Justice Paul Finn, Federal Court of Australia

Knowing Receipt and Knowing Assistance: Balkanising Equity

KNOWING RECEIPT AND KNOWING ASSISTANCE: Balkanising Equity

I need to begin with several explanatory comments. First, when I accepted Mariette's generous invitation to address you, it was to be on a completely different topic – that of mortgage indefeasibility. Necessarily I would have mentioned that aspect of *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89, but not its treatment of *Barnes v Addy* (1874) LR 9 Ch App 244. Now all is changed.

This brings me to the second matter. I have persistently refused to accept invitations to speak about *Farah*. I should indicate why. *Farah* obviously represents Australian law at the moment on third party liability both for knowing assistance in a breach of trust or of fiduciary duty and for knowing receipt of property consequent upon a breach of trust or of fiduciary duty. I say "at the moment" for this reason. The High Court acknowledged the radical difference between the decision of the Privy Council in *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378 and the earlier decision of the High Court in *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373 on the knowing assistance limb of *Barnes v Addy*. In *Royal Brunei* it was indicated that, provided the third party was acting dishonestly, it mattered not whether the trustee or fiduciary committing the breach of trust or of fiduciary duty was also acting dishonestly or fraudulently. In contrast, *Consul* was said to have accepted that there must be a dishonest or fraudulent design on the part of the defaulting trustee or fiduciary. As I will later indicate, the distinction is not unimportant.

While not discountenancing that it might revisit *Consul* in light of *Royal Brunei*, the High Court indicated that (at [163]):

> *Until such an occasion arises in this Court, Australian courts should continue to observe the [Consul] distinction mentioned above and, in particular, apply the formulation in the second limb of* Barnes v Addy.

We now live in consequence with settled, but lame, law. What makes this situation regrettable is that it simply accentuates the vice in the case law identified by Lord Nicholls in *Royal Brunei* which is implicit in the title to this session. His Lordship said (at 386):

> *… there has been a tendency to cite and interpret and apply Lord Selborne L.C.'s formulation in* Barnes v Addy, *L.R. 9 Ch.App. 244, 251-252, as though it were a statute. This has particularly been so with the accessory limb of Lord Selborne L.C.'s apothegm. This approach has been inimical to analysis of the underlying concept. Working within this constraint, the courts have found themselves wrestling with the interpretation of the individual ingredients, especially "knowingly" but also "dishonest and fraudulent design on the part of the trustees," without examining the underlying reason why a third party who has received no trust property is being made liable at all.*

For the moment we have to continue to engage in the illusion that we can solve problems by formulae, although it was acknowledged almost 25 years ago that the law in this area "suffers from over much classification at the expense of sound underlying principle"[1].

In this state of affairs there is not much, in my view, that can profitably be said about *Farah's* treatment of *Barnes v Addy*. In Australia it is simply "business as usual".

Not that it is of any significance or consequence at all[2], I nonetheless should indicate that I consider that, based on the trial judge's findings, the actual conclusion reached in *Farah* is immune to criticism. I equally consider that the ultimate rejection of a restitution based, strict liability alternative to the knowing receipt limb of *Barnes v Addy* was entirely appropriate. My reasons for so thinking, as will be seen, are somewhat different from those of the Court. Finally, I should add that this is not the place to express views on those aspects of what I might euphemistically describe as the High Court's methodology in *Farah* which have attracted responses, most notably from Keith Mason, the recently retired President of the New South Wales Court of Appeal. I would say, though, that it was that unworthy dimension of *Farah* more than anything that had till now disinclined me to comment on the case at all.

Now let me turn to what I will talk about and it will not be an analysis of Australian – or for that matter comparative – case law as such. Rather it will be about the factors which at the moment make the case law so problematic[3]. I would preface what I have to say with the comment that if you think the reasons are self-evident why and when we should impose personal liability on a third party who is implicated in another's breach of fiduciary duty or breach of trust, I would suggest you think again. If you survey the *Barnes v Addy* case law in the UK, Canada, New Zealand and Australia you will find the judicial equivalent of Babel.

Having said I will not talk about case law, I should indicate I have appended to the CD version of my paper a lengthy research memoranda prepared by my associate. It compares and contrasts the various national responses to themes in the case law.

BACKGROUND

Simply to set the scene I should indicate that the type of situation with which we are generally concerned is that where A commits an equitable wrong on B and X (a third party) participates in, or is otherwise implicated in, the commission of that wrong. In such circumstances B will ordinarily be entitled to equitable relief against A – the award of compensation, an account of profits, the avoidance of a dealing, etc. But often enough relief against A will be illusory. And thus the questions arise whether, when and why relief of some sort (but usually for compensation) can be sought against X. I will for convenience refer to X's potential liability here as "participatory liability" – a neutral description.

The major point of which we should never lose sight is that where participatory liability arises, it is a pendant liability in the sense that it is predicated upon the primary wrong of another, i.e. of A to B. One would have thought that if X was to be held severally liable for participation in that primary wrong it should only be because X was itself, in the

1 See Sir Anthony Mason in Finn (ed), *Essays in Equity* (1985) at 247.
2 Cf the comments of P Young J in (2008) 82 ALJ 349.
3 For a now dated foray into this see Finn, "The Liability of Third Parties for Knowing Recept or Assistance" in Waters (ed), *Equity, Fiduciaries and Trusts* (1993) at 195.

circumstances, also a wrongdoer to B, i.e. X's liability would not be a secondary liability[4] and would be fault based. I will return to this issue.

Now let me begin to catalogue the complications and incoherences in *Barnes v Addy* jurisprudence.

EQUITABLE WRONGS

The first relates to equitable wrongs. One can envisage a considerable range of equitable wrongs in which a third party is implicated and in which the issue of participatory liability could arise. A simple example is that of a third party purchaser who is complicit in a mortgagee's abuse of its power of sale. Assume that the purchaser has resold the property. Can it be sued for compensation by the mortgagor for its complicity in the mortgagee's breach of its equitable duty of good faith to the mortgagor[5]? I do not pause to answer that question because what is clear is that the species of equitable wrong that potentially attract the *Barnes v Addy* style liabilities are limited to breaches of trust and breaches of fiduciary duty.

What in consequence is clear is that there is a range of situations in which third party participatory liabilities can arise but which are not conventionally analysed in *Barnes v Addy* terms. Simple examples are the possible liabilities of third parties who knowingly receive and use information obtained in breach of confidence[6] and the bank that seeks to take advantage of a security given in favour of the dominant party to a relationship of undue influence[7].

I need hardly add that there is wide disagreement between Commonwealth common law countries as to whether relationships of confidence or of influence are fiduciary ones. I long ago expressed the view that they were and cannot understand the argument to the contrary[8].

DERIVING A BENEFIT FROM THE TRUSTEE'S OR FIDUCIARY'S WRONG: PRIVILEGING PROPERTY

A common reason for a third party's implication in a breach of fiduciary duty or breach of trust is that that third party has sought to derive or has derived a tangible benefit in consequence of the breach – e.g. the receipt or purchase of property, the exploitation of a business opportunity, a contract entered into, etc. But for historical reasons[9], the third party's receipt of "trust" property from the defaulting fiduciary or trustee has been given a privileged and, I would suggest, an increasingly anomalous position in *Barnes v Addy* jurisprudence.

It is appropriate at this point to refer at last to what Lord Selbourne LC actually said on this matter in *Barnes v Addy*[10]:

> *Now in this case we have to deal with certain persons who are trustees, and with certain other persons who are not trustees. That is a distinction to be borne in mind throughout the case. Those who create a trust clothe the trustee with a legal power and control over the trust property, imposing on him a corresponding responsibility.*

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4 See Ridge "Justifying the Remedies for Dishonest Assistance" (2008) 124 LQR 445 at 446 ff.
5 Cf *Downsview Nominees Ltd v First City Corporation Ltd* [1993] AC 295.
6 Cf Meagher Gummow & Lehane's *Equity Doctrines and Remedies* (4th ed) at [41-110] which advocates resort to the *Barnes v Addy* **analogy** in this context.
7 *Bank of New South Wales v Rogers* (1941) 65 CLR 42.
8 *Fiduciary Obligations* (1977) chs 16 and 19.
9 Related to participatory liability's provenance in the law of trusts.
10 LR 9 Ch App at 251-252.

> *That responsibility may no doubt be extended in equity to others who are not properly trustees, if they are found either making themselves trustees* de son tort*, or actually participating in any fraudulent conduct of the trustee to the injury of the* cestui que trust*. But, on the other hand, strangers are not to be made constructive trustees merely because they act as the agents of trustees in transactions within their legal powers, transactions, perhaps of which a Court of Equity may disapprove, unless those agents receive and become chargeable with some part of the trust property, or unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees.*

I should make the following comments immediately. *First*, Lord Selbourne did not speak of knowing receipt of trust property but rather of becoming "chargeable with trust property". The former we take to be the modern expression of the latter. *Secondly*, the responsibility as a constructive trustee of which he spoke is, put shortly, to be equated with the liabilities to which the recipient would be exposed as if he or she was in fact a trustee and most particularly liability to pay compensation for loss of trust property. *Thirdly*, despite the hares set running by the High Court in *Farah* (at [120]), it is well accepted from long standing authority that "trust property" extends to property possessed, held or controlled by a person in a fiduciary capacity as, for example, corporate property subject to the control of corporate directors[11]. *Fourthly*, it is also well accepted that for there to be a "receipt" for *Barnes v Addy* purposes, the recipient third party must receive the trust property for his or her own benefit or else appropriate it to his or her own benefit. Importantly for banks, it is insufficient to receive and deal with trust property as a mere depository or a channel for transmission to others[12]. The four Commonwealth countries to which I have been making reference, acknowledge this own benefit vs agency distinction.

Now let me return to the trust property - other benefit distinction. With a distinct rule of participatory liability being formulated for "trust property" (in the extended sense I have noted above), participatory liability for other types of benefit acquired by a third party in consequence of a breach of fiduciary duty, e.g. the exploitation of an opportunity, seemingly required a different explanation. This, as I will indicate, was to be found, but only partially, in the knowing assistance limb of *Barnes v Addy*.

A SEPARATE RATIONALE FOR THE TRUST PROPERTY LIMB OF *BARNES v ADDY*?

The differentiation of the factually distinct phenomena of receipt of trust property and of participating in a breach of fiduciary duty or breach of trust without such a receipt tends to suggest that there are at least two distinct participatory liability rules at play here with differing rationales and different incidents, most notably in relation to the level of knowledge of the trustee's or fiduciary's wrongdoing and/or of its character which is required to attract liability.

It was on this question that Stephen J commented (at 410) in *Consul*:

> *It is not clear to me why there should exist this distinction between the case where trust property is received and dealt with by the defendant and where it is not; perhaps its origin lies in equitable doctrines of tracing, perhaps in equity's concern for the*

[11] See *Kalls Enterprises Pty Ltd (in liq) v Baloglow* (2007) 63 ACSR 557 at [152] ff.
[12] See *Robb Evans of Robb Evans & Associates v European Bank Ltd* (2004) 61 NSWLR 75 at [159] ff.

> *protection of equitable estates and interests in property which comes into the hands of purchasers for value.*

I would have to admit to the same difficulty.

Yet all four jurisdictions acknowledge that there is a difference between trust property receipt cases and other cases of participatory liability and this justifies differing requirements for each. But the rationales for the differences vary between countries, as do the respective requirements for liability for knowing receipt. In making this comment I include Australia, although with our preoccupation with the theology of doctrine, little has been said by the courts here about the underlying reasons why a third party recipient or for that matter a third party who has received no trust property is being made liable at all: cf *Royal Brunei* at 386.

Historically, the rationale of protecting the wronged beneficiary's property interest about which Stephen J speculated has loomed large in the shaping of the requirements for participatory liability in property receipt cases. Influenced significantly by the doctrine of bona fide purchaser for value without notice all four countries did – and most still do – adhere to a liability rule concerned with the protection of equitable estates and interests and not with any question whether the recipient was guilty of such fault in the matter as would warrant the imposition of not merely proprietary but also personal liability on him. The recipient's constructive knowledge (in Australia) or constructive notice (in New Zealand and Canada) of a breach of trust or of fiduciary duty would suffice to attract participatory liability[13].

The property protection concern has led to some flirtation with the imposition of strict liability subject to defences on a third party recipient (i.e. a restitution/unjust enrichment rationale). Though some lip service to unjust enrichment has been paid in Canada[14], strict liability has made no headway in any of the four countries as its rejection in *Farah* attests, although it has had some notable proponents in the UK and particularly Lord Nicholls. My own view is that strict liability would result in the wholly unappetising consequence of making a third party recipient the insurer for the beneficiary of the defaulting fiduciary's or trustee's probity and, often, competence. It is difficult, with respect, to see what could justify such a perverse risk allocation[15].

There are three comments I would like to make about the knowledge/notice requirement in receipt cases. First, I earlier referred to the illusion of solving problems by formula and to Lord Nicholls' comment on "wrestling with the interpretation" of the knowledge requirement in knowing assistance cases. It is now appropriate to refer to the decision of Peter Gibson J in *Baden's* case ([1993] 1 WLR 509 at 582) on the refined distinctions possible in the degrees of knowledge or notice. The schemata propounded there attained what the authors of *Jacobs' Law of Trusts* (7th ed) (at [1335]) have described as the "zenith of complexity". It had five categories:

(i) "actual" knowledge;

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13 In the UK see the discussion in *BCCI (Overseas) Ltd v Akindele* [2001] Ch 437; in New Zealand see *Westpac Banking Corporation v Savin* [1985] 2 NZLR 41 but note the reservation of Richardson J at 53; in Canada see *Gold v Rosenberg* [1997] 3 SCR 767 and *Citadel General Assurance Co v Lloyds Bank Canada* [1997] 3 SCR 805; in Australia this issue was not addressed in *Farah* but in *United States Surgical Corporation v Hospital Products International Pty Ltd* [1983] 2 NSWLR 157 which accepts a watered down version of constructive notice.

14 See *Citadel General Assurance* at [51].

15 See generally Dietrich and Ridge, "The Receipt of What?: Questions Concerning Third Party Recipient Liability in Equity etc" (2007) 31 MULR 47.

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

I should note in passing that for Australian purposes *Consul* mandates categories (i) to (iv) but not category (v).

Secondly, whether or not one stops at category (iv) or category (v), it cannot in my view be said convincingly that the type of liability being imposed on the third party recipient is fault based in the equitable sense that the recipient's conscience is in the circumstances so affected that his or her receipt is knowingly wrongful. As Megarry V-C noted in *In Re Montagu's Settlement Trusts* [1987] Ch 264 at 285, the carelessness involved in categories (iv) and (v) would "not normally amount to a want of probity".

Thirdly, after considerable indecision in the case law, the UK courts have abandoned at least a simple constructive notice basis for liability. In *BCCI (Overseas) Ltd v Akindele* [2001] Ch 437 at 455 it was held that there ought to be a single test of knowledge for knowing receipt. It was that –

> *"The recipient's state of knowledge must be such as to make it unconscionable for him to retain the benefit of the receipt."*

Of this it was said:

> *"A test in that form, though it cannot, any more than any other, avoid difficulties of application, ought to avoid those of definition and allocation to which the previous categorisations have led. Moreover, it should better enable the courts to give commonsense decisions in the commercial context in which claims in knowing receipt are now frequently made …"*

The final comment I want to make about having a separate liability rule for receipt cases which, seemingly, has its own rationale is this. I would not wish to be taken as suggesting that the non-receipt cases similarly have their own distinct rationale and incidents. The contrary is the case.

KNOWING RECEIPT'S COUNTERPOINT: KNOWING ASSISTANCE

I have already indicated that not all cases of participatory liability not involving a property receipt fall potentially within the second limb of *Barnes v Addy* for the reason that they do not involve a breach of fiduciary duty or breach of trust.

Now for two further complications. The first is a product of the knowing assistance formula used by Lord Selbourne in *Barnes v Addy*. This was of agents "assist[ing] with knowledge in a dishonest and fraudulent design on the part of the trustees". Both Australia (because of *Farah*) and Canada[16] adhere literally and dogmatically to this formula in its

[16] See *Air Canada v M & L Travel* [1993] 3 SCR 787.

requirement of a dishonest and fraudulent design. Subject to what I will say below, knowledge of simply a breach of fiduciary duty or breach of trust as such will not suffice. *Farah* has seen to that. And neither would a dishonest or fraudulent design on the part of the third party alone.

For the sake of completeness – and to compound the confusion – the required knowledge of the relevant design differs as between Australia and Canada. Again in consequence of *Farah* constructive knowledge (*Baden* category (iv)) will suffice. In Canada, which has a truly fault based liability for knowing assistance, what is required is actual knowledge or else reckless or wilful blindness to the circumstances[17].

I earlier said that there was an exception to the proposition that knowledge of a breach of fiduciary duty or a breach of trust would not suffice for participatory liability purposes. The exception, which was acknowledged in *Farah* (at [161]-[162]), is that a third party who knowingly induces or immediately procures a breach of trust or of fiduciary duty is liable therefore to the wronged beneficiary: see *Elders Trustee and Executor Co Ltd v E G Reeves Pty Ltd* (1987) 78 ALR 193 at 238. This exception goes far to undermine the knowing assistance limb of *Barnes v Addy*. It appears, properly in my view, to have a more intense knowledge requirement than is permitted by *Consul*. Equally importantly, though, it embraces potentially two of the largest and most practically significant classes of case: (i) that of company directors whose decisions cause a corporate trustee to commit a breach of trust or of fiduciary duty; and (ii) advisers, be they solicitors, financial advisers or otherwise, who aid, abet, counsel or procure breaches of fiduciary duty or of trust.

What should be borne in mind in relation to this "exception", if I can so call it, is that, though it does not fall under the *Barnes v Addy* rubric, what differentiates it from "knowing assistance" is the different and more damning character of the third party's participatory role in the fiduciary's or trustee's own wrong. And when one puts it alongside the type of case with which the *Barnes v Addy* formulation was concerned, i.e. the agent who assists in a breach of trust or of fiduciary duty, what seems to be suggested is that there are three variables at play in the shaping of third party liability. These are (i) the actual manner of participation by the third party in the fiduciary's or trustee's wrong; (ii) the character of that wrong, i.e. was it fraudulent or innocent; and (iii), to use a neutral term, the extent of the third party's "appreciation" of the likelihood of a wrong being committed by the trustee or fiduciary.

To digress slightly, in my 1993 paper, I ventured to suggest that an overarching principle of third party liability in equity could be distilled from the cocktail of those factors. But that's another story.

What is not another story is the radical departure first in the UK – and then in New Zealand[18] – from the traditional understanding of the second limb of *Barnes v Addy*. *Royal Brunei*, as far as it goes, represents a real attempt to put accessorial liability in equity on a principled and coherent footing. The hallmark of accessorial liability is the third party's dishonest participation in a breach of fiduciary duty or breach of trust.

For the moment in this setting *Royal Brunei*'s burden is something for New Zealanders to ponder. For Australians, it is a distant prospect.

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17 Ibid.

18 See *US International Marketing Ltd v National Bank of New Zealand Ltd* [2004] 1 NZLR 589.

CONCLUSION

I earlier referred to Sir Anthony Mason's comment that the law as it presently stands in Australia suffers from overmuch classification at the expense of sound underlying principle. In my view this does us little credit. Much of the difficulty lies in *Barnes v Addy* itself and in its skewed focus on trust property and agents. It was a most imperfect progenitor for a coherent body of principle concerned with participatory liability. First, its focus on trusts and trust property was understandable enough for its time. But it predates the rise of the fiduciary relationship and the remedial constructive trust. Fiduciary wrongdoing – and I include undue influence and breach of confidence in this – now looms large in commerce. The accessory question is becoming increasingly a fiduciary related one.

Secondly, the agent assisting in a breach of trust or breach of fiduciary duty is in a sense the atypical type of accessory which raises quite unique issues. These result from the agency relationship itself and from its demands such as carrying out the principal's instructions, etc. Contrast the person who induces, procures, or facilitates such breaches or who takes advantage of them. Such are strangers to the knowing assistance limb of *Barnes v Addy*. Yet we see them daily in corporate collapses, financial scams and the like and they are fitting targets for a principled, accessorial liability regime.

This leads me to my final observation. Today *Barnes v Addy*, I would suggest, is a distraction.