held that the entitlement of a party to act in his own interests in some respects did not necessarily exclude a fiduciary relationship, where superimposed upon a general obligation to act in the interests of another.<sup>81</sup>

## V. FREEDOM OF CONTRACT

The competing principle addressed in the judgments in *Hospital Products* is, at its widest, the basic principle of the law of contract that “contractual obligations are by definition self-imposed”,<sup>82</sup> and that in consequence the parties to a contract ought to be able to restrict their obligations by the terms of their agreement.<sup>83</sup> Expressions of such a principle have not been lacking in the cases.<sup>84</sup> It followed that, at least in circumstances of relative equality of bargaining power — and paradigmatically between parties of commercial experience dealing at arm’s length, who are taken to have the ability to protect their own interests — the court’s role was simply to give effect to the parties’ common intention, as defined by their agreement.<sup>85</sup> This competing principle seems to have informed the argument of Counsel in the High Court that fiduciary principles had no application where a party had the means to protect himself by other means, as within “an arm’s length commercial transaction between experienced businessmen.”<sup>86</sup>

Clearly, contractual and fiduciary relationships are not mutually exclusive. In *Chan v. Zacharia* Deane J. pointed out that contractual and fiduciary

79 Note 3 *supra*, 207.

80 Note 1 *supra*, 96-97.

81 *Id.*, 99.

82 A.W.B. Simpson, “Innovation in Nineteenth Century Contract Law” (1975) 91 *Law Q Rev* 247; D. Kennedy, “Form and Substance in Private Law Adjudication” (1976) 89 *Harv L Rev* 1685, 1728.

83 W. Friedmann, *Law in a Changing Society*, (1972) 123.

84 *Printing & Numerical Registering Co. v. Sampson* (1875) LR 19 Eq 462, 465 *per* Sir George Jessel M.R.; *Stockloser v. Johnson* [1954] 1 QB 476; *Esso Petroleum Co. v. Harper’s Garage (Stourport) Pty Ltd* [1967] 1 All ER 699, 712 *per* Lord Morris; G.H.L. Fridman, “Freedom of Contract” (1967) 2 *Ottawa L Rev* 1, 9.

85 A.E.S. Tay & E. Kamenka, “New legal areas, new legal attitudes” in A.E.S. Tay & E. Kamenka (eds), *Law-making in Australia*, (1980) 252.

86 Note 1 *supra*, 48.

obligations may coexist within a partnership.<sup>87</sup> McLelland J. at first instance in *Hospital Products* observed that contractual obligations and fiduciary duties have different conceptual origins, the former depending upon the assent of the parties and the latter reflecting “circumstances in which equity will regard conduct of a particular kind as unconscionable and consequently attracting equitable remedies”.<sup>88</sup> Mason J. similarly recognised that contractual obligations and fiduciary duties may coexist although insisting that the fiduciary duty must accommodate itself to the “terms of the contract so that it is consistent with, and conforms to, them”.<sup>89</sup>

The more difficult question for the Court in *Hospital Products* was whether a contractual relationship within a commercial setting gave rise to the vulnerability of the beneficiary which might found a fiduciary duty. The majority in the High Court (Gibbs C.J., Wilson, Dawson JJ.) — each of whom relied upon the characterisation of the dealings of HPI and USSC as “at arm’s length”, and emphasised the contractual basis of those dealings — apparently gave the greater weight to the principle that in commercial transactions the contract ought to determine the mutual obligations of the parties, and placed a correspondingly lesser weight upon the fiduciary principle in such circumstances.<sup>90</sup> Lehané characterises the majority’s reasoning as denying fiduciary duties within relationships of a commercial character, and criticises such approach as inconsistent with the reasoning of previous decisions implicitly allowing that fiduciary duties *might* have existed in commercial settings although holding that on the facts they had not been established.<sup>91</sup>

Gibbs C.J. recognised vulnerability as an essential element within the fiduciary relationship. His Honour emphasised that, although HPI had the ability to affect USSC’s interest, it had been open to USSC to protect its position by the terms of the distributorship contract.<sup>92</sup> Dawson J. similarly

87 Note 4 *supra*, 196.

88 Note 2 *supra*, 799.

89 Note 1 *supra*, 97. The view of Mason J. that fiduciary obligations must be defined by the terms of the contract might be contrasted with Shepherd’s observation that in many cases “the whole point of the fiduciary doctrine is its ability to override clearly unfair contractual obligations”: Shepherd, note 68 *supra*, 68-69. To the extent that Shepherd’s comments are directed to situations where a stronger fiduciary in an unequal relationship seeks by contract “to reduce or remove the fiduciary obligation”, then his reasoning is not necessarily inconsistent with respecting the terms of the contract in dealings between parties of relatively equal bargaining power.

90 Some of the issues addressed in this section have been considered in a condensed form by the writer in “Joint Ventures, Partnerships and Fiduciary Duties: *United Dominions Corporation Ltd v. Brian Pty Ltd*” (1986) 15 *MULR* 708.

91 Note 17 *supra*, 104. Lehané refers to *Amalgamated Television Services Pty Ltd v. Television Corporation Ltd* [1969] 2 *NSWLR* 257 and *Walden Properties Ltd v. Beaver Properties Pty Ltd* [1973] 2 *NSWLR* 815, observing that on the reasoning of the majority in *Hospital Products* “in each case the decision should simply have been that the relationship was not fiduciary because it was commercial”. It might be noted that in *Amalgamated Television Services*, Walsh J.A., with whom Wallace P. agreed, recognised the commercial quality of the relationship but looked primarily to the question of the appropriate form of remedy in interlocutory proceedings (263-264). Jacobs J.A., dissenting, must have assumed that fiduciary obligations might exist within a commercial relationship (265).

92 Note 1 *supra*, 72.

remarked that “[t]he circumstances in which the contract between USSC and Blackman were made do not suggest any disadvantage or vulnerability on the part of USSC requiring the intervention of equity to protect its interests”. His Honour noted that the “negotiations were of a commercial nature and at arm’s length” and “were conducted by persons on both sides who were experienced in the market place”, and that if USSC ultimately found itself vulnerable it was as a result of its own choice in failing to reach a formal agreement with Blackman.<sup>93</sup>

Gibbs C.J. observed, more generally, that

the fact that the arrangement between the parties was of a purely commercial kind and that they had dealt at arm’s length and on an equal footing has consistently been regarded by this Court as important, if not decisive, in indicating that no fiduciary duty arose.<sup>94</sup>

Wilson J. indicated a reluctance to allow the cutting back of contractual principle by “the extension of equitable principles into the domain of commercial relationships” where the parties are dealing at arm’s length and there is no evidence of undue influence.<sup>95</sup> Dawson J. emphasised the “undesirability of extending fiduciary duties to commercial relationships and the anomaly of imposing those duties where the parties are at arm’s length from one another”.<sup>96</sup> The cogency of the majority’s reasoning here depends, of course, upon their rejection of the Court of Appeal’s finding that the implied terms of the contract between USSC and HPI gave the distributorship special features which would have questioned the “arm’s length” characterisation.

The emphasis in the majority judgments upon the concept of an “arm’s length” dealing is striking. The attraction of such a characterisation likely arises from its close association with the principle of freedom of contract. It is less clear that such a characterisation is of analytical value. As Austin observes, such a characterisation restates rather than justifies the finding that no fiduciary duty lies, since to describe parties as being “at arm’s length” is to assert the absence of a “special relationship”.<sup>97</sup>

By contrast with the majority, Mason J. was not prepared to accept that the characterisation of a relationship as commercial was itself sufficient to exclude fiduciary obligations, suggesting that

it is altogether too simplistic, if not superficial, to suggest that commercial transactions stand outside the fiduciary regime as though in some way commercial transactions do not lend themselves to the creation of a relationship in which one person comes under an obligation to act in the interests of another.<sup>98</sup>

His Honour observed that “every such transaction must be examined on its merits with a view to ascertaining whether it manifests the characteristics

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93 *Id.*, 146-147; Gordon & Plimer, note 1 *supra* 76.

94 *Id.*, 70.

95 *Id.*, 118.

96 *Id.*, 149.

97 Austin, note 1 *supra*, 454.

98 Note 1 *supra*, 100.

of a fiduciary relationship”<sup>99</sup>, and held that in the circumstances of the dealings between HPI and USSC a limited fiduciary obligation arose as to USSC’s “product goodwill” in the Australian market.<sup>100</sup> The effect of this reasoning is to avoid the conflict of principles which led the majority to adopt a contractual approach to the obligations of the parties rather than an approach upon fiduciary principles.

It may seem, then, that in *Hospital Products* the High Court’s use of principle was essentially as a basis for explicating and defining the scope of legal rules determining the circumstances in which a fiduciary obligation will arise.

## VI. THE DWORKIN THESIS AND THE NATURE OF POLICY

Dworkin’s “Rights Thesis” is problematical in the assertion that the courts ought to take into account arguments of principle rather than arguments of policy. Dworkin argues that litigants have a right to decisions based on principles rather than on policy, the former addressing pre-existing individual rights and the latter an assessment of the social good.<sup>101</sup> For Dworkin, arguments as to principle are characteristic of judicial decision-making, while arguments of policy are the concern of the legislature.<sup>102</sup> It is the exclusion here rather than the inclusion which is the source of difficulty. At its strongest — as will be seen, the effect of Dworkin’s definitional strategy is to make the proposition much less radical than it may seem — the argument is that courts ought not to consider which result in “hard cases” would bring about more desirable social consequences, since the judicial role is to apply existing legal standards rather than to create new standards felt to be socially beneficial.

Dworkin’s rejection of policy reasoning depends primarily upon his account of “rights”, which he argues define a liberty allowed to individuals and which have a “threshold weight” which cannot be overbalanced by general community goals. In Dworkin’s account, the judicial obligation to address arguments of principle is the necessary consequence of the proposition that judicial decisions recognise rather than create the rights of the parties:

if the decision in a hard case must be a decision about the rights of the parties, then an official’s reason for that judgment must be the sort of reason that justifies recognizing or denying a right.<sup>103</sup>

<sup>99</sup> *Id.*, 100-101.

<sup>100</sup> The finding of a fiduciary duty attached to USSC’s product goodwill was rejected by the other members of the Court: *id.*, 70-71 *per* Gibbs C.J. concluding that “[t]he contract did not oblige HPI to protect USSC’s goodwill nor were representations made that it would be protected”, and pointing to HPI and USSC both having the right to terminate the agreement; 124 *per* Deane J. rejecting such duty on the ground that “[p]rovided it did not act in breach of the terms of the contract, HPI was ... entitled to exploit that local goodwill for its own benefit”; 144-145 *per* Dawson J.

<sup>101</sup> Dworkin, “‘Natural Law’ Revisited”, note 35 *supra*, 165; Dworkin’s *Law’s Empire*, note 5 *supra*, 244.

<sup>102</sup> Dworkin, *Taking Rights Seriously*, note 5 *supra*, 82-86, 90-94; Kress, note 34 *supra*, 386.

<sup>103</sup> Dworkin, *Taking Rights Seriously*, note 5 *supra*, 104.



Dworkin points to the retrospective effect of judicial decisions, which he argues renders it unfair to the losing party that a decision depend upon newly-made law. As Greenawalt observes, the latter argument is valid only if, as Dworkin argues, the litigant's right exists independently of the court's decision.<sup>104</sup>

Dworkin emphasises the limited public accountability of the judiciary, suggesting that the compromise between competing claims of policy ought be achieved through "the operation of some political process designed to produce an accurate expression of the different interests that should be taken into account".<sup>105</sup> Such an argument is weaker in areas where the law is previously judge-made law, and in areas where the legislature is inactive.<sup>106</sup>

Dworkin argues, moreover, that judges must decide with "articulate consistency", deciding on general grounds, while he argues that decisions in policy do not require such consistency. For judges to reason on policy grounds is to breach this requirement.<sup>107</sup> It might be suggested that the doctrine of precedent has the effect that a decision relying on policy grounds — if treated by subsequent decisions as of binding authority as to its reasoning — may give rise to a line of decisions which is no less capable of consistency than a line of decisions originating with a case decided on reasoning as to principle.<sup>108</sup> On this argument, the consideration of policy in judicial decisions is not inconsistent with stability in the subsequent development of the law. This does not, however, deny Dworkin's primary objection to a policy decision, that the litigant in the first case in the line was denied a decision founded in principle and therefore consistent with individual "rights".

Only if Dworkin can adequately differentiate arguments in principle and arguments in policy<sup>109</sup> is the normative argument that judges should appeal to arguments of principle rather than of policy sustainable. Dworkin suggests that arguments of principle "justify a political decision by showing that the decision respects or secures some individual or group right."<sup>110</sup> Dworkin however defines arguments of principle to include at least some kinds of statements of social goals, asserting that "consequentialist" arguments are arguments in principle — even where they look to the social or economic

104 K. Greenawalt, "Policy, Rights and Judicial Decision" (1977) 11 *Ga L Rev* 991, 1005.

105 Dworkin, *Taking Rights Seriously*, note 5 *supra*, 88. For the recognition that the fact that courts are not elected in England or Australia is a constraint upon decisions on policy grounds, see also Mr Justice R.W. Fox, "The Judicial Contribution" in note 85 *supra*, 170.

106 Note 104 *supra*, 1005. On legislative inactivity, Fox, note 105 *supra*, 170-171.

107 Dworkin, *Taking Rights Seriously*, note 5 *supra*, 88.

108 Note 104 *supra*, 1008.

109 Dworkin maintains the distinction in "A Reply by Ronald Dworkin", note 26 *supra*, 263-268 and Dworkin, *Law's Empire*, note 5 *supra*, 221.

110 Dworkin, *Taking Rights Seriously*, note 5 *supra*, 82, 88, 295; MacCormick, note 30 *supra*, 230.

consequences of a legal rule — to the extent that they address a question of rights.<sup>111</sup>

By contrast, for Dworkin, arguments of policy “justify a political decision by showing the decision advances or protects some collective goal of the community as a whole.”<sup>112</sup> Dworkin here adopts legislative decisions as the basis of his model of policy, and indeed draws most of his examples (such as that of legislative subsidies) from that field. It might be suggested that this approach fails to recognise that there is a substantial distinction between policy in the sense considered by the legislature and the policy of the law, as expressed in the case law and its justifying reasoning.<sup>113</sup>

Dworkin's account of the distinction between arguments in principle and arguments in policy is, in the writer's view, substantially flawed. Firstly, it may be argued that when lawyers and judges distinguish arguments of principle and arguments of policy, the distinction to which they refer is that of whether the argument is consequentialist in nature. Dworkin's inclusion of “consequentialist” arguments within the category of arguments of principle arguably renders the category of arguments of “principle” so wide and the category of arguments of “policy” so narrow as to render the distinction between the two vacuous.<sup>114</sup> If “principle” is defined so widely as to include the large part of what the law has traditionally thought of as “policy”, whether social policy or the policy of the law, then Dworkin has effectively limited out of existence the category of policy arguments to be rejected, and his injunction to reason by principle rather than by policy is rendered both uncontroversial and ultimately unnecessary.<sup>115</sup>

The legitimacy of Dworkin's contrast between arguments of “principle” and arguments of “policy” goes to the logical structure of his model, and cannot be tested by applying the model to particular cases. In the writer's view, the difficulties noted above are so substantial that they render Dworkin's concept of “policy” reasoning of little value in the analysis of judicial reasoning in particular cases. Most, more likely all, of the arguments in *Hospital Products* which would in legal usage be regarded as arguments of “policy” would be categorised by Dworkin as arguments of “principle”, in that they addressed the rights of the litigants. The “policy” category would, by definitional *fiat*, have been denied content.

In analysing the use of “policy” reasoning in *Hospital Products*, we shall therefore identify “policy” arguments as arguments which are

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111 Dworkin, *Taking Rights Seriously*, note 5 *supra*, 294, 295 and especially 297, where Dworkin argues that “[i]f an argument is intended to answer the question whether or not some party has a right to a political act or decision, then the argument is an argument of principle, even though the argument is thoroughly consequentialist in its detail.”

112 *Id.*, 82.

113 Lyons, note 2 *supra*, 430.

114 “Note: Dworkin's Rights Thesis”, note 27 *supra*, 1181.

115 Note 104 *supra*, 1002.

consequentialist in nature.<sup>116</sup> On this approach, an argument of policy is one which suggests that a rule would have valuable social effects, which “shows that to decide the case in *this* way will tend to secure a desirable state of affairs”.<sup>117</sup>

## VII. POLICY REASONING IN *HOSPITAL PRODUCTS*: OF MARKETS AND COMMERCIAL CERTAINTY

The majority’s reasoning in *Hospital Products* is consistent with considerations of social and economic policy which underlie the historical reluctance of the courts to apply fiduciary concepts to commercial settings. It has traditionally been thought that the strict obligations consequent upon the fiduciary status would restrict the ability of commercial parties to serve their own interests. It followed that as a matter of policy, given the social values of economic efficiency and the free operation of commerce, such duties ought not be too readily imposed.<sup>118</sup> Where the majority’s approach is characteristic of that of Anglo-Australian courts is in its leaving such policy factors largely unarticulated. This approach contrasts with that of the American courts, to which Dworkin generally refers, where the policy basis of a decision is likely to be expressed in “instrumentalist” reasoning in the judgment itself.

The majority’s reasoning may find some support in the identification of the function of contract in commercial settings, albeit that such support operates at a high level of abstraction. The function of contract in such circumstances may be identified, following Weber, with the support of private market decisions and the facilitation of market transactions.<sup>119</sup> Contract operates to allow commercial parties a basis for planning, and to provide security for such planning by allowing determinate remedies for breach.<sup>120</sup> The function of sustaining market operation is said to require certainty within contractual dealings and predictability of decision within contractual disputes.<sup>121</sup> The existence of determinate rules in contract law, expressed in specific terms and allowing little discretion to the decision-maker, is said to allow the parties to anticipate the effects of contract law in setting the terms of their dealings and

116 MacCormick, note 30 *supra*, 311; Dworkin, “A Reply by Ronald Dworkin”, note 26 *supra*, 267-268, where Dworkin argues that his critics “have taken too narrow a view of what an argument of principle can be, because they have not been careful to distinguish between an argument of policy and a consequentialist argument.”

117 MacCormick, *id.*, 263.

118 Weinrib, note 70 *supra*.

119 D.M. Trubek, “Max Weber on Law and the Rise of Capitalism” (1972) *Wis L Rev* 720, 744-745; K.A. Strasser, “Contract’s ‘Many Futures’ after *Death*; Unanswered Questions of Scope and Purpose” (1981) 32 *S C L Rev* 501, 531.

120 J.M. Feinman, “Critical Approaches to Contract Law” (1983) 30 *UCLA L Rev* 829, 848-849.

121 Kennedy, note 82 *supra*, 1704; R.B. Ferguson, “Commercial Expectations and the Guarantees of the Law: Sales Transaction in mid-19th Century England” in G.R. Rubin & D. Sugarman (eds), *Law, Economy and Society, 1750-1914: Essays in the History of English Law* (1984) 194; Trubek, note 119 *supra*, 740, 743.

in settling disputes, and to allow a rational assessment and allocation of market risks.<sup>122</sup>

On this view, limited interventions in contract may be justified by failings in the bargaining process or in order to advance fundamental social policies, but such interventions must be restricted if the goal of market support is to be achieved.<sup>123</sup> To the extent that contracts between commercial parties dealing at arm's length involve an allocation of risk,<sup>124</sup> then arguably the imposition of fiduciary duties allowing equitable remedies disturbs that allocation of risk. The failing of this argument is, however, that the risks allocated by a contractual relationship are essentially market risks. The economic justification for respecting such an allocation is its function in shifting the risk of a future possibility to a party better able to bear the risk in commercial terms.<sup>125</sup> Even where an allocation of the risk of non-performance is reached between the parties, such allocation will typically not extend to the risk of fraudulent conduct by one party.<sup>126</sup>

There is a strong argument that the imposition of fiduciary duties in contractual dealings is economically efficient, by making it unnecessary for individual contracting parties to insert specific terms defining the obligations of good faith owed between the parties and providing for the consequences of breach of such obligations. On this argument, the application of fiduciary doctrine to commercial dealings reduces the transactional costs of contracting.<sup>127</sup> It might be replied that the control of fraud in contractual performance is possible through contractual remedies, which do not disturb but rather confirm the contractual allocation of risk.

The availability of contractual remedies, and particularly damages for breach of contract, was given considerable emphasis in the reasoning of the majority in *Hospital Products*, and was seen as denying the need for equitable remedies. Gibbs C.J. observed that

122 S. Macaulay, "Private Legislation and the Duty to Read — Business Run by IBM Machine, the Law of Contracts and Credit Cards" (1966) 19 *Vand L Rev* 1051, 1057-1058.

123 For this argument applied to unconscionability in contract law by an exponent of the Chicago model of "law and economics", R.A. Epstein, "Unconscionability. A Critical Reappraisal" (1975) *J L & Econ* 293, 297.

124 P.S. Atiyah, "Judicial Techniques and the English Law of Contract" (1968) 2 *Ottawa L Rev* 337, 337-338; P.S. Atiyah, "Contracts, Promises and the Law of Obligations" (1978) 94 *Law Q Rev* 193, 217.

125 Atiyah, "Contracts, Promises and the Law of Obligations", *id.*, 217.

126 "Law and economics" theory has generally treated fraud in contractual dealings as economically inefficient: R.A. Posner, *Economic Analysis of Law*, (2nd ed. 1977); A.T. Kronman & R.A. Posner (eds), *The Economics of Contract Law*, (1977); A.T. Kronman, "Contract Law and Distributive Justice" (1980) 89 *Yale L J* 472, 490 as to fraudulent misrepresentation.

127 V. Brudney & R.C. Clark, "A New Look at Corporate Opportunities" (1981) 94 *Harv L Rev* 997, 999; Austin, note 70 *supra*, 163. One has the uneasy feeling that the economic efficiency of fiduciary principles is largely irrelevant to the essentially moral concerns which provided the historical basis of the doctrine.

[w]hat is attempted in this case is to visit a fraudulent course of conduct and a gross breach of contract with equitable sanctions. It is not necessary to do so in order to vindicate commercial morality, for the ordinary remedies for damages for fraud and breach of contract were available to USSC although it did not choose to pursue the former ...<sup>128</sup>

It might be thought that his Honour's point is weakened by the lack of evaluation of the effectiveness or commercial efficacy of contractual as against equitable remedies. The availability of common law damages may not exclude the desirability of equitable remedies if — as USSC's legal advisers clearly believed — the latter are particularly effective in a commercial setting. The particular benefit of the constructive trust as a proprietary remedy is obvious where the defendant is close to insolvency — as in *Hospital Products* — so that any award of damages will likely be unsatisfied in part, ranking behind any secured creditors of the defendant.<sup>129</sup> It might further be suggested that the purpose of “vindicat[ing] commercial morality” sits more comfortably with equity's acting upon the conscience of the guilty party rather than with concepts of contractual breach.

The reasoning of the majority addresses a narrower assertion of the “need for commercial certainty”. Counsel argued that to extend the concept of the fiduciary duty into a contractual setting “erodes the value of the contract and leads to an undesirable level of uncertainty in commercial transactions.”<sup>130</sup> The denial by Dawson J. of fiduciary obligations upon HPI emphasised both upon the commercial context of the dealings and the perceived threat of equitable doctrine to commercial certainty:

[t]o invoke the equitable remedies sought in this case would, in my view, be to distort the doctrine and weaken the principle upon which those remedies are based. It would be to introduce confusion and uncertainty into the commercial dealings of those who occupy an equal bargaining position in place of the clear obligations which the law now imposes upon them.<sup>131</sup>

These observations recall similar remarks in *Hewett v. Court*, where Dawson and Wilson JJ. observed that to allow an equitable lien in favour of particular creditors of a company “would be destructive of that certainty which is the basis of sound commercial practice.”<sup>132</sup> Both Dawson and Wilson JJ. find the reluctance to import equitable doctrines into commercial dealings to be illustrated by the earlier decision of *New Zealand & Australian Land Co. v. Watson*, where Bramwell J. warned against the introduction into commercial transactions of “the various intricacies and doctrines connected with trusts”.<sup>133</sup>

128 Note 1 *supra*, 73-74.

129 The effect of the imposition of a constructive trust upon priorities of creditors will require further consideration below.

130 Note 1 *supra*, 48.

131 *Id.*, 149. To similar effect, 119 *per* Wilson J.

132 (1983) 149 CLR 639, 659 *per* Wilson, Dawson JJ.; M. Christie, “The Equitable Lien in a Commercial Context: Some Recent Australian Developments” (1986) *A Bus L Rev* 435, 437, 440.

133 (1881) 7 QBD 374, 382.

The characterisation of a dealing as “commercial” or as “at arm’s length” is of limited value in addressing the competing consequentialist arguments. We have referred above to the “prophylactic” justification of fiduciary principles.<sup>134</sup> It is arguable that such justification is no less applicable to commercial dealings, as a means of encouraging higher standards of commercial morality and on the assumption that a certain amount of trust in business will promote economic efficiency and encourage commercial interchange.<sup>135</sup> It is at least possible, as Weinrib suggests, that fiduciary principles might operate in a commercial context as a means of “fostering incentive by protecting the entrepreneur’s business apparatus”, of maintaining “the integrity of commercial organizations” and of the operation of the marketplace and “preserving an ordered framework for commercial activity”.<sup>136</sup> There are difficulties in balancing a commitment to preserving integrity within commercial dealings against the encouragement of profit-making in a market.<sup>137</sup> Such difficulties are not sufficiently recognised by the characterisation of a relationship as “commercial” or as at “arm’s length”.

By contrast with the reasoning of the majority, Mason J. explicitly addressed issues of policy, although the policy to which he refers would seem to be the policy of the law. His Honour pointed to a change in the nature of commerce over time, and to the value of imposing fiduciary obligations in complex commercial transactions in order to allow equitable remedies to the aggrieved party. His Honour seems to have accepted that a relationship might be characterised as fiduciary in order to allow the imposition of a constructive trust:

[t]he disadvantages of introducing equitable doctrine into the field of commerce, which may be less formidable than they were, now that the techniques of commerce are far more sophisticated, must be balanced against the need in appropriate cases to do justice by making available relief in specie through the constructive trust, the fiduciary relationship being the means to that end.<sup>138</sup>

His Honour therefore rejects the majority’s view that commerce is an inappropriate setting for equitable remedies, concluding that “[i]f, in order to make relief in specie available in appropriate cases it is necessary to allow equitable doctrine to penetrate commercial transactions, then so be it.”<sup>139</sup>

Mason J. supports that conclusion by recognising that any intrusion of equity may be limited by precisely defining the range of availability of the constructive trust as a remedy.<sup>140</sup> His Honour’s approach, supporting the use

134 See text accompanying note 72.

135 Note 71 *supra*, 57.

136 Weinrib, note 70 *supra*, 11, 15; Note 71 *supra*, 56-57; Shepherd, note 68 *supra*, 78-79.

137 Weinrib, *id.*, 18; note 71 *supra*, 58.

138 Note 1 *supra*, 100.

139 *Ibid.*

140 *Ibid.*

of the constructive trust in defined circumstances, may be compared with Gareth Jones' argument that "a proprietary claim should be available only if the court considers it appropriate that the plaintiff should be allowed the additional benefits (for example, to obtain priority over the fiduciary's general creditors or to recover not merely the property itself but also its fruits) which flow from it".<sup>141</sup> Both approaches limit the availability of the constructive trust. They are however inconsistent to the extent that Mason J. contemplates defining the range of situations where the constructive trust will be available, whereas Jones appears to prefer a case-by-case assessment of whether the remedy ought to be allowed in the circumstances.

We adopted here a usage which identifies "policy" arguments as consequentialist arguments, addressing the effects of a particular decision. That concept of "policy" is not Dworkin's, for whom the consequentialist arguments to which we have referred would be arguments of "principle" to the extent that they addressed the rights of the parties. The usage we adopted may be justified both as the most common legal usage, and as allowing the best access to the arguments of "policy" in a particular case. On that usage, analysis of the High Court's treatment of policy arguments in *Hospital Products* suggests that those arguments were right-conferring. This recognition involves no fundamental threat to Dworkin's account in its normative aspect, since Dworkin could simply treat such policy reasoning as misdirected, leading the court toward the error of creating new rights rather than "finding" existing rights.

To the extent that Dworkin's thesis has a descriptive aspect,<sup>142</sup> however, it is questioned when it appears that the High Court looked in *Hospital Products* to "policy" as well as to principle in order to determine whether a party had the rights it claimed. Dworkin's response would be, perhaps, to deny that his thesis can be tested using a definition of arguments of "policy" other than his own. That response is of doubtful force if the identification of policy and consequentialist reasoning is indeed the characteristic legal usage, and would fail to address the substantive issue of the patterns of use of consequentialist reasoning in legal argument in particular cases.

### VIII. THIRD PARTIES AND CONSTRUCTIVE TRUSTS

Consequentialist reasoning may further impact upon judicial decisions where the court addresses the consequences of granting a particular form of remedy for the parties to the litigation, or for third parties whose interests will

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141 G. Jones, "Unjust Enrichment and the Fiduciary's Duty of Loyalty" (1968) 84 *Law Q Rev* 472, 498.

142 The descriptive aspect of Dworkin's thesis is emphasised in Dworkin, "Seven Critics" (1977) 11 *Ga L Rev* 1201, 1223-1224, where he argues that his account offers "a better characterization of what we all know judges do, better because it would enable us to see that many familiar problems of political and conceptual jurisprudence are caused not by the facts of adjudication, but by our own misleading ways of describing these facts."

be affected by the decision. In the case of parties not represented before the court, the consideration of such consequences will generally not be explicit, although the relevant issues may be recognised both by counsel and by the court. The significance of the court's awareness of such consequences will generally be difficult to determine. It could hardly be said, however, that consideration of the impact of a particular form of remedy upon parties affected — and not only upon parties before the court — is irrelevant to the exercise of judicial discretion in shaping equitable remedies.

The High Court's recognition in *Hospital Products* of the impact upon third parties of its decision is a factor of potentially considerable significance. Several loans had been made to HPL for the development of its business, and in particular in relation to the development of its manufacturing capacity. In September 1981 credit and advances had been made available to HPL by Broadlands International Finance Limited ("Broadlands") under a floating charge; in April 1982 funds were lent to HPL by Pittsburgh National Bank under a deed of equitable mortgage; further monies were made available by American Hospital Supplies Corporation (the distributor of HPL's products in the United States) ("AHS") in February and May 1983, secured by a fixed charge over HPL's knowhow, information and technology. The charge taken by AHS was, under the terms of the Deed of Charge, expressly made subject to any claim established by USSC, while by a Deed of Priorities executed in February 1983 Broadlands had consented to its charge ranking after that of AHS.<sup>143</sup>

The third parties whose interests would be affected by the result of the litigation and more particularly by the form of remedy granted had been refused leave to intervene by the Court of Appeal, having sought such leave after the Court's reasons for judgment had been published but prior to its making final orders. AHS and Broadlands had relied in their applications to intervene upon their having an interest in the proceedings resulting from their charges over the property of HPL. The Court of Appeal denied the application on the grounds that AHS and Broadlands had failed to apply to be joined earlier in the proceedings, and that since AHS and Broadlands had not been parties to the proceedings they were not bound by orders made in relation to HPL.<sup>144</sup> The practical force of the latter ground is limited, since their Honours also observed that it would not be open to HPL to assert the interests of third party creditors to avoid the effect of orders made against it.<sup>145</sup>

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143 This information is drawn from the unreported judgment of the New South Wales Court of Appeal in *American Hospital Supply Corporation v. United States Surgical Corporation; Broadlands International Finance Limited v. United States Surgical Corporation*, No. 345 of 1982, delivered 8 August 1983; and the unreported judgment of Kearney J. in *Struthers v. Nicholl & Chant*, Supreme Court of New South Wales, No. 4287 of 1985; *American Hospital Supply Corporation v. Hospital Products Limited (Receivers & Managers Appointed)*, Supreme Court of New South Wales, No. 4316 of 1985.

144 *American Hospital Supply Corporation v. United States Surgical Corporation*, *id.*, 4.

145 *Id.*, at 4-5.



USSC had sought the imposition of a constructive trust over all of the assets of HPL, except those of HPL prior to the reverse take-over in July 1981 by which it acquired the assets of HPI, on the ground that HPL had acquired the business of HPI with notice of HPI's breach of fiduciary duty. The authors of *Jacobs' Law of Trusts* observe that where a constructive trust is imposed over a business undertaking, "a question arises concerning third parties who have dealt innocently with the defendants while the business was being established in breach of duty."<sup>146</sup>

The imposition of a constructive trust in favour of USSC over the business of HPL would have vitally affected the ability of lenders to recover upon the loans made. The traditional view is that imposition of a constructive trust gives the beneficiary an equitable proprietary interest in the property subject to the trust, allowing priority over general creditors in the event of receivership.<sup>147</sup>

Where the lenders to HPL had taken security in the form of a floating charge or equitable mortgage over assets of HPL, the imposition of a constructive trust arising from events prior to the granting of the securities would prima facie allow the constructive trustee a higher priority than the secured creditors, since the constructive trust would rank as the equitable interest first in time.<sup>148</sup> This result would follow even in the absence of the express acknowledgement of USSC's claims contained in AHS's Deed of Charge, noted above. The prejudice to the creditors would not be avoided by their having made advances to HPL in good faith.

The view that the constructive trustee has priority over secured creditors depends upon the assumption that the trust arises at the moment of the breach of fiduciary duty. The question of priority would be of lesser significance were Australian courts to adopt the view of the constructive trust as essentially a remedial device, and to assume that the trust arose on the court's decree.<sup>149</sup> There is a strong argument, however, that even on a remedial analysis the constructive trust should be taken to arise when the obligation of restitution arises, on breach of fiduciary duty, rather than when the ultimate order of the court is made.<sup>150</sup>

In the context of the *Hospital Products* litigation, the postponing of the interests of secured creditors to a constructive trust imposed for the benefit

146 R.P. Meagher & W.M.C. Gummow, *Jacobs' Law of Trusts in Australia*, (5th ed. 1986) 305.

147 A.J. Oakley, *Constructive Trusts*, (1978) 4; D.W.M. Waters, *Law of Trusts in Canada*, (2nd ed. 1984) 395.

148 *Heid v. Reliance Finance Corporation Pty Ltd* (1983) 49 ALR 229, 232 per Gibbs C.J.; 237, per Mason, Deane JJ.

149 Note 146 *supra*, 305. There is some recent English and Australian authority supporting a view of the constructive trust as a remedial device: *English v. Dedham Vale Properties Ltd* [1978] 1 All ER 382, 398 per Slade J.; *Hospital Products*, note 1 *supra*, 100 per Mason J., 125; per Deane J. The issue was expressly left open in the Court of Appeal, note 3 *supra*, 247.

150 A.W. Scott, *The Law of Trusts*, (3rd ed. 1967) 3420; *Chase Manhattan Bank NA v. British Israel Bank (London) Ltd* [1981] Ch 105.

of USSC may have appeared particularly unfortunate, given that USSC's failure adequately to protect its interests by contract contributed to subsequent events. The better view may be that in circumstances such as those in *Hospital Products*, the merits are unequal and the equity first in time ought not prevail.<sup>151</sup>

Arguably — admittedly the suggestion is somewhat speculative — the interests of third parties provide a basis for the generalised policy considerations addressed in *Hospital Products*, allowing specific content to the reasoning of the majority in the High Court as to the commercial inconvenience of equitable remedies. The generality of the majority's reasoning may result in part from the fact that the third parties were not before the Court.

The effect on secured creditors of imposing a constructive trust may well have reinforced the reluctance of the majority in the High Court to allow equitable remedies in a commercial setting. It is submitted that the better approach to protecting, so far as is possible, the interests of innocent third parties is not to deny equitable proprietary remedies, but rather to mould the remedy granted in the light of the circumstances. In the court's exercise of its discretion in granting an equitable remedy, it might require the beneficiary of a constructive trust to make allowances for the rights of innocent third parties. Such a requirement is hardly unreasonable in circumstances where the monies made available by lenders have been used to develop the business upon which the constructive trust is imposed.<sup>152</sup>

## IX. THE FUNCTION OF PRECEDENT

The use of principle to evaluate and clarify legal rules is typically undertaken in conjunction with the consideration of precedent in Anglo-Australian law. Dworkin provides a subtle account of the operation of precedent, and it is in this area that his theory arguably best accounts for the complexity of judicial reasoning.

For Dworkin, judicial decisions give effect to "rights" by treating like cases alike, applying to a later case the considerations that justified the decision in an earlier case. It follows that considerable weight is to be given to precedent, even when an earlier decision is not precisely on point.<sup>153</sup> Dworkin's wider model of the "best fit"<sup>154</sup> in legal reasoning has particular value when the

151 *Latec Investments Ltd v. Hotel Terrigal Pty Ltd (in liq.)* (1965) 113 CLR 265, 276; note 148 *supra*, 232 *per* Gibbs C.J., 239 *per* Mason, Deane JJ.; note 146 *supra*, 305. This argument involves an extension of the concept of postponing conduct. Although Mason, Deane JJ. in note 148 *supra*, 239 support "a more general and flexible principle that preference should be given to what is the better equity in an examination of the relevant circumstances", it is doubtful that the conduct of USSC was such that it was "reasonably foreseeable that a later equitable interest [would] be created and that the holder of that later interest [would] assume the non-existence of the earlier interest."

152 Note 146 *supra*, 305.

153 Dworkin, *Taking Rights Seriously*, note 5 *supra*, 113, 115.

154 Dworkin, "How Law is Like Literature" in *A Matter of Principle*, (1985) 158-162.

court, in addressing potentially applicable precedents, has to reconcile cases of competing weight from within the jurisdiction, and from other jurisdictions the decisions of which have persuasive force. Dworkin argues, as noted above, that the judge will look in each case to those principles which provide the best explanation and justification of the already settled case law, adequately explaining the majority of decisions in that area of law.<sup>155</sup> Further, Dworkin's account of the "gravitational" force of previous cases usefully describes the persuasive force of such decisions outside their original context, suggesting that "the enactment force of a precedent requires later judges to follow the rules or principles laid down in an earlier case", while "the gravitational force tugs on later cases that are plainly beyond the language of any such rule or principle".<sup>156</sup>

The appeal to precedent is evidenced within *Hospital Products* at a number of levels. We referred above to Gibbs C.J. having considered and distinguished American authorities as to the relationship between manufacturer and distributor.<sup>157</sup> While such authorities applied directly to the type of relationship at issue, his Honour found that they did not address the existence of the particular duties on which USSC sought to rely.

At a higher level of generality, the majority referred to a number of previous decisions of the High Court as indicating a reluctance to import fiduciary obligations into commercial relationships. Gibbs C.J. referred to *Jones v. Bouffier*,<sup>158</sup> which held that a contract for the sale of land was specifically enforceable although the purchaser had not disclosed an agreement for resale to a third party, the majority having found that no agency relationship existed between vendor and purchaser. Griffith C.J. there emphasised that the parties were dealing "at arm's length and on an equal footing", while Barton J. pointed to the absence of a fiduciary relationship.<sup>159</sup> Gibbs C.J. further cited *Dowsett v. Reid*,<sup>160</sup> where the defendant in an action for specific performance of an agreement for the lease of agricultural land, stock and a hotel claimed rescission on the ground that the plaintiff had been his agent and in breach of fiduciary duty in entering the agreement. Griffith C.J. there held that an agency relationship had not been established on the facts, and emphasised the equality of the parties' knowledge of the property and the fact that "they were dealing at arm's length."<sup>161</sup> Gibbs C.J. also referred to *Parra Wirra Gold & Bismuth Mining Syndicate NL v. Mather*,<sup>162</sup> where Rich, Dixon and McTiernan JJ. had

155 *Ibid*; Dworkin, *Taking Rights Seriously*, note 5 *supra*, 283; Dworkin, "A Reply by Ronald Dworkin", note 26 *supra*, 272; Kress, note 34 *supra*, 392; Bix, note 26 *supra*, 317-318.

156 Dworkin, *Taking Rights Seriously*, note 5 *supra*, 318.

157 See text accompanying notes 50-51.

158 (1911) 12 CLR 579, cited *Hospital Products*, note 1 *supra*, 70.

159 *Id.*, 599 *per* Griffith C.J., 605 *per* Barton J.

160 (1912) 15 CLR 695, cited *Hospital Products*, note 1 *supra*, 70.

161 *Id.*, 702, 705.

162 (1934) 51 CLR 582, cited *Hospital Products*, note 1 *supra*, 70.

allowed specific performance of a contract for the sale of mineral claims, again referring to the absence of a fiduciary relationship between vendor and purchaser and to the sale being “between parties at arm’s length.”<sup>163</sup> None of these decisions were directly analogous to the facts in *Hospital Products*, and indeed Gibbs C.J. undertook no analysis of their respective fact situations. Rather, the cases were used to warrant a generalised statement of principle as to the inconsistency of fiduciary duties and “arm’s length” relationships.

Two decisions to which the Court referred appear to bear a closer resemblance on their facts to *Hospital Products*, both involving dealings between commercial entities. Gibbs C.J. and Wilson J. referred to the decision of the High Court in *Keith Henry & Co. Pty Ltd v. Stuart Walker & Co. Pty Ltd*,<sup>164</sup> where the plaintiff had claimed that an import quota, granted to the defendant on the basis of his having imported goods under the plaintiff’s previous quota, was held in trust for the plaintiff. The Court rejected that claim where no fiduciary relationship existed between the parties and where “business men — or business firms — were engaged in ordinary commercial transactions with each other, dealing with each other, as the saying goes, at arm’s length.”<sup>165</sup>

The most closely analogous decision, on its facts, was *Jirna Ltd v. Mister Donut of Canada Ltd*,<sup>166</sup> decided by the Ontario Court of Appeal, and cited by Gibbs C.J. in *Hospital Products*.<sup>167</sup> That case arose from a contractual arrangement, established by negotiations between persons of business experience seeking to protect their own interests, although involving a franchise rather than a distribution agreement. Again, Gibbs C.J. relied not on the facts of the precedent case but upon the principles for which it stood: that the courts ought “give full effect and recognition to the express intention of the terms of the agreement made between parties on equal footing and at arm’s length”, possibly excepting “circumstances where there is a real disparity amounting to a serious inability on the part of one of the parties to effectively negotiate and so protect his interest.”<sup>168</sup>

It therefore seems that, in a hard case where no previous decisions appeared directly in point, the High Court relied upon precedent largely to establish and elaborate legal principles. In so far as such reasoning placed little emphasis upon the facts of the previous decisions, and allowed the application of principles established by those decisions to the manufacturer-distributor relationship at issue in *Hospital Products*, then it is consistent with Dworkin’s account of the “gravitational force” of precedent.

163 *Id.*, 592.

164 (1958) 100 CLR 342, cited *Hospital Products*, note 1 *supra*, 70 *per* Gibbs C.J., 119 *per* Wilson J.

165 *Id.*, 351 *per* Dixon C.J., McTiernan, Fullagar JJ.

166 (1972) 22 DLR (3d) 639, affirmed Supreme Court of Canada (1974) 40 DLR (3d) 303.

167 Note 1 *supra*, 70.

168 Note 166, 645 *supra*, *per* Brooke J.A. (delivering the judgment of the Court) quoted with approval in the Supreme Court, note 166 *supra*, 305 *per* Martland J.

Dworkin, however, restricts the legitimate force of precedent to the basis in principle rather than in policy of previous decisions, on the ground that fairness requires consistency only as to principle. Dworkin thus asserts that “if an earlier decision were taken to be entirely justified by some argument of policy, it would have no gravitational force.”<sup>169</sup> In the reference to previous decisions in *Hospital Products*, it seems that the Court made no such express distinction of principle and policy in the reasoning of those decisions. Moreover, the reliance by Dawson and Wilson JJ. upon *New Zealand & Australian Land Co. v. Watson* as to the appropriate scope of equitable remedies, noted above,<sup>170</sup> involves a direct appeal to precedent on an issue of the policy of the law.

On this approach to precedent, judges are likely to be influenced by any policies operative beneath the surface of a previous decision, while the appeal to precedent will allow the policy reasoning of an earlier decision to influence a later decision although the later decision itself makes no express reference to policy arguments.<sup>171</sup>

## X. CONCLUSION

Dworkin’s “Rights Thesis” has some value in the analysis of particular “hard cases”. The arguments in principle to which Dworkin refers are central to judicial reasoning in such cases, although even in “hard cases” arguments in principle seem to be used by the court to define the scope of legal rules having potential application or to elect between them.

At the level of principle, the majority’s reasoning in *Hospital Products* may best be understood as reflecting the competing principles of equity’s commitment to holding the fiduciary in conscience to his undertaking to act in the interests of another, on the one hand, and on the other the principle of the parties’ freedom to define their obligations by the terms of their contract and thereby protect their own interests. The latter principle has its greatest force in dealings at arm’s length between parties of commercial experience, and is typically associated with a recognition of a need for certainty in commercial dealings. For Mason and Deane JJ., taking the view that fiduciary duties were not inconsistent with a commercial setting, the conflict of equitable and contractual principles did not arise.

It is submitted that the better approach is to leave open the possibility that, even within a commercial relationship, where either party has the ability to affect the interests of the other and where there exists an express or implied undertaking to act in the interests of the other, then “a fiduciary undertaking

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169 Dworkin, *Taking Rights Seriously*, note 5 *supra*, 113; Lyons, note 20 *supra*, 429-430.

170 See text accompanying note 133.

171 MacCormick, note 30 *supra*, 186.

will be inferred from factors which create a position of vulnerability and make it appropriate to insist that conflicts of interest be avoided."<sup>172</sup>

Dworkin's account of policy proved substantially less useful, since his definition shifts those arguments which would in legal usage be regarded as arguments of 'policy' to the category of arguments of 'principle'. The difficulty here is in the logical structure of Dworkin's theory. This difficulty suggests that the more widely accepted legal usage identifying 'policy' and 'consequentialist' arguments ought to be adopted in the discussion of particular cases. On the basis of that usage it seems clear that in *Hospital Products* consequentialist arguments were treated by the court as right-conferring, or at least as relevant to establishing the existence of the rights claimed by the parties.

In *Hospital Products* — which would seem in this respect characteristic of the High Court — policy reasoning was largely directed to the policy of the law, although wider issues of policy were arguably present in the majority judgment to the extent that the traditional reluctance to apply fiduciary concepts in a commercial setting reflected perceived social policy justifications for allowing freedom of commercial transactions. Mason J. however referred directly to policy justifications for the imposition of fiduciary duties to allow equitable remedies in commercial transactions. The Court may well have been influenced by the unarticulated awareness that third party creditors not before the Court would be substantially prejudiced by the grant of a remedy in constructive trust to USSC.

The decision in *Hospital Products* illustrates the complexity of the judicial approach to hard cases, which MacCormick observes typically involve the "complex interplay between considerations of principle, consequentialist arguments, and disputable points of interpretation of established valid rules".<sup>173</sup> In resolving a hard case such as *Hospital Products*, the Court was not unrestrained by previous authority, but neither did such authority fully determine the result to be reached. Rather, the fresh situation was approached by reasoning formed by the application of the principles which the Court saw as underlying existing legal rules,<sup>174</sup> and by further reference to 'consequentialist' considerations, including the value of the market and the needs of commercial certainty.

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172 Austin, note 1 *supra*, 446.

173 MacCormick, note 30 *supra*, 156.

174 Bell, note 41 *supra*, 927.