

STRANGER LIABILITY: A QUESTION OF CONSCIENCE PROPERTY OR STANDARDS?

by

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PART ONE

Introduction

Trustees have some onerous duties. Their principle duty is to discharge themselves by accounting to their beneficiaries for the trust property. That duty or a duty akin to it should not be imposed lightly on any persons other than an express trustee, unless those persons' actions in relation to the trust property are such that they ought to attract such a duty. Furthermore, before equity imposes a liability on persons other than an express trustee (referred to as strangers to the trust) for participating in a breach of trust or breach of fiduciary duty there should be a clear reason for so doing. Is it because of:

1. the unconscionable behaviour of the stranger in relation to the property; or
2. the stranger's fault in not realising that the dealing with the property constitutes a breach of trust or fiduciary duty or that any assistance rendered enables a breach to be committed;
or
3. the stranger's notice in respect of the breach; or
4. the stranger's unjust enrichment by receipt of property,

or for more than one of these reasons? Judges and academics cannot agree on the underlying basis for the obligations imposed on strangers for receipt of property received in breach of trust or in breach of fiduciary duties or for the rendering of assistance in such breaches.¹ It is then no small wonder that with the offering of different paths, the law in relation to constructive trust liability for strangers to trusts is in disarray. This paper outlines briefly what the writer perceives to be the **current direction of the law** in relation to the liability of a stranger who participates in some way in a breach of trust or fiduciary duty. The purpose of the paper is twofold:

1. to "capture" in one place and examine the varying concepts that both the academics² and courts use to explain why equity imposes a liability on strangers for participatory breach; and
2. to examine the consequences of preferring one concept over another.

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1 One need go no further than the introductions to the respective theses of Dr Paul Finn and Professor Peter Birks, both of which are referred to later in this paper.

2 It is not possible to discuss any category of "constructive trusts" without acknowledging and referring to these views. The academic writings are ahead of the cases in trying to find a basis for liability and it is false to refer to these writings these days as "secondary sources". There are many cases reported where writings have been relied on by the Courts as opposed to cases. In *Sorochan v. Sorochan* [1986] 5 WWR 289 at 290, articles and texts dealing with the constructive trust were cited in the authorities considered by the Court along with the then major works on restitution. See also *Rawluk v. Rawluk* (1990) 65 DLR (4th) 161 at 184-185 per McLachlin J. In Australia see the judgment of Dean J in *Muschinski v. Dodds* (1986) 160 CLR 583 at 612-613 which relied on texts when discussing the nature of the constructive trust.

It is never far from mind that the equitable liability imposed is one allocated to the emerging "law" of constructive trusts. The major submission which this paper makes is that **if proprietary considerations prevail** as the basis for treating strangers differently in respect of knowing receipt of property than for knowing assistance, then the currently accepted categories for liability as set out in Part Three of this paper should be redefined in the manner suggested by Charles Harpum³ as:

1. beneficial receipt; and
2. all others which include knowing assistance and inconsistent dealing with trust property after acquiring notice of the breach of trust or fiduciary duty. Liability in this category is generally accepted to rest on the concept of a want of probity or dishonesty.

This paper is not an analysis of agency liability⁴ nor does it seek to restate the ground or re-examine old cases so well covered by others.⁵ My focus in this paper is on the general principles.

PART TWO

The Nature of the Liability for Participatory Breach

When liability is imposed on strangers for participatory breach, liability is described as being imposed by way of constructive trust or, alternatively, the stranger is held liable as constructive trustee. Professor Malcolm Cope says that the terms "constructive trust" and "constructive trustee" are distinct in that the first term denotes proprietary relief and does not necessarily give rise to a personal liability whereas the latter denotes a personal liability only.⁶ Others do not make this distinction in the nature of the "constructive trust" liability imposed but simply refer to the liability imposed as one arising in equity. For example, Ungood-Thomas J in *Selangor United Rubber Estates Ltd v. Cradock (No. 3)*⁷ said that the constructive trust:

"is nothing more than a formula for equitable relief. The court of equity says that the defendant shall be liable in equity, as though he were a trustee."⁸

and Austin considers that the subject matter of the liability of those who receive and are involved in breaches of trust or fiduciary duties is not one of constructive trusts "but is rather an area of substantive liability from which personal and proprietary remedies, including the constructive trust, may flow".⁹ The range of remedies that can be awarded against a stranger on establishment of liability has been summarised by Rickett as follows:

1. With knowing receipt, since receipt of property is what is in issue, the remedies range from declaring a constructive trust, granting a lien, or allowing a tracing claim where the property has changed its nature, all these being equitable proprietary remedies, to the granting of a personal remedy to account as constructive trustee; and
2. The primary remedy in a knowing assistance case is a liability to account.

In both categories the Court can also award compensatory damages.¹⁰ When one looks at the remedies normally imposed for participatory breach, ie, a personal account and compensatory damages, it is clear that the **character of the trustee**¹¹ is **constructively imposed** upon the

3 Charles Harpum 'The Stranger as Constructive Trustee', 102 LQR 114.

4 Their position supports the above submission. For the special position see RP Austin 'Constructive Trusts' in Finn (ed.) *Essays in Equity* 1985 at 228-229.

5 *Ibid.* See also Malcolm Cope *Constructive Trusts* Sydney The Law Book Company 1992 and Harpum *supra* n.3.

6 *Ibid* at 385-389.

7 [1968] 1 WLR 1555.

8 *Ibid* at 1582.

9 Austin, *supra* n.4 at 200.

10 CEF Rickett 'Strangers as Constructive Trustees in New Zealand', [1991] OJLS 598 at 607-608.

11 This term was used by Lord Selborne in *Barnes v. Addy* (1874) 9 Ch App 244 at 252.

stranger and in this respect the concept of the “constructive trust” loses any proprietary connotations. Where though a stranger has control of another’s property in the “receipt” category, there is an important sense where the trust is imposed in a proprietary sense with identifiable trust property.¹²

An examination of the nature of the constructive trust is outside the scope of this paper.¹³ However, it can be said that the continuing debate as to whether the nature of the constructive trust is institutional or remedial and the dual remedial role, **proprietary and personal**, does contribute to the diverging approaches to the explanation of liability for participatory breach.

PART THREE

Barnes v. Addy and “the Categories”

Nearly all treatments of stranger liability start with reference to *Barnes v. Addy*.¹⁴ It is an important starting point as the law on stranger liability has developed in such a manner that the real message of that case has often been “glossed” over. Charles Harpum says that in *Barnes v. Addy*, the Court wanted to restrict the circumstances in which an agent would be held liable as a constructive trustee and that *dealing* with the property is not the foundation of the complaint unless the agent becomes “chargeable with” the property.¹⁵ *Barnes v. Addy* concerned the estate of a testator, who, by his will had appointed three trustees. Two of these died and the third, Addy, wished to retire. There was provision in the will for appointment of new trustees but none for a decrease in the number. Addy instructed his solicitor to prepare an instrument appointing Barnes, the husband of one of the beneficiaries, sole trustee. Even though his solicitor advised him against taking a course where there would only be one trustee the solicitor prepared the necessary instrument and it was executed by Addy and Barnes. After Addy retired from the trust Barnes misappropriated the trust funds and went bankrupt. Addy had clearly breached his trust duties.¹⁶ The question that the Court was concerned with was whether the respective solicitors for Messrs Barnes and Addy, as their agents, could be made personally liable to the beneficiaries for the consequences of Barnes’s breach of trust. This was despite the fact that both solicitors strenuously advised their clients against the transaction. The alleged assistance arose from the solicitors’ separate roles in:

1. advising, perusing and preparing the instrument appointing Barnes as trustee; and
2. the subsequent introduction of Barnes by Addy’s solicitor to a broker for the sole purpose of selling some trust assets to meet previously incurred legal costs.

¹² CEF Rickett ‘Banks as “Stranger Constructive Trustees”: Two High Court Decisions’ [1992] NZLJ 366 at 369.

¹³ The argument here is whether the constructive trust arises as a substantive right by force of law independently of any court order, so that on the establishment of certain criteria the constructive trust will be imposed by a court or whether the function of the court rather than merely declaratory is not to recognise a pre-existing proprietary right but rather to impose a trust in certain circumstances provided a right to have a proprietary remedy can be established. See Roy Goode, in Burrows (ed.) *Property and Unjust Enrichment* Oxford Clarendon Press 1991. There are some academics who question the value in pursuing the analysis, most notably Peter Birks *Restitution - The Future* Sydney The Federation Press 1992 at 117. See also Peter Birks *An Introduction to the Law of Restitution* Oxford Clarendon Press 1989 at 89-90 who considers for the most part that constructive trusts are opaque and confusing. Compare George E. Palmer *The Law of Restitution* Vol. 1 Boston Little Brown and Co 1978 at 16 “The constructive trust idea stirs the judicial imagination in ways that *assumpsit*, *quantum meruit* and other terms associated with quasi-contract have never quite succeeded in duplicating” quoted in *Stephenson Nominees Pty Ltd v. Official Receiver on Behalf of Official Trustee in Bankruptcy: Ex parte Roberts and Another* (“*Re Stephenson Nominees*”) (1987) 76 ALR 485 at 503-504 per Gummow J.

¹⁴ (1874) 9 Ch App 244.

¹⁵ Harpum *supra* n.3 at 146-147. See also Cope *supra* n.5 at 345-346.

¹⁶ (1874) 9 Ch App 244 at 252 per Lord Selborne.

Lord Selborne considered that liability should only be extended to the solicitors as strangers to the trust if:

1. they are found making themselves trustees *de son tort*, or actually participating in any fraudulent conduct of the trustee to the injury of the *cestui que trust*; or
2. as *agents* of a trustee and acting within their legal power they:
 - (a) receive and **become chargeable** with some part of the trust property (Charles Harpum suggests knowing receipt and inconsistent dealing are both covered by this expression)¹⁷; or
 - (b) assist with knowledge in a dishonest and fraudulent design on the part of the trustees.¹⁸

On a strict interpretation of Lord Selborne's categories there is no reference to the stranger who **becomes chargeable** with the trust property outside the agency relationship. Lord Selborne said that the agent's liability arose under 2(b) above because of the dishonesty or fraudulent design of the stranger. Even though Barnes and Addy's respective solicitors had actual knowledge of all the facts constituting Addy's breach of trust the Court said that since they had not actual knowledge of Barnes' misappropriation of the trust funds they could not have been liable.¹⁹

The Courts have subsequently categorised the liability of strangers generally regardless of whether the person who "receives" or "assists" is an agent²⁰ though it can be said that:

1. generally the cases concern agents; and
2. the fact that agents do not normally beneficially receive trust property has not always been made clear by the Courts when stating the requirements of "knowledge".²¹

Professor Austin in his essay *Constructive Trusts* identifies three categories where strangers can be liable for participatory breach. They are as follows:

1. Where a third party acts as trustee without appointment, eg, trusteeship *de son tort* and cases where an agent receives property subject to an obligation to keep it and account for it as a separate fund (this paper is not concerned with this category)²²; or
2. Receipt of property with knowledge that it has been received in breach of trust or fiduciary duty and the situation where there is no knowledge of such breach on receipt, but there is a subsequent dealing with the property "with knowledge" (which excludes agents for mere receipt if acting within the scope of their instructions); or
3. "Knowing assistance" in the breach of trust or fiduciary duty.²³

17 Harpum *supra* n.3 at 146.

18 *Barnes v. Addy* (1874) 9 Ch App 244, 251-252. It is clear that Lord Selborne, with whom the rest of the Court agreed, meant **actual knowledge**. Ungood-Thomas J in *Selangor* [1968] 1 WLR 1555 at 1581 suggested the question was left open as to whether the knowledge was actual or constructive.

19 (1874) LR 9 Ch App 244 at 254 per Lord Selborne.

20 See, eg, *Carl-Zeiss Stiftung v. Herbert Smith & Co. (No. 2)* [1969] 2 Ch 276 at 296-298 per Sachs LJ referred to by Stephens J in *Consul Development Pty Limited v. D.P.C. Estates Pty Limited* ("Consul") (1975) CLR 373 at 409.

21 This was a point strongly made by Sir Clifford Richmond in *Westpac Banking Corporation v. Savin* [1985] 2 NZLR 41 at 69.

22 See further Austin *supra* n.4 at 209-211 and Cope *supra* n.5 at 355-357, 370-379.

23 Austin *supra* n.4 at 200-201. See also MJ Brindle and RJA Hooley 'Does Constructive Knowledge Make a Constructive Trustee' (1987) 61 ALJ 281 at 281. This categorisation is not accepted by all academic writers in the field nor used by all judges. For a summary of the different categorisations, see Cope *supra* n.5 at 347-359. Cope deals separately with the category of the "stranger who, whether or not he has received trust property, has knowingly induced a trustee to commit a breach of trust ..." (359). In Australia neither Stephen J in *Consul* (1975) 132 CLR 373 at 408 nor the New South Wales Court of Appeal in *Stephens Travel Service International Pty Ltd (Receivers and Managers Appointed) and others v. Qantas Airways Ltd* ("Stephens Travel Service") [1988] 13 NSWLR 331 at 360-366 per Hope JA followed this approach. A strict approach as referred to by Lord Selborne in *Barnes v. Addy* was followed with beneficial receipt treated as an exception.

Austin makes the point that the “knowing assistance” category of stranger liability is the only one that is broad enough to extend to cases in which third parties have no title or control of property, eg, fiduciaries and agents.²⁴ He considers his classification started with *Karak Rubber Co. Ltd v. Burden (No. 2)*.²⁵ However, it appears as early as *Soar v. Ashwell*²⁶ where Kay LJ restated the rules on stranger liability without any reference to agents, seemingly by way of subdivision of the *Barnes v. Addy* “agent” category. The classification was then confirmed by the Court of Appeal in *Belmont Finance Corporation v. Williams (No. 2)*,²⁷ a particularly relevant case since there was no question of agency involved.²⁸ Recently Fox LJ in the Court of Appeal decision in *Agip (Africa) Ltd v. Jackson and others*²⁹ confirmed this approach. It is also the approach in New Zealand.³⁰

Charles Harpum, in his thesis, separates “beneficial receipt” from “subsequent dealing” and includes “dealing” in the same category as “knowing assistance”, named by him as “acting inconsistently with the terms of a trust”. This categorisation has the result that a lesser level of “knowledge” of the wrongdoing is required in the former category than the latter before liability can be established.³¹ Harpum considers the imposition of constructive trusteeship for beneficial receipt as property based and that “constructive knowledge” (which in some cases includes a duty to enquire but not negligence) is sufficient to impose liability. He considers all other categories are based on the implication of the stranger in the breach and knowledge of the trustee’s fraudulent design is necessary. Professor Harpum considers that in this second category before the stranger is made “guarantor” for the trust property he should know or as good as know of the design.³² This is not a unanimous view in the academic world. Professor Peter Birks differs as to the requirement of the level of knowledge of the wrong, considering “beneficial” receipt to be a strict restitutionary liability grounded in the principle of unjust enrichment, the “ignorance” of the plaintiff providing the vitiating element for the unjustness of the enrichment of the recipient.³³ His opinion is that the liability imposed upon a constructive trustee in this category is in accordance with the principle

²⁴ Austin *supra* n.4 at 230.

²⁵ [1972] 1 WLR 602 at 632-633 per Brightman J.

²⁶ [1893] 2 QB 390 at 405.

²⁷ [1980] 1 All ER 393. It could be argued that the Court limited the first category to beneficial receipt.

²⁸ *Ibid* at 405 per Buckley J.

²⁹ [1991] 3 WLR 116, 131.

³⁰ See *Westpac Banking Corporation v. Savin* [1985] 2 NZLR 41. *Powell v. Thompson* [1991] 1 NZLR 597 at 607 per Thomas J and *Marshall Futures Ltd v. Marshall* [1992] 1 NZLR 316 at 324 per Tipping J.

³¹ Harpum *supra* n.3 at 126-127 and Part Two at 290. Harpum repeats this view in a later article ‘Liability for Intermeddling with Trusts’ (1987) 50 Modern Law Review 217 where he considers the judgment of Sir Clifford Richmond in *Westpac Banking Corporation v. Savin* [1985] 2 NZLR 41 at 69-70 supports his thesis. Millet J in *Agip* (1989) 3 WLR 1367 at 1387-1388 treats beneficial receipt as a sub category of receipt although he does not make any distinction between the sub categories for “knowledge” requirements. Similarly Vinelott J in *Eagle Trust plc v. SBS Securities Ltd* [1992] 4 All ER 488. Jacobs J in *D.P.C. Estates Pty Ltd v. Grey and Consul Development Pty Ltd* (CA) [1974] 1 NSWLR 443 at 457-458 pointed to the different consequences of beneficial receipt, ie, that only constructive knowledge is required.

³² Harpum *supra* n.3 at 126-127 and 290.

³³ Peter Birks ‘Misdirected Funds: Restitution from the Recipient’ [1989] LMCLQ 296.

that any person who receives into his hands trust moneys, not being a purchaser for value without notice becomes a trustee of them.³⁴ Therefore the concept of notice does not go to the primary nature of the liability (fault based) but to the defence of bona fide purchase (strict).³⁵ In the case of knowing assistance and what he calls “ministerial receipt” there must be a want of probity.³⁶ We need to put to one side for the moment both Birks’ view and the possibility that all liability for the imposition of constructive trusts or trusteeship in this area should be founded on the concept of a want of probity as held by Megarry V-C in *In re Montagu’s Settlement Trusts*,³⁷ (and seemingly without reference to what the Court of Appeal had held in *Belmont Finance Corporation v. Williams Furniture and others (No. 2)*).³⁸

If Harpum’s categorisation were the one predominantly followed in the Courts, there would be a firmer basis for arguing that the liability imposed on a stranger participant for knowing receipt if limited to “beneficial receipt”, was property based, separating it juristically from knowing assistance or dealing inconsistently even if there was a receipt involved in the latter two categories. I submit that if the courts are to maintain that the receipt cases are property based then it can only be if some benefit is involved. The agency cases show the reluctance of the courts to extend the knowledge categories required for the imposition of liability where there is no beneficial receipt involved. If the “benefit” is what incurs equity’s higher demands then there is every reason to separate “beneficial receipt” from all other categories.³⁹ It is the benefit and not the receipt per se that attracts the stricter liability. On this view the ministerial recipient, ie, one who obtains no benefit on receipt, should be treated differently from the beneficial recipient.⁴⁰ The inability of the courts to definitively weed the “beneficial receipt” category out into one of its own, causes some of the juristic problems in explaining the reason for liability in the separate categories. The oft criticised “rubber” company takeover cases of *Selangor United Rubber Estates Ltd v. Cradock (No. 3)*⁴¹ and *Karak Rubber Co. Ltd v. Burden*⁴² with the lesser level of knowledge requirement can be more satisfactorily explained on the basis that in both the receiving

34 *An Introduction to the Law of Restitution* supra n.13 at 443-445. In the Endnotes to the 1989 edition, Birks acknowledges that the decision *In re Montagu’s Settlement Trusts* [1987] 2 WLR 1192 is contrary to his thesis in that the decision requires a high degree of fault as opposed to strict liability for the recipient stranger to be personally liable. In *Ninety Five Pty Ltd (in liquidation) v. Banque Nationale de Paris* [1988] WAR 132, Smith J (before whom *In re Montagu’s Settlement Trusts* was not cited) at 173-174 stated this as the rationale for the receipt based liability but still required constructive notice. Birks theme is reiterated in his article ‘Misdirected Funds: Restitution from the Recipient’ [1989] LMCLQ 296 although he withdraws from his position of the exception of the bona fide purchaser for value preferring instead the approach that the purchaser cannot make counter restitution (301-303). His approach is difficult to follow. Even in an action for money had and received, the recipient will have a defence if he/she has given consideration. It does not accord with the rest of Birks thesis that the liability is so strict so as to even make the purchaser for value liable. Cope, supra n.5 at 383-387 clearly treats the bona fide purchaser for value as an exception from liability.

35 [1989] LMCLQ at 318.

36 Birks *An Introduction to the Law of Restitution* supra n.13 at 439 and 445.

37 [1987] 2 WLR 1192 at 1203.

38 [1980] 1 All ER 393 per Buckley LJ at 405 and Goff LJ at 410.

39 Whilst this is at odds with Cope supra n.5 at 359 it is a view that appears to be gathering support. The Hon. Mr Justice Millet in his article ‘Tracing the Proceeds of Fraud’, *Trust Law and Practice* November 1990 134 at 139 cites *Agip* in support of the receipt based category covering only those who receive the property for their own use and benefit. He points out that this would normally exclude agents who set up no title of their own.

40 See Birks, *An Introduction to the Law of Restitution*, supra n.13 at 445.

41 [1968] 1 WLR 1555.

42 [1972] 1 WLR 602.

banks obtained a benefit.⁴³ In *Selangor* for example the bank which advanced temporary funds was held liable for the funds “received” back in a series of cheque transactions. The provision of funds enabled Selangor to provide financial assistance in the purchase of its own shares, contrary to the provisions of the UK Companies Act 1948. Ungood-Thomas J held the bank liable for *assisting* in spite of the officers of the bank acting in good faith and being unaware of what was happening although they could by inquiry have discovered the true facts. Liability was imposed on the bank because the Bank were put on enquiry or ought to have known.

The Courts, in the main, no matter the difference in opinion as to what level of knowledge must be applied to determine liability in each of the receipt and assistance categories, have shown a willingness **in stating the rules** relating to stranger liability to keep “knowing receipt” and “inconsistent dealing after receipt” together but despite this have been reluctant when met with an inconsistent dealing case to apply the same standard of “knowledge” as in a knowing “beneficial” receipt case to determine the question of liability”.⁴⁴

PART FOUR

The Law

To establish liability, under the knowing assistance category there must be four elements:

1. the existence of a trust;
2. the existence of a dishonest and fraudulent design on the part of the trustee of the trust;
3. the assistance by the stranger in that design;
4. the knowledge of the stranger of:
 - (a) the trust;
 - (b) dishonest design; and
 - (c) that he or she is assisting in that dishonest design.⁴⁵

Peter Gibson J in *Baden*, said that taken together the Court must be satisfied that the alleged constructive trustee was a party or privy to dishonesty on the part of the trustee.⁴⁶ For knowing receipt there need be no dishonest design as such⁴⁷ but there must be a trust, and a receipt or inconsistent dealing with the property “with knowledge” of both the trust and that the receipt or inconsistent dealing is in breach of trust.⁴⁸ The mental states that Peter Gibson J considered could amount to knowledge for either knowing assistance or knowing receipt were as follows:

- (i) actual knowledge;
- (ii) wilfully shutting one’s eyes to the obvious;
- (iii) wilfully and recklessly failing to make such inquiries as an honest and reasonable man would make;

⁴³ See, eg, Harpum, *supra* n.3 at 153.

⁴⁴ See Cope, *supra* n.5 at 406-411 and Harpum 102 LQR 114 at 131-138.

⁴⁵ *Baden and others v. Societe Generale pour Favouriser le Developpement du commerce et de l’Industrie en France SA* (“Baden”) [1992] 4 All ER 161 at 232, 234-235 per Peter Gibson J. These elements are adopted by Cope, *supra* n.5 at 427 for his discussion of the knowing assistance category. In the Supreme Court of Canada in *Re Air Canada and M&L Travel Ltd, et. al.* (1993) 108 DLR (4th) 592, Iacobucci J, delivering the judgment of the Court confirmed in the knowing assistance category that the knowledge is to be both of the trust’s existence and that what is being done is in breach of trust.

⁴⁶ *Baden, Ibid* 233.

⁴⁷ Harpum 102 LQR at 114-116. For Court of Appeal authority see *Belmont Finance* [1980] 1 All ER 393 at 410 per Goff LJ and *Polly Peck International plc v. Nadir (No. 2)* [1992] 4 All ER 769 at 777 per Scott LJ.

⁴⁸ The elements for receipt are seldom spelt out. In New Zealand Thomas J in *Powell v. Thomas* [1991] 1 NZLR 597 at 608 required both as did the Court of Appeal in *Westpac Banking Corporation v. Savin* [1985] 2 NZLR 41. In England in *Polly Peck International plc v. Nadir and another (No. 2)* [1992] 4 All ER 769 at 777 both elements were required. Buckley and Goff LJJ in *Belmont Finance* [1980] 1 All ER 393 stated that the requirement was knowledge of the breach. It is obvious that to have knowledge of the breach is first to “acknowledge” knowledge of the trust.

(iv) knowledge of circumstances that would indicate the facts to an honest and reasonable man; or

(v) knowledge of circumstances that would put an honest and reasonable man on inquiry.⁴⁹

Peter Gibson J said that allowing only those types of knowledge in which the conscience of the alleged constructive trustee was affected would accord with the **equitable basis** of constructive trusteeship.⁵⁰ He felt though that the necessity for a “want of probity” was **too restrictive** of the circumstances in which a court would impose a constructive trust. There is a divergence of opinion in England, Australia and New Zealand as to what level of knowledge is required to establish liability in both knowing receipt and knowing assistance cases and whether in both or just the latter there must be a clear “dishonest or fraudulent purpose”, the *Baden* categories (i)-(iii) designated as “actual knowledge” supplying this element and the *Baden* categories (iv) and (v) designated “constructive knowledge” or as in some cases more unfortunately styled, “constructive notice”⁵¹ not.

The *Selangor* and *Karak* cases referred to previously have given rise to what has been called the “honest and reasonable man test”⁵² of constructive knowledge (categories (iv) and (v) in *Baden*) ie, the test will impute knowledge and therefore constitute trusteeship where there is knowledge of circumstances that would indicate the facts to an honest and reasonable man or put him on inquiry. Neither the *Selangor* or the *Karak* cases offer any guidance on the underlying basis for imposing liability. In *Selangor* for example, a case treated as a knowing assistance case,⁵³ Ungood-Thomas J generally referred to the constructive trustee as an “equitable conception” and did not investigate the equitable basis for liability except to say that it was not criminal, tortious or contractual. Ungood-Thomas J referred to equity’s concerns to give effect to equitable interests re tracing and the doctrine of constructive notice in conveyancing transactions, and felt that in general that persons with actual or constructive notice of rights should be fixed with knowledge of them and considered this the “equitable approach of equity”.⁵⁴ Such a view would accord with any remedy being property based but makes no allowance for the knowing assistance category being based on “fraud” or a “want of probity”.

It will be argued in Part 5 that “negligence”, *Baden* category (v), was wrongly imported into this area, (in both cases the plaintiffs succeeded on their negligence claims as well). The cases are inconsistent with dicta in decisions up to the Court of Appeal decision in *Agip (Africa) Ltd v. Jackson*.⁵⁵ In none of the appellate decisions up to *Agip* is there a suggestion that “constructive knowledge” alone is sufficient in a “knowing assistance” case. An element of lack of probity or “dishonest design” is necessary. In the Court of Appeal in *Agip*, Fox LJ (with whom the other two members of the Court agreed) adopted Ungood-Thomas J’s statement in *Selangor* to the effect that constructive knowledge is sufficient to establish liability in a knowing assistance case.⁵⁶ While this has been “smoothed over” by Vinelott J in *Eagle Trust plc v. SBC Securities*,⁵⁷ his

49 *Baden* [1992] 4 All ER 161 at 235.

50 *Ibid* at 236.

51 For the inappropriate use of this word as opposed to “knowledge” in encompassing concepts that do not amount to knowledge, see *In re Montagu’s Settlement* [1987] 2 WLR 1192 at 1203-1207 per Megarry VC and *Model Trustee Code for Australian States and Territories*, prepared by Members of a working party and edited by WA Lee, published March 1989 at 148-150, 156.

52 *Canadian Imperial Bank of Commerce v. Valley Credit Union* (1989) 63 DLR (4th) 632 at 640 per Philp JA (Manitoba Court of Appeal).

53 But argued by *Harpum* 102 LQR at 151 to be more appropriately explained as one of knowing receipt with respect to the claim against District. See further at 153-154.

54 *Selangor* [1968] 1 WLR 1555 at 1582-1583.

55 [1991] 3 WLR 116.

56 *Ibid* at 133.

57 [1992] 4 All ER 488 at 499.

reasoning is not convincing. In New Zealand, Wylie J in *Equiticorp Industries Group Ltd v. Hawkins* (“Equiticorp”)⁵⁸ referred to the casual approach of the Court of Appeal “of dealing with a problem which has produced such a wide divergence of judicial opinion”.⁵⁹

In *Agip*, cheques had been altered by Agip’s “in house” accountant and so that the proceeds could reach bank accounts controlled by companies of the accountant’s associates, a firm of Accountants, had, as intermediary for the transfer of funds from one bank to another, provided a shelf company and given instructions regarding the further transfer of funds to the Bank. The Court of Appeal held that the Accountants were personally liable to account to Agip for the amounts of money they must have known they were laundering, having assisted in a breach of Agip’s “in house” accountant’s fiduciary duty to Agip. Because of Fox LJ’s insistence that whether the accountants had acted honestly was the question to be addressed⁶⁰ I submit that *Agip* is consistent with the requirement of a “want of probity” in knowing assistance cases. The approach of the Court of Appeal was to base any enquiry on the **circumstances known** and not on a negligence duty of care as in the *Selangor* case. The defendants did not give evidence and the court was left to **infer their state of knowledge** in circumstances where the defendants “must have known they were laundering money”. The case is a warning not to place too much emphasis on a strict categorisation of mental states to establish knowledge. The underlying basis for liability in a knowing assistance case is a “want of probity”. As Millet J said in the Court of first instance in *Agip*:

“According to Peter Gibson J, a person in category (ii) or (iii) will be taken to have actual knowledge, while a person in categories (iv) or (v) has constructive notice only. I gratefully adopt the classification but would warn against over refinement or a too ready assumption that categories (iv) or (v) are necessarily cases of constructive notice only. The true distinction is between honesty and dishonesty. It is essentially a jury question. If a man does not draw the obvious inferences or make the obvious inquiries, the question is: why not?”⁶¹

Peter Gibson J himself in *Baden* had given a warning about being astute to find “knowledge” in the absence of “actual knowledge” in category (v) in particular.⁶² The latest English decisions referred to below accept that Peter Gibson J’s first three classifications in *Baden* will establish liability in both knowing receipt and knowing assistance cases emphasising that in knowing assistance there must be some “want of probity”. The decisions, all of which arise in the commercial context, acknowledge the distinction between beneficial receipt and inconsistent dealing where the receipt is not beneficial. The Courts are reluctant to apply the constructive knowledge test in the commercial context where money has “passed through” the defendant’s hands even though the receipt was for the defendant’s benefit. The decisions are complicated by the presence of some form of consideration.

*Eagle Trust plc v. SBS Securities*⁶³ is a prime example. Eagle Trust had brought proceedings against the defendant underwriter SBS Securities, claiming a personal account of monies received. Eagle Trust argued that when SBS accepted money to discharge some sub-underwriting liabilities, it should have realised that the monies paid by one of Eagle Trust’s directors’, Ferriday

⁵⁸ [1991] 3 NZLR 700.

⁵⁹ *Ibid* at 723. The same “casual” approach appeared in the Court of Appeal in New Zealand in *Gathergood v. Blundell and Brown Ltd* [1992] 3 NZLR 643, discussed later in this paper.

⁶⁰ *Agip* [1991] 3 WLR 116 at 132-133.

⁶¹ *Agip* [1989] 3 WLR 1367, 1389-90 per Millet J. The Accountants had chosen not to give evidence. There was some documentary evidence before the Court which tended to show that the Accountants knew the payments to its shelf company were fraudulent.

⁶² [1992] 4 All ER 161 at 243.

⁶³ [1992] 4 All ER 488.

(known to be in financial difficulties), to discharge his sub-underwriting liabilities, were in fact funds of Eagle Trust. The funds had been misapplied by Ferriday in breach of his director's fiduciary obligations to the company. SBS moved to have the statement of claim struck out as showing no reasonable cause of action on the basis that it could not be shown that SBS had knowledge that the monies were misapplied trust funds. In giving judgment to strike out the claim Vinelott J confirmed by way of dicta that in the case of knowing assistance:

"There must have been something amounting to want of probity on his part. Constructive notice is not enough, though, as I have said, knowledge may be inferred in the absence of evidence by the defendant if such knowledge would have been imputed to an honest and reasonable man".⁶⁴

Vinelott J relied on Millet J's judgment at first instance in *Agip*, and identified the different underlying basis of participatory liability as "rights of priority in relation to property taken by a legal owner for his own benefit" in knowing receipt cases and the "furtherance of fraud" in knowing assistance cases.⁶⁵ Vinelott J agreed with Millet J that there were the two sub-categories in knowing receipt referred to in Part 2 of this paper. He thought there was **no reason** why a stricter standard of knowledge should apply with receipt based liability.⁶⁶ After concluding that there was no need to make a decision on whether in the knowing receipt category (where the property is not retained) more than actual knowledge is necessary for liability, he relied on such cases as *Manchester Trust v. Furness*,⁶⁷ *Thomson v. Clydesdale Bank Ltd*⁶⁸ and *Blundell v. Blundell*⁶⁹ to draw the conclusion that **notice** was not enough in the commercial context to impose a liability on the recipient who has received money in the ordinary course of business to discharge a commercial liability. It must be shown that the circumstances are such that **knowledge** that the payment was improper can be imputed to the receiver.⁷⁰ Vinelott J said that knowledge could be inferred in such a case if:

"the circumstances are such that an honest and reasonable man would have inferred that the moneys were probably trust moneys and were being misapplied, and would either not have accepted them or would have kept them separate until he had satisfied himself that the payer was entitled to use them in discharge of the liability".⁷¹

Has Vinelott J created a new class of the knowing receiver, ie, one who receives beneficially in discharge of a liability in the commercial context but has no identifiable property remaining in his hands? Vinelott J's approach is not so much directed at the distinction between beneficial and non beneficial receipt but whether the recipient still retains the property. He was reluctant to impose a personal liability in circumstances where the property has gone unless there is actual knowledge of the breach of trust.⁷² This position is in contrast to the common law actions for money had and received, where the sole fact that the recipient has disposed of the property is no defence.

The same approach was adopted by Knox J in *Cowan de Groot Properties Ltd v. Eagle Trust plc*.⁷³ Eagle Trust argued that Cowan de Groot and its subsidiary, Pinepad Ltd should have known that certain Eagle Trust properties were sold to them at a gross undervalue by Ferriday in breach

⁶⁴ *Ibid* at 499.

⁶⁵ *Ibid* at 495.

⁶⁶ *Ibid* at 505.

⁶⁷ [1895] 2 QB 539.

⁶⁸ [1983] AC 282.

⁶⁹ (1888) 40 Ch D 370.

⁷⁰ [1992] 4 All ER 488 at 509. Thomas J in *Powell v. Thompson* [1991] 1 NZLR 597 at 614 said there should be no different rules in commercial transactions, rather all the circumstances are to be taken into consideration.

⁷¹ *Ibid*.

⁷² In his judgment he used the terms "notice" and "knowledge".

⁷³ [1992] 4 All ER 700.

of his fiduciary duties as a director of Eagle Trust. Knox J considered that “the relegation of a purchaser for value to a category more, rather than less, exposed to claims of constructive trusteeship to be misconceived”.⁷⁴ He declined to extend the knowledge categories for knowing receipt beyond the first three *Baden* categories in what was as he saw a typical **commercial situation**. Knox J said that in such a situation it would not be appropriate for the court to be astute to find circumstances which could indicate knowledge by a purchaser of breach of fiduciary duty on the part of directors of a vendor company.⁷⁵ He did, however, accept that the last two *Baden* categories were not always cases of constructive notice only and said:

“it may well be that the underlying principle which runs through the authorities regarding commercial transactions is that the court will impute knowledge, on the basis of what a reasonable person would have learnt, to a person who is guilty of commercially unacceptable conduct in the particular context involved.”⁷⁶

The tension between the personal liability often imposed for participatory breach and the priority rules in property transactions is evident in these two cases. Rights of priority raise different issues to personal liability. In the former, someone **has the property** and the question is does that person take subject to a prior equity? The worst scenario is that the person stands to lose the property or take subject to a prior equity. An investment might be lost. Often the “proprietary” constructive trust will be the appropriate remedy. With stranger liability, the focus is different. The imposition of a personal liability is primarily to **compensate** a plaintiff for loss.⁷⁷ Often the one sought to be made liable no longer has the property.

The adoption of the property base for knowing receipt has accounted for those who favour it, accepting constructive knowledge to let in liability, though noticeably the concept of negligence when one is put on enquiry, is not generally accepted.

In *Polly Peck International plc v. Nadir and other (No. 2)*,⁷⁸ a recent decision of the Court of Appeal on the subject, the facts were briefly as follows. Nadir was the principle director of PPI. The Court accepted that there was a breach of fiduciary duty by Nadir as a director of PPI where Nadir had dishonestly diverted PPI funds to improper purposes in having the funds channelled through the bank account of a private bank, IBK, a subsidiary of PPI and of which Nadir was also a director. IBK held an account with the Central Bank of the Turkish Republic of Northern Cyprus. The Central Bank and IBK had accounts at London’s Midland Bank International. In a number of transactions Nadir, misappropriating PPI funds, deposited sterling in the Midland Bank IBK account and the sums deposited were:

- in nine transactions transferred to the Central Bank Account and forwarded by the Central Bank from its Midland bank account to the IBK account at the Central Bank’s office in Northern Cyprus; and
- in the remainder exchanged for lire by the Central Bank through its Midland Bank Account and the lire then sent by the Central Bank to the same IBK account referred to above.

In respect of the nine transactions, Scott LJ said that “knowing assistance” was the relevant category, but that in the remainder since the Central Bank **received the sterling to its own benefit** “as purchaser” (the bank exchanged the sterling for lire) knowing receipt was the relevant

⁷⁴ *Ibid* at 760.

⁷⁵ *Ibid* at 761. This position was reached after a review of the authorities including *Belmont Finance (No. 2)*.

⁷⁶ *Ibid*. He considered *Westpac Banking Corporation v. Savin* [1985] NZLR 41 as such an example where the banker took a three to one chance regarding the source of the sums paid into the debtor’s account.

⁷⁷ *Cope supra* n.5 at 453.

⁷⁸ [1992] 4 All ER 769.

⁷⁹ *Ibid* at 777. Scott LJ’s finding was contrary to Millet J who held at first instance that the case was one of knowing assistance.

category.⁷⁹ The appeal arose from Millet J's decision to grant a Mareva injunction in respect of the assets of the Central Bank. The Central Bank appealed against the order. The Court of Appeal considered one ground to be taken into consideration in whether the Mareva injunction should be discharged was how strong the case was against the Central Bank with respect to the constructive trust claim. Scott LJ (with whom Stocker LJ and Lord Donaldson Master of the Rolls agreed) referred to *Agip, Baden, Eagle Trust* and *Cowan de Groot*, and said that the critical questions were whether the Central Bank knew or must be treated as knowing that the funds were PPI funds and were being misappropriated. With respect to the second of these Scott LJ said that mere curiosity or the silence of the Bank to explain in suspicious circumstances would not be sufficient to establish knowledge⁸⁰ nor did he accept an argument as to "the sheer scale of the payment". He said that in order to establish liability:

1. In the "knowing assistance" category, something amounting to dishonesty or want of probity on the part of the defendant must be shown;⁸¹ and
2. With respect to the receipt of funds, the misapplication of funds does not need to be fraudulent but the receiver does need to know that the funds are trust funds and that they are being misapplied.⁸²

Scott LJ considered that with respect to the second category, actual knowledge would suffice but in response to Counsel's submission, he doubted whether it would suffice to establish liability that "the defendant can be shown to have had knowledge of facts which would have put an honest and reasonable man on inquiry ...".⁸³ He also said that:

"The various categories of mental state identified in *Baden's* case are not rigid categories with clear and precise boundaries. One category may merge imperceptibly into another."⁸⁴

Scott LJ **did not think the appeal was the time to decide** whether all the mental states identified by Peter Gibson J in *Baden* would suffice to establish knowledge for the purpose of the knowing receipt category. The final points that Scott LJ made although with respect to the tracing claim as to whether the Central Bank was a purchaser for value "without notice" were that:

- the Courts would not be willing to extend the equitable doctrine of "constructive" notice from land where title was in dispute, to commercial transactions.⁸⁵
- the degree of knowledge for the constructive trust claim would be the same as for the equitable tracing claim.⁸⁶

The latest Court of Appeal decision then, accepts the two categories of knowing receipt and knowing assistance albeit with no acknowledgment of the underlying basis or bases for liability. It would seem improbable from either the approach or the dicta of the Court that the *Selangor* approach will be accepted for knowing receipt.⁸⁷ The Court did not seem to think this approach would suffice and for the purpose of examining PPI's claim in the light most favourable to it, restricted its examination of the actual circumstances and what the Central Bank could have inferred from those circumstances. In the absence of actual or close to actual knowledge, there is a clear reluctance to extend the constructive trust/trusteeship into the arena of commercial transactions.

⁸⁰ *Ibid* at 781. This position is contrary to that of Vinelott J in *Eagle Trust plc* at 497.

⁸¹ *Ibid* at 777.

⁸² *Ibid*.

⁸³ *Ibid*. Although he examined the claim against the bank on this ground.

⁸⁴ *Ibid*.

⁸⁵ Scott LJ relied on the dicta of both Megarry VC in *Re Montagu's Settlement Trusts* and Vinelott J in *Eagle Trust plc* as well as that of Lindley LJ in *Manchester Trust v. Furness* [1985] 2 QB 539 at 545.

⁸⁶ *Polly Peck International plc v. Nadir and other (No. 2)* [1992] 4 All ER 769 at 782.

⁸⁷ The requirement for a want of probity in knowing assistance cases does seem to be beyond doubt with the knowledge requirement reformulated as "knowledge that can be imputed".

England is not the only country where the courts are not yet willing to set a precedent as to what level of knowledge is needed to establish liability for participatory breach. In Canada in *Re Air Canada and M&L Travel Ltd et al.*,⁸⁸ two company directors were held by the Supreme Court to be personally liable to Air Canada when the company of which they were the directors, failed to keep money paid by customers for Airline tickets separate in a trust account for the Airline as opposed to mixing the money in a general account. The Supreme Court held unanimously that the directors were liable on the basis of their participation in the breach of trust, being the controlling minds of the company. It was accepted that in the case the directors' breach was fraudulent and dishonest but McLachlin J thought it was not necessary to resolve the question already resolved in England in this category as to whether the test of knowledge in the participation was objective or subjective. Iacobucci J, delivering the main judgment of the Court, pointed to two separate Canadian lines of authority, where persons could be held liable where there was an innocent but negligent participation in a fraudulent breach of trust.⁸⁹

In New Zealand, in the latest Court of Appeal decision, *Gathergood v. Blundell & Brown*,⁹⁰ the Court held that whether knowing assistance or receipt was applicable, the question was whether the person implicated "knew of the material facts giving rise to the existence of the duty and its breach". If this means there is no requirement for a want of probity in knowing assistance cases, then the decision is contrary to dicta in *Westpac Banking Corporation v. Savin*.⁹¹

Gathergood, a real estate agent, purchased his principal's property but failed to both properly account to his principal for the deposit monies under the contract and obtain his principal's authorisation to the lesser deposit. He onsold the property to a third party at a profit without his principal's authority. His principal, the Vendor, sought to recover the profit. Gathergood and his wife had left New Zealand and the profit which had been accounted for to Mrs Gathergood could not be traced. The Vendor sought to make Gathergood's solicitor, Leishman, personally liable to account for the profit on the ground of either Leishman's receipt or assistance in the breach of fiduciary duties owed by Gathergood. The alleged "assistance" arose out of Leishman's dual roles in acting as solicitor and as trustee for Gathergood in the contracts for the purchase and "onsale". As solicitor in both transactions the monies passed through his trust account.

The majority of the Court appeared to think that Leishman had both knowingly received and knowingly assisted Gathergood in the latter's breach of fiduciary duties (there was no indication of beneficial receipt). Cooke P cited Fox LJ in *Agip* and considered that since Leishman had sent a letter to the Vendors' solicitors in his capacity as solicitor to Gathergood stating that the deposit was short from the amount stated in the contract, that he "knew the facts material to whether Mr Gathergood's fiduciary relationship to the vendor continued."⁹² Knowing the facts, he could not be heard to say that he was ignorant of the law as to fiduciary duties".⁹³ Cooke P and Gault J used the expressions "implicated" and "participated" in the breach of fiduciary duty respectively, though Gault J did consider the case as one of both receipt and knowing assistance.⁹⁴

From Leishman's point of view it was unfortunate that he was a solicitor. The decision whilst not referring to any possible underlying principle for imposing liability, adopts a similar approach to that of Smith J in Australia in *Banque Nationale de Paris*. Although Smith J was concerned with

⁸⁸ (1993) 108 DLR (4th) 592.

⁸⁹ *Ibid* at 613-619.

⁹⁰ [1992] 3 NZLR 643. Leave to appeal to the Privy Council is being sought.

⁹¹ [1985] 2 NZLR 41. See, eg, judgment of Sir Clifford Richmond at 69-70.

⁹² McKay J dissented. Whilst agreeing with the majority as to the legal principles to be applied, he disagreed that the letter from Leishman to the vendor's solicitors was sufficient to establish knowledge.

⁹³ [1992] 3 NZLR 643 at 646. Gault J at 648 agreed with his judgment.

⁹⁴ *Gathergood* [1992] 3 NZLR 643 at 647 and 648.

a knowing receipt case he held the bank was also liable in the knowing assistance category.⁹⁵ The decision is also consistent with *Consul* in Australia where in the knowing assistance category there is no requirement for dishonesty provided the stranger knew all the facts which would have indicated the impropriety to a reasonable man.⁹⁶

PART FIVE

Policy Considerations - The Possible Underlying Principles

It is important to examine the reasons relied on by the Courts for imposing a personal liability on the stranger for participatory breach, and the consequences of preferring one approach to another. The following possibilities arise for consideration, ie, whether the stranger's liability rests on:

- a consideration of what is equitably just or unconscionable;
- unjust enrichment;
- a proprietary notion as opposed to one that essentially looks to the conduct of the stranger in finding a "lack of probity" or "dishonesty";
- standards or notions of negligence;

or one and any other depending on whether the stranger is the receiver or the assister.⁹⁷

Equitably Just

Buckley LJ in *Belmont Finance Corp. Ltd v. William Furniture Ltd*,⁹⁸ thought that to depart from Lord Selborne's formula in *Barnes v. Addy* as to the requirement of dishonesty to establish liability in a knowing assistance case and to look instead to what was "equitably just" would lead to an unacceptable level of uncertainty in the law. In contrast, Thomas J in New Zealand has taken the approach that the constructive trust is a broad equitable remedy for reversing that which is inequitable or unconscionable.⁹⁹ His approach, which examines the **circumstances between the parties** and not just the defendant's knowledge,¹⁰⁰ has met with judicial criticism. Wylie J in *Equiticorp*¹⁰¹ preferred (at least in a knowing assistance case) the concept of a want of probity which concentrates on the conscience of the defendant. Tipping J in *Marshall Futures v. Marshall*¹⁰² "preferred the herald of equity to be better dressed", saying that dishonesty is the feature for the knowing assistance category and implying in receipt cases that property considerations were relevant. He thought any **general ground of unconscionability should be limited** to the special field of de facto marriage cases.¹⁰³

95 [1988] WAR 132 at 177-178. See also *Stephens Travel Service* [1988] 13 NSWLR 331 at 356 per Hope JA.

96 Stephen J in *Consul* (1975) 132 CLR 373 at 411-412 did tentatively accept the proposition that if one knew all the facts, liability would ensue as did Gibbs J at 397-398. Barwick CJ agreed with Stephen J at 376.

97 For example, both Cope *supra* n.5 at 356 and Brindle and Hooley *supra* n.23 at 282-283 refer to the underlying principles being 1) proprietary and 2) based on the stranger's conduct, depending on receipt or assistance. In some contrast Stephens J in *Consul* (1975) 132 CLR 373 at 410 "wondered" about the equitable basis and did not see any reason why there should be a distinction between the two cases but said that in respect of knowing receipt it may lie in "equity's concern for the protection of equitable estates and interests in property which comes into the hands of purchasers for value".

98 [1979] 1 All ER 118, 130.

99 *Powell v. Thomas* [1991] 1 NZLR 597 at 615.

100 *Ibid* at 608.

101 [1991] 3 NZLR 700 at 727-728.

102 [1992] 1 NZLR 316.

103 *Ibid* at 325-326. CEF Rickett's two articles 'Strangers as Constructive Trustees in New Zealand' [1991] OJLS 598 and 'Banks as "Stranger Constructive Trustees": Two High Court Decisions' [1992] NZLJ 366 support Thomas J's approach of looking at stranger liability in terms of the underlying principles rather than a slavish adherence to *Baden*'s mental states to establish knowledge "to establish liability". However, Rickett does not go so far as to support Thomas J's general "unconscionability" approach.

In Australia there is the future (though I submit, remote) possibility of “unconscionability” being the primary concept that brings all constructive trust liability together much the same way that the concept of unjust enrichment has in an analogous category of cases.¹⁰⁴ *Consul* does appear at this stage to raise a problem with the concept of unconscionability underlying the “constructive trust” for participatory breach, although the case is consistent with a **fault based** approach in the knowing assistance category.

Unjust Enrichment in the Receipt Category

I submit that there are **juristic difficulties** in suggesting that the “principle”, **as espoused** by Thomas J in *Powell v. Thompson*¹⁰⁵ to the effect that one can look at the equities between the parties, underlies recovery in the **receipt category**. Thomas J acknowledged that in the case of agents, if there is no beneficial receipt there can be no liability under the receipt category.¹⁰⁶

If unjust enrichment is accepted as a cause of action and therefore able to form the basis of recovery, then subject to accepted defences, **liability should be strict**, despite Thomas J looking to “constructive knowledge” as the determinant of liability. Another difficulty in applying a “doctrine” of unjust enrichment, if one accepts the argument that there is such a doctrine or a cause of action as opposed to an “underlying concept”,¹⁰⁷ is that in the cases where unjust enrichment has arisen in the English and Australian Courts to date, examination has focused on the circumstances surrounding the transaction from the point of view of the plaintiff in predominantly *common law* actions.¹⁰⁸ For example, in a case of a mistaken payment the question is asked when the payer parts with money under a mistake of fact or law¹⁰⁹ whether he or she parted with the

¹⁰⁴ *Muschinski v. Dodds* (1985) 160 CLR 583, 614-616 per Deane J, *Baumgartner v. Baumgartner* (1987) 164 CLR 137, 147 per Mason CJ, Wilson and Deane JJ and 152-154 per Toohey J. It can be argued that the joint majority in *Baumgartner* did not make clear that the concept of unconscionability was limited to Deane J’s context in *Muschinski v. Dodds* that unconscionability is a **concept** that underlies some fundamental rules or principles of equity.

¹⁰⁵ [1991] 1 NZLR 597 at 608-609. His dicta in this regard has enjoyed a measure of acceptance. Rickett in [1992] NZLJ 366 refers to two unreported decisions, *N.Z. Lankshear v. ANZ Bank* and *Ancell and others v. Westpac Bank* where unjust enrichment was accepted as the underlying basis for the receipt category. Rickett himself accepts this basis.

¹⁰⁶ *Ibid* at 607, 613.

¹⁰⁷ *Pavey & Matthews Pty Ltd v. Paul* (1987) 162 CLR 221 at 227 and 254-257. This view that unjust enrichment is an underlying concept as opposed to a doctrine or independent cause of action in Australia has been confirmed in *Australia and New Zealand Banking Group Ltd v. Westpac Banking Corporation* (1988) 164 CLR 662, 673 and more recently in *David Securities Pty Ltd v. Commonwealth Bank of Australia* [1992] 66 ALJR 768, 778. Peter Birks in his *An Introduction to the Law of Restitution*, *supra* n.13 at 26-27 is of the same opinion as Lord Diplock in *Orakoo v. Manson Investments Ltd* [1978] AC 95 at 104 whom he cites, that there is no doctrine as such. He considers there are cases in which a restitutionary remedy is awarded and the “generic conception” merely gives a better understanding to what is there already. See also Chapter IV particularly the last paragraph on 99. In New Zealand, John Dixon in his article, ‘The Remedial Constructive Trust Based on Unconscionability in the New Zealand Commercial Environment’ 7 [1992] Auckland Law Review 147 at 157 is of the opinion that the “doctrine” of unjust enrichment has not been accepted as such in New Zealand.

¹⁰⁸ In this respect the High Court has agreed with Lord Wright’s view in *Fibrosa Spolka Akcyjna v. Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32 at 61 that remedies for unjust enrichment fall within a third category of the common law outside tort and contract, called restitution. See *Australia and New Zealand Banking Group Ltd v. Westpac Banking Corporation* (1988) 164 CLR 662 at 673 and generally the discussion of The Hon. Mr Justice WMC Gummow in Finn (ed.), ‘Unjust Enrichment, Restitution and Proprietary Remedies’, *Essays on Restitution* Sydney The Law Book Company 1990 47 at 47-49 and 61-71. There is nothing in *David Securities* (1992) 66 ALJR 768 to contradict this nor in the judgment of Deane J in *Pavey v. Matthews Pty Ltd v. Paul* (1987) 162 CLR 221 at 256.

¹⁰⁹ *David Securities Pty Ltd v. Commonwealth Bank of Australia* (1992) 66 ALJR 768.

money under an operative mistake. This mistake establishes the “unjustness” of the payment.¹¹⁰ The recipient’s conduct to establish “unjust” is irrelevant and is only relevant to establish a possible defence, eg, change of position. In England and Australia there is no overall examination of the **equities** between the parties as contemplated by Thomas J.

Unjust enrichment is recognised as a cause of action in both America¹¹¹ and Canada¹¹² but not in England or Australia. In America and Canada unjust enrichment encompasses both common law and equitable obligations. The common law actions have been described in Australia as ones where the defendant must restore a benefit to the plaintiff, the underlying concept being, his unjust enrichment. The remedy is related to this concept, ie, it is restitutionary. There is no question of a constructive trust arising as an appropriate remedy in these cases.¹¹³ In cases dealing with the “constructive trust or trusteeship” in the area of participatory breach the Courts whilst concerned with the conduct of the “giver” to establish a breach of trust or fiduciary duty, determine whether the “constructive trust/trusteeship” should be imposed as a remedy on the basis of the conduct of the one at the other end of the transaction, ie, the receiver or assister.¹¹⁴

One should not tangle the constructive trust as a remedy with a cause of action or a concept that underlies various categories of causes of action as does the concept of unjust enrichment. In Australia there has yet to be recognition that the concept of unjust enrichment can underlie obligations arising in equity. I submit that if the concept of unjust enrichment is to be used it would more appropriately be fitted into Birks’ scheme of restitution for an anti-enrichment wrong as opposed to the concept of enrichment by subtraction, with ignorance as the vitiating factor, the path which he advocates.¹¹⁵ Under this approach the Court would have to recognise the stranger’s conduct **as being a wrong** grounded in unjust enrichment. This emphasis is different from the principles applied in enrichment “by subtraction” as in mistake with its concentration on the plaintiff. However, it is clear that the reason for imposing liability for participatory breach does not arise from a benefit based obligation (ground in unjust enrichment), but is a *response* to the wrong inherent in a breach of equitable obligation. It is the defendant’s as opposed to the plaintiff’s conduct that is the important focus. I submit that the concept of unjust enrichment is not appropriate.

110 Lord Goff of Chieveley and Gareth Jones *The Law of Restitution* 3rd edition London Sweet and Maxwell 1986 at 29-30. See also Goff J., as he then was in *B.P. Exploration Co. (Libya) Ltd v. Hunt (No. 2)* [1979] 1 WLR 783 at 839 where receipt of the benefit at the plaintiff’s expense is in such circumstances that to allow the defendant to retain it would be unjust. Similarly see Dickson J in *Pettkus v. Becker* 117 DLR (3d) 257 at 274 whose basis for applying the Canadian doctrine of unjust enrichment was approved in *Sorochan v. Sorochan* [1986] 5 WWR 289 and more recently in *Air Canada v. Attorney-General of British Columbia* (1989) 59 DLR (4th) 161. Peter Birks in his *An Introduction to the Law of Restitution*, *supra* n.13 at 20-21 and 99 stresses that “unjust” refers to factors calling for restitution, eg, mistake and compulsion that vitiate a plaintiff’s intention to enrich a defendant. In Australia this view has been adopted. For authorities, see FN 107. Birks overcomes the difficulty of finding a vitiating factor in receipt based liability by adding “ignorance” to mistake and compulsion as grounds for vitiating the consent of the plaintiff [1989] LMCLQ 296.

111 American Law Institute (reporters Warren A. Seavey and Austin W. Scott), *Restatement of the Law of Restitution Quasi Contracts and Constructive Trusts* Washington American Law Institute Publishers 1937.

112 *Pettkus v. Becker* (1980) DLR (3d) 257.

113 *Australia and New Zealand Banking Group Ltd v. Westpac Banking Corporation* (1988) 164 CLR 662, *David Securities Pty Ltd v. Commonwealth Bank of Australia* [1992] 66 ALJR 768, *Stephenson Nominees Pty Ltd v. Official Receiver in Bankruptcy* (1987) 76 ALR 485.

114 For an early example of this recognition see *Soar v. Ashwell* [1893] 2 QB 390, 396 per Bowen LJ. See also *In re Montagu’s Settlement* [1987] 2 WLR 1192, 1204 per Megarry VC and Wylie J in *Equiticorp v. Hawkins* [1991] 3 NZLR 700 at 727.

115 Birks *An Introduction to the Law of Restitution*, *supra* n.13 at 39, 67-70, 106-107, 313-357. Birks’ reason for choosing ignorance as the basis is because the defendant is correspondingly enriched by the plaintiff’s subtraction.

Cooke P's comments in *Pasi v. Kamana*¹¹⁶ to the effect that it does not matter whether one spoke of unjust enrichment, unconscionability, constructive or equitable fraud, justice and good conscience, or unfairness, since all categories were "driving in the same direction"¹¹⁷ is I submit wide of the mark. Whilst it shouldn't matter the reality is that it does matter a good deal. The Court's examination of the circumstances and the remedy available depends which tag is used. For example if unjust enrichment underlies recovery in the receipt category, liability should be strict though the Courts have not adverted to this fact. If dishonesty or unconscionability is the underlying basis liability will be based on the state of the conscience of the defendant. "Dishonesty" is narrower in that it is a more subjective enquiry. "Unconscionability" can be enlarged to include "what the rest of the world would have seen". If property notions prevail then what the defendant "ought to have known", ie, **a standard or yardstick** will be sufficient to establish liability.

Proprietary Notion or Want of Probity

If it is accepted that the receipt category is property based then constructive knowledge should suffice to establish liability, but only if "beneficial" receipt is involved. Except generally speaking, a property based liability does not accord with the equitable conception of a constructive trust which looks to the conscience of the stranger. The property approach is contrary to a number of dicta including:

Sachs, LJ and Edmund Davies LJ in *Carl Zeiss*;¹¹⁸

Megarry VC in *Re Montagu's Settlement Trusts*;

Alliott J in *Lipkin Gorman (a firm) v. Karpnale Ltd and another*;¹¹⁹ and

Steyn J in *Barclays Bank plc v. Quincecare Ltd*.¹²⁰

Megarry VC whose views are at the forefront of those who require a "want of probity" in both knowing receipt and knowing assistance cases is of the view that rights of priority belong to tracing not to stranger liability.¹²¹ This approach does tend to ignore the fact that the stranger, particularly the volunteer who "beneficially receives" has received something he/she is not entitled to. Harpum criticises Megarry VC's approach on the basis that he considers Megarry VC confuses the questions of constructive notice for knowing receipt and whether the recipient of property is fixed with notice.¹²² Margaret Halliwell, goes further. She is of the opinion that the knowing receipt category should be abandoned and that the tracing rules and priority rules can provide adequate protection. She argues that the receipt category should only be retained if these, the *Diplock* principle and common law remedies are not fulfilling their task.¹²³ Her view to this

¹¹⁶ [1986] 1 NZLR 603.

¹¹⁷ *Ibid* at 605 cited by *Rickett* [1991] OJLS 598 at 599.

¹¹⁸ [1969] 2 Ch 276 298 and 301 respectively.

¹¹⁹ [1992] 4 All ER 331 at 349. Halliwell suggests that because of Alliott J's insistence on a want of probity, he limits "constructive notice" to *Baden's* types (ii) and (iii). Margaret Halliwell 'The Stranger as Constructive Trustee Revisited' [1989] Conv. 328 at 330. Alliott J's view was confirmed in the Court of Appeal by May LJ [1992] 4 All ER 409 at 420.

¹²⁰ (1988) [1992] All ER 363 at 375-377.

¹²¹ See Megarry VC in *Re Montagu's Settlements* [1987] 2 WLR 1192 at 1200, 1203.

¹²² Harpum (1987) 50 Modern Law Review at 220-221. Millet J also considers that Megarry VC's view is mistaken resting on a passage of *Re Diplock* taken out of context ('Trust Law and Practice', November 1990 134 at 138 and *supra* n.39).

¹²³ Halliwell *supra* n.119.

extent concurs with Austin's,¹²⁴ but not with Harpum's.¹²⁵ Halliwell further says that all claims for participatory breach including the **liability of a commercial purchaser** should be based on knowing assistance with the requirement of establishing knowledge of the fraudulent design of the trustee, *Baden's* categories (i)-(iii), thereby making imposition of liability more assertively tied to a want of probity.¹²⁶ Her view concerning the liability of a commercial purchaser represents the current English approach at the Court of Appeal level.

If the property basis for knowing receipt is accepted, a decision has to be made as to whether the existing rules are adequate. Do we need to add another to the list?

Negligence in Either the Knowing Receipt or Knowing Assistance Cases

Stephens J in *Consul* felt that to accept that constructive notice in effect exposes a party to liability as accepted in *Selangor* on the basis of **negligence to make enquiries** "disregards equity's concern for the state of conscience of the defendant".¹²⁷ In *Consul* as already noted, three of the judges accepted Peter Gibson J's category (iv) but not (v) to establish knowledge.¹²⁸

Ford and Lee¹²⁹ suggest the honest though possible negligent conduct of the stranger warrants a postponing of rights but should not be the basis of the imposition of personal liability. A contrary view is expressed by Tettenborn who considers that professionals such as banks and solicitors should be under a duty of care to beneficiaries to make enquiries and that *Selangor Karak*, and *Rowlandson v. National Westminster Bank*¹³⁰ should be accepted in that light, with the consequence that there is an extension into trusts law in line with the extension of negligence liability for these professionals. In contra distinction private persons should have actual knowledge.¹³¹

Thomas J in *Powell v. Thompson*¹³² considered negligent conduct should not be beyond the purview of unconscionable conduct but his view has not been accepted in two later single judge decisions.¹³³ In *Baden* Peter Gibson J said with respect to the negligence claim involving a bank's duty of care to beneficiaries under a trust:

¹²⁴ Austin *supra* n.4 at 217 and 228. Austin considers that if the recipient still retains the property then these rules and an improved version of *Re Diplock* will suffice. If the *property is not available* and personal liability must be imposed he favours some culpability.

¹²⁵ Harpum is of a contrary view as he considers *Re Diplock* is unable to be extended, being probably limited to estates. HAJ Ford and WA Lee *Principles of the Law of Trusts* The Law Book Company Limited Second Edition 1990 at paragraph [1730] are of the opinion that *Re Diplock* applies to all improper distributions of trust property. It must be borne in mind in Queensland that the provisions of Section 109 of the Trusts Act extends the liability to inter vivos transactions but otherwise adopts the strict liability of *Re Diplock* albeit with a defence of change of position.

¹²⁶ Halliwell *supra* n.119 at 334-335.

¹²⁷ (1975) 132 CLR 373 at 412.

¹²⁸ Austin *supra* n.4 at 237-239 examines the ramifications of *Consul* and *Hospital Products Ltd v. United States Surgical Corporation and others* [1983] 2 NSWLR 157 (CA), concluding a party who omits to inquire by calculation but not one who omits to do so by negligence will let in liability for knowing assistance.

¹²⁹ Ford and Lee *supra* n.125 at [2219].

¹³⁰ [1978] 1 WLR 798.

¹³¹ A. Tettenborn "The Fiduciary Duties of Banks" [1980] JBL 10 at 13-16.

¹³² [1991] 1 NZLR 597 at 612.

¹³³ *Equiticorp Industries Group Ltd v. Hawkins* [1991] 3 NZLR 700 at 727-728 per Wylie J and *Marshall Futures Ltd v. Marshall* [1992] 1 NZLR 316 at 325.

“the scope of the duty of care owed by the bank to the beneficiaries extends at least this far, that the bank must exercise reasonable care and skill in transacting banking business relating to the account and [that] such duty included making such inquiries as may in the circumstances be appropriate and practical if the bank has, or a reasonable banker would have, grounds for believing that the customer or its authorised signatories are misapplying, or acting fraudulently in respect of, the trust moneys in that account. This much is, I believe, common ground between the parties. *Counsel are further at one in submitting that the circumstances which give rise to a duty of inquiry and the duties consequent on the arising of that duty are the same in relation to a claim in negligence as in relation to a claim that a person alleged to be a constructive trustee has type (v) knowledge [knowledge of circumstances that would put an honest and reasonable man on inquiry].*”¹³⁴

Peter Gibson J’s above quoted dictum followed the proposition stated by Ungood-Thomas J in *Selangor* and accepted by Brightman J in *Karak* that the equitable claim as constructive trustee and the common law claim in negligence are identical in that under both any standard of care which puts one on inquiry or notice is the same, the objective standard of reasonableness.¹³⁵ I submit that the standard of care test that puts a stranger on notice has wrongly been imported into this area of the law through *Selangor*, *Karak*, and *Baden*¹³⁶ on a misconceived basis without exploring the underlying equitable basis for liability for participatory breach. The misconception has recently been ferreted out by two judges as causing “muddle-headedness” of principle in two recent cases, May LJ in *Lipkin Gorman (a firm) v. Karpnale Ltd and another*¹³⁷ and Steyn J in *Barclays Bank plc v. Quincecare Ltd*.¹³⁸ May LJ considered that it was wrong in *Selangor* and *Karak* to equate the two and that this led to a wrong statement of principle. Steyn J said only actual knowledge gave rise to a constructive trust for knowing receipt and knowing assistance but acknowledged that **under the common law** there may be wider duties, eg, a duty to enquire.¹³⁹

Paul Finn argues that all participatory liability should be fault based, (with the role a participator plays a major consideration) in view of the drastic consequence of personal liability. He says that no less a notion should make a third party liable, otherwise the third party becomes an insurer for the beneficiary.¹⁴⁰ Finn’s thesis makes no distinction between the receipt and assistance category. He says there should be three questions to be asked to determine liability, namely whether:

1. there has been a breach of trust or fiduciary duty; and
2. any participation in it by the third party, and if so; and
3. does the third party **know or have reason to know** a wrong was committed against the beneficiaries.¹⁴¹

¹³⁴ *Baden* [1992] 4 All ER 161 at 273 per Peter Gibson J. Authors italics. He specifically referred to *Selangor* and *Karak* on this point.

¹³⁵ *Selangor* [1968] 1 WLR 1555 at 1591 per Ungood-Thomas J; *Karak* [1972] 1 WLR 602 at 639-640, per Brightman J.

¹³⁶ [1992] 4 ALL ER 161.

¹³⁷ [1992] 4 All ER 409 at 421. However, Parker LJ was not so clear. For a discussion of his views, see Halliwell *supra* n.119 at 331-333.

¹³⁸ [1992] 4 All ER 363 at 375.

¹³⁹ For a similar view, *Logicrose Ltd v. Southend United F.C.* [1988] 1 WLR 1256 at 1261 per Millet J.

¹⁴⁰ Paul Finn “The Liability of Third Parties for Knowing Receipt or Assistance” Paper delivered at the Second International Symposium on Trusts, Equity and Fiduciary Relationships, University Victoria, British Columbia, January 1993. At p.8 he highlights the incongruity observed by Millet J in *Agip (Africa) Ltd v. Jackson* [1989] 3 WLR 1367, 1389 of requiring one standard of wrongdoing for the primary wrongdoer (the trustee) and a lesser standard for the third party participant.

¹⁴¹ *Ibid* at 35.

Fault or Standards

Dr Finn's thesis is one that is directed to an enquiry as to facts.¹⁴² He considers it is not necessary to establish whether there has been any dishonesty. Therefore his thesis falls short of adopting "unconscionability" as the criteria even though unconscionability will often be present. Whilst Dr Finn rejects notions of negligence as being relevant he accepts that there may be standards to apply. Birks has, in contrast to Finn, criticised participatory liability **in the receipt category** being fault based and points to the tension involved between fault based liability in *Montagu* and the strict personal liability in *Diplock*¹⁴³ and mistaken payments. He cites *Kelly v. Solari*¹⁴⁴ an authority for showing that even a carelessly mistaken payer can recover against an innocent payee. Birks considers that if at common law a defendant who receives a plaintiff's money by reason of the latter's mistake is personally liable to repay without reference to the moral quality of his receipt, it is difficult to see how, in equity, there can be room for a requirement of fault, particularly in the light of *Diplock*.¹⁴⁵

However, this difference as to whether the court is concerned with a common law or equitable obligation is the reason for the different approach. Equity is concerned with the state of the conscience of the defendant, whereas at common law, such enquiries are largely irrelevant where the question is more one of an adjustment of rights between parties.¹⁴⁶

PART SIX

Conclusion

If the imposition of constructive trusteeship liability is concerned with remedying breach of an equitable obligation where there has been "unconscionable conduct" as seems clear at least in the area of stranger liability for knowing assistance despite the use of the different tags want of probity and "dishonesty" (these being illustrations of unconscionable conduct), then there is no room for any extension of the concept of knowledge to constructive knowledge or notice provisions beyond a factual context allowing for what circumstances should have inferred in this category. There is no room for the importation of negligence notions which arise separately outside equity in the fields of tort and contract. Arguably the test of knowledge should not go beyond (iii) on the *Baden* scale. As the bottom line the test is not one that should equate standards with liability **beyond** what "everyone else would have seen" as in *Agip*.

The English Courts do require a "want of probity" in the knowing assistance category but appear to accept that provided this is present none of the *Baden* knowledge categories can be excluded (though it seems unlikely that (v) will be accepted). In Australia negligence again would appear not to suffice but there is no requirement for a want of probity. The latest decision in the New Zealand Court of Appeal leaves that country's position in an uncertain state.

It is arguable that if constructive trusteeship is the vehicle for imposing personal liability for all participatory breach, the notion of unconscionable conduct should also underlie liability in the receipt based category.

¹⁴² This is made perhaps clearer in the commentary to the Model Trustee Code, *supra* n.51 at 150.

¹⁴³ [1948] Ch 465.

¹⁴⁴ (1841) 9 M & W 54.

¹⁴⁵ Birks 'An Introduction to the Law of Restitution' *supra* n.13 at 478.

¹⁴⁶ Particularly where the question is which of two innocent parties will bear the loss as in *Lipkin Gorman (a firm) v. Karpnale Ltd* [1991] 2 AC 548 and *R.E. Jones Ltd v. Wallow Waring and Gillow Ltd* [1926] AC 696.

In making a choice as to where to make that vital cut in the knowledge requirements to determine the type of unconscionable conduct required, the Courts may need to focus on whether by unconscionable they mean the defendant's conscience or "Equity's". Equity's conscience can be offended by less than the subjectively viewed unconscionable behaviour of a defendant. The selection of behaviour must be balanced against the nature of the remedy, ie, the imposition of a personal liability. This is in essence the issue in whether to allow **knowledge of the circumstances** (without more) to let in liability.

Only in the case of "beneficial receipt" is there any justification for allowing any form of constructive knowledge **alone** to establish liability and then only if it is correct that the underlying principle is proprietary. The concept of knowledge must be kept separate from notice, the former being the catalyst for the imposition of a personal liability and the latter a test that helps in determining which of a number of contenders is entitled to "the property" retained in the recipient's hands. The test of constructive notice is premised on the basis that the recipient often has no knowledge.

If one focuses on the nature of the remedy as restitutionary and based on unjust enrichment in the receipt category, Professor Birks presents forceful reasons why receipt based liability should be strict, based on the concept of unjust enrichment. I have submitted here if it is accepted that unjust enrichment has a part to play (I have submitted that it has not) then the focus should be on the defendant's **wrong** as opposed to the plaintiff's **ignorance** as in the area of constructive trusts the Courts focus on the defendant's as opposed to the plaintiff's conduct, with the constructive trust liability imposed as the remedy. Unjust enrichment belongs to causes of action or explains why the new law imposes obligations and in Australia cannot be said to have crossed the common law/equity barrier. In spite of this submission I acknowledge there is much territory to be explored in this area.

I further submit that Charles Harpum is on the right track to separate beneficial receipt from all other categories and to adopt a proprietary base here. The voluntary recipient has received something that he/she is not entitled to. The bona fide purchaser for value at both common law and in equity has consistently been treated as safe in the absence of **notice** or knowledge. In the commercial context the purchaser for value is well protected if the English Courts' requirement of actual or close to actual **knowledge** prevails.

It is the receipt based category that presents the challenges of the future for lawyers, particularly where the property is no longer in the hands of the stranger. First, it must be settled what the underlying basis for liability is here. Is the liability based on unconscionability, is it property based, or based on the notion of unjust enrichment? As illustrated in this paper each basis adopted a different approach to determine liability. The questions that also need to be further explored are whether the existing rules, ie, priority, tracing and the *Diplock* principle are adequate and whether the receipt based category is required at all outside the context of agents. The failure to mention it in *Barnes v. Addy* leaves one to wonder if *Barnes v. Addy* is a false starting point for receipt based liability where there is no agency involved.