PERSPECTIVES ON KNOWING RECEIPT LIABILITY

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This paper discusses a number of issues of importance in respect of the equitable cause of action called "knowing receipt". In many cases, it is referred to as "constructive trust liability for knowing receipt". So the first question must be: what exactly is the connection between "knowing receipt" and "constructive trust"? Secondly, what special features are there in the banking context which might impact on this form of liability? Thirdly, what are the requirements for liability, and how do these reflect the underlying rationale of the action? This area of the law has been bedevilled by conflicting voices (my own included!), but it appears that some semblance of order is now appearing. A new property-based approach is beginning to demand attention, and it may solve many of the problems in this area.

1 The Language of Constructive Trusteeship

Equitable liability in knowing receipt has been historically and linguistically linked to constructive trusteeship. However, the term "constructive trustee" in this context is no more than a shorthand form of saying "liable to account [for the loss caused by knowing receipt] as if one were a constructive trustee". The phrase "as if one were a constructive trustee" adds nothing. It refers at most to a *personal obligation* in the recipient defendant. It does not refer to a real or true trusteeship, which requires the identification of trust property and trust beneficiaries. Indeed, the *substantive liability* of knowing receivers, while it is part of the law of equity, is not part of trust or fiduciary law at all. Certainly, the equitable liability of a third party, who becomes involved in a breach of trust or fiduciary duty by the receipt of trust property, is not inherently part of the law of "constructive trusts", however that law is made up. That is not to say that some form of constructive trust might not make an appearance at the remedial stage, but, to repeat, the liability itself is independent of any constructive trusteeship of the liable receiver.

(See, for further discussion on the true scope and fit of constructive trusts generally, C Rickett and R Grantham, "Towards a More Constructive Classification of Trusts" [1999] LMCLQ 111; CEF Rickett, "The Classification of Trusts" (1999) 18 NZULR 1).

It is time to come clean on this and avoid the confusion which the gobbledegook language of constructive trusteeship introduces. Fortunately, there is an influential English judge who has recently drawn attention to the problem. In *Paragon Finance plc v DB Thakerar & Co (a firm)* [1999] 1 All ER 400, Millett LJ (as he then was) discussed the use of "constructive trust" terminology in these circumstances (at p 408-409):

> "[T]he expressions 'constructive trust' and 'constructive trustee' have been used by equity lawyers to describe two entirely different situations. ... The second covers those cases where the trust obligation arises as a direct consequence of the unlawful transaction which is impeached by the plaintiff.
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> . . .
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> The second class of case ... arises when the defendant is implicated in fraud. Equity has always given relief against fraud by making any person sufficiently implicated in the fraud accountable in equity. In such a case he is traditionally though I think unfortunately described as a constructive trustee and said to be 'liable to account as a constructive trustee'. Such a person is not in fact a trustee at all, even though he may be liable to account as if he were. He never assumes the position of a trustee, and if he receives the trust property at all it is adversely to the plaintiff by an unlawful transaction which is impugned by the plaintiff. In such a case the expressions 'constructive trust' and 'constructive trustee' are misleading, for there is no trust and usually no possibility of a proprietary remedy; they are 'nothing more than a formula for equitable relief': *Selangor United Rubber Estates Ltd. v Cradock* [1968] 1 WLR 1555 at p. 1582 *per* Ungoed-Thomas J."

Later in his judgment, his Lordship described this use of constructive trust terminology as (at p 414) "remedial [but "necessarily confined to a personal remedy"] .... though not in the sense in which it is used in the United States and Canada, where it is

the basis of a discretionary proprietary remedy". The terminology was (at p 414) "a catch phrase ... employed ... to justify the exercise of equity's concurrent jurisdiction in cases of fraud. 125 years later it is surely time to discard it. If we cannot bring ourselves to discard it, at least we can resolve not to take it literally."

Thus, a "knowing receiver" defendant is not a constructive trustee prior to his receipt of the property in which the plaintiff has an equitable interest. Nor does the defendant become a constructive trustee ipso facto on his receipt of the property. This is revealed by a quick examination of the relevant remedial scheme.

If found liable in "knowing receipt", and if a "wrongdoing" analysis best explains such liability (see herein under points 3A and 3C), the recipient defendant is primarily susceptible to an award against him of equitable compensation to meet the plaintiff's loss, or an account of profits to be disgorged by monetary payment. (Of course, a knowing receipt defendant may often, on the same facts, be liable to an altogether different claim by the plaintiff equitable owner, founded upon a *direct* vindication of that plaintiff's equitable property right. The plaintiff says in effect, "That is my property, because I can, by tracing if necessary, identify it as the substitute for the value belonging to me originally in the asset which you received." And, if successful, the claim will and must – because it is a direct property claim - be followed by an equitable proprietary remedy, which some call a constructive trust. This was the distinction which Lord Browne-Wilkinson drew in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669, 707.)

Alternatively, if knowing receipt is regarded as restitutionary in nature (see herein under point 3B), the correct remedial response is monetary "restitution" equating to the recipient defendant's gain.

Whichever view of the substantive nature of knowing receipt liability is adopted, the primary personal remedy might be displaced in an appropriate case by a proprietary remedy (see, for example, *Fortex Group Ltd (In Receivership and Liquidation) v Macintosh* [1998] 3 NZLR 171 (NZCA), discussed in C Rickett and R Grantham,

"Towards a More Constructive Classification of Trusts" [1999] LMCLQ 111). That remedy might (confusingly and unnecessarily in my view) be called a "constructive trust" or "remedial constructive trust", but that is not the same as saying that knowing receipt liability is based in constructive trusteeship. Nor does this remote remedial possibility legitimate the introduction of constructive trust gobbledegook. On the contrary, to understand knowing receipt liability, it is necessary to be free of it.

2 The Banking Context

A claim in knowing receipt in the banking context needs to be understood within the matrix of the banker-customer (creditor-debtor) relationship, which provides important presumptions as to the nature of a bank's title to or interest in funds on their receipt when deposited or collected. A bank does not receive funds from depositors as a trustee, unless it acts as an express trustee, in which case it receives and holds funds not as bank but as trustee. A bank, on receipt of deposited funds, becomes entitled to use those funds as its own property. Of course, that proprietary entitlement of the bank is tempered by the contractual position between it and its customer, whereby the customer acquires a debt owed by the bank, or reduction of a debt it owes the bank. But, even in a case where a bank knows its customer is a trustee and/or fiduciary, the bank does not, by virtue of that fact itself, become a trustee (express or constructive) of the deposited funds. These propositions are absolutely incontrovertible: see *Foley v Hill* (1848) 2 HL Cas 28; *Goddard v DFC Ltd* [1991] 3 NZLR 580 (HC), [1992] 2 NZLR 445 (CA); and *Space Investments Ltd v Canadian Imperial Bank of Commerce Trust Co (Bahamas) Ltd* [1986] 3 All ER 75. This basic legal framework has its obvious impact on the law of knowing receipt. It throws up special problems in defining receipt. In one sense, the bank receives the funds; in another sense, that receipt is circumscribed by the contractual matrix. It also throws up particular issues about the role of the bank's knowledge in founding liability.

3 The Requirements of Knowing Receipt

The requirements for a successful "knowing receipt" claim are not settled. There are three possible variations, dependent upon the underlying conceptual approach one adopts to knowing receipt liability.

A Is knowing receipt a form of equitable wrongdoing requiring dishonesty?

This analysis builds on the modern understanding of *dishonest assistance liability*. It seeks essentially to incorporate "knowing receipt" into "dishonest assistance". It is now established (following *Royal Brunei Airlines v Tan* [1995] 2 AC 378) that the requirements which a plaintiff must prove for a "dishonest assistance" claim to succeed are:

(a) The existence of a trust or fiduciary duty which is breached by the fiduciary;

(b) The "assistance" by the defendant in that breach;

(c) The *dishonesty* of the defendant in rendering that "assistance"; and

(d) Loss suffered by the plaintiff as a result of the dishonest assistance.

Requirement (a) is already seen as common to both "knowing receipt" and "dishonest assistance". It is convenient to say something about it here. The requirement defines the activity of the primary actor in the relevant chain of events. Just what activity is required?

On the one hand, it has been suggested recently that a much broader range of activity than the usual breach of trust / breach of fiduciary duty matrix might suffice. In *Equiticorp Industries Group Ltd v Attorney General* [1998] 2 NZLR 481, 540, Smellie J suggested that the first requirement could be satisfied if there were some unauthorised basis or act, apparently distinct from a breach of fiduciary duty. He articulated this extended notion for both knowing receipt and dishonest assistance. There is no authority for this suggested notion, which would extend considerably the reach of both dishonest assistance and knowing receipt liability. It was in any event obiter, since the Judge held there had been a breach of fiduciary duty (in the traditional sense) in the facts. Further,

Smellie J did not repeat his suggested "unauthorised act" basis when he dealt later in his judgment with another separate dishonest assistance claim: see pp 664-665.

On the other hand, it has also been suggested recently that a "mere" breach of fiduciary duty which does not of itself constitute or involve the disposition of trust property beyond the terms of the trust will not suffice to ground liability. This is a particularly important issue where companies sue third parties on the basis of breaches of fiduciary duty by their directors. (See for full discussion on this difficult issue, R Grantham, "Illegal Transactions and the Powers of Company Directors" (1999) 115 LQR 296, and R Grantham, "Civil Liability for Money Laundering" (1999) 18 NZULR 74.) Recent cases do suggest that there must be a disposition of property involved. This would seem to be the correct position: see further herein under point 3E.

Although dishonest assistance liability, like knowing receipt liability, has historically been called "constructive trustee" liability, this is extremely confusing. There is no role for trusteeship at all. This is clearly a form of equitable liability to compensate for loss caused by participation, dishonestly, in a breach of a fiduciary's fiduciary duties. It is, as Lord Nicholls recognised in *Royal Brunei Airlines v Tan*, the equitable equivalent of the tort of inducing a breach of contract. It is simply an equitable tort (a word which means no more than "wrong"), for which the primary remedy is equitable compensation. The equitable tort is committed by the defendant when the requirements as outlined above are met, and it can be seen as the breach by the defendant of a duty on him not to assist dishonestly in a breach of trust or fiduciary duty by a trustee or fiduciary. The duty owed by the defendant is, however, neither a trustee duty nor a fiduciary duty (ie, the defendant is neither a trustee nor a fiduciary). One school of thought sees this analysis as extremely significant in reaching an understanding of the true basis of knowing receipt liability.

To found liability in dishonest assistance, the assistance must have been provided "dishonestly": see *Royal Brunei Airlines v Tan*. Lord Nicholls said that "acting dishonestly, or with a lack of probity, which is synonymous, means simply not acting as an honest person would in the circumstances" and that "for the most part dishonesty is to

be equated with conscious impropriety" (p 389). The test for dishonesty seems two-fold, with an objective and a subjective element. The objective element is designed to prevent people from setting their own standards of behaviour to avoid liability: see p 389. There must be an examination of the circumstances and the standards of behaviour expected of honest people on the given facts to assess whether there has been objective dishonesty. At the second stage of the inquiry, there is an examination of the particular behaviour of the alleged assister. Was the alleged assister conscious of the impropriety of his acts or omissions, so that it could be said that he is dishonest, as assessed against the objective standard? In that sense, it seems that the personal attributes of the defendant assister might be relevant. There is also, in the cases, a close link between dishonesty and the notion of "commercially unacceptable conduct", which is concerned with the situation in which a commercial party takes a risk in its business activities in a way which might jeopardise the position of others: see *Cowan de Groot Properties v Eagle Trust Plc* [1992] 4 All ER 700 (cited by Lord Nicholls); *HR v JAPT* [1997] Pensions LR 99 (noted C Mitchell (1998) 2 CFILR 133); and *Satnam Investments Ltd v Dunlop Heywood & Co Ltd*, The Times, 31December 1998; *Dubai Aluminium Co Ltd v Salaam* [1999] 1 Lloyd's Rep 415; and *Bank of Credit and Commerce International (Overseas) Ltd v Akindele* (Unreported, High Court, Chancery Division, 19 November 1998, Carnwath J).

The *analysis of knowing receipt as a form of equitable wrongdoing* proceeds in this way. Recipient and accessory liability in equity are both historically (*Barnes v Addy* (1874) 9 Ch App 244) *and* doctrinally linked. They should both be understood as manifestations of a single form of *participatory liability* in equity of a third party who participates in a breach of trust. Participating in a breach of trust is to breach one's own primary duty not so to participate. Participation may result in the receipt of the beneficiaries' property by the third party, as one manifestation of helping or assisting; and participation may also occur by helping or assisting in the breach without receipt of trust property.

If this analysis is sustained, then the consequences are that: (i) "receipt" and "assisting" are simply two forms of the act of participation; (ii) dishonesty is required for what is a form of "intentional" equitable tort; and (iii) equitable compensation is the

proper remedy, since the tort focuses essentially on loss suffered by the plaintiff. Strong support for this approach, and in particular that dishonesty (or at least knowledge within the first three *Baden* categories (see herein at point 3C), amounting thereby in effect to "dishonesty") is required for liability, is found in most of the English cases: see *Barnes v Addy* (1874) 9 Ch App 244, 251-252; *Williams v Williams* (1881) 17 Ch D 437, 445-446; *Re Blundell* (1889) 40 Ch D 370, 382-383; *Carl Zeiss Stiftung v Herbert Smith (No 2)* [1969] 2 Ch 276, 290-292, 298-299, 300-301, 303-304; *Re Montagu's Settlement Trust* [1987] Ch 264, 276-282, 285; *Barclays Bank Ltd v Quincecare* [1992] 4 All ER 363, 375; *Eagle Trust plc v SBC Securities Ltd* [1992] 4 All ER 488; *Polly Peck International plc v Nadir (No 2)* [1992] 4 All ER 769, 777; *Jonathan v Tilley*, unreported CA (Eng), 30 June 1995 (see (1998) 12 TLI 36); *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669. This approach also has the strong extra-curial support of Professor Finn (now Finn J of the Federal Court of Australia): see "The Liability of Third Parties for Knowing Receipt or Assistance" in *Equity, Fiduciaries and Trusts 1993* (ed DWM Waters), 195. See also *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669, 707 (per Lord Browne-Wilkinson).

Recent English authorities seem to be moving towards this *participatory liability* position. In *Dubai Aluminium Co Ltd v Salaam* [1999] 1 Lloyd's Rep 415, Rix J provided a comprehensive account of the state of English law on accessory liability. His entire account, while drawing some distinctions between knowing receipt and dishonest assistance, was premised upon a fundamental unity between the two. In particular, his Lordship stated (at p 453):

> "I revert to the principle of knowing receipt. In the light of *Tan* the question arises whether the mental element of 'knowing' is to have the same content in knowing receipt as in what should now be called 'dishonest assistance'. Indeed *Cowan de Groot Properties v Eagle Trust*, which Lord Nicholls had quoted ... , was a case of knowing receipt. Mr Justice Knox's test, approved by Lord Nicholls, of 'commercially disreputable conduct in the particular context involved' comes, in fact, from the obiter part of the former's judgment, in case he was wrong to say, as he preferred, that constructive knowledge would not suffice

to render a defendant liable in knowing receipt. It seems to me that in the circumstances, the test in knowing receipt and dishonest assistance is likely to be the same.

... In the circumstances [of the present case], very little attention was paid to any separate issues which might otherwise have arisen under the heading of knowing receipt. I have already said that in the light of *Tan* I would regard the test of the mental element involved as being dishonesty in the *Tan* sense. ..."

In *Bank of Credit and Commerce International (Overseas) Ltd v Akindele* (Unreported, High Court, Chancery Division, 19 November 1998), a claim – by a bank!!!! – against a customer in both dishonest assistance and knowing receipt, Carnwath J made similar comments. His Lordship was not prepared to discount the help that could be gained, in analysing the mental element required for knowing receipt, from the *Baden* classification (see herein under point 3C). After listing them, his Lordship stated:

"There remains controversy as to which of these states of mind is sufficient for the purposes of 'knowing receipt'. Before me (while reserving his position for a higher court), Mr Sheldon [for the plaintiff bank] accepted that the 'thrust of the authorities' requires one of the first three categories. ... On that basis, it is doubtful whether the test differs materially in practice from that for 'dishonest assistance'.

...

The discussion [about the liability of the defendant, in both knowing receipt and dishonest assistance] ... has concentrated on the ... issue, whether the defendant was a dishonest participant or recipient. (It is convenient to use the single word 'dishonest', while acknowledging the possible differences mentioned in my earlier discussion of the authorities)."

B Is knowing receipt a cause of action founded on unjust enrichment?

At common law any liability founded on receipt of money (where title to the money passes to the recipient) is primarily by way of the action for money had and received. This recovery lies in the law of unjust enrichment, where – although title passes to the transferee - the intent of the transferor is vitiated (by, for example, mistake, failure of basis, or, as some suggest, ignorance). A crucial feature of this liability is that it is strict liability. (Where for some reason title to the money does not pass on receipt, the claim is again by way of an action for money had and received, but here the basis of the claim is not unjust enrichment, but a persisting property right. See further for this crucial distinction, C Rickett and R Grantham, "Property and Unjust Enrichment: Categorical Truths or Unnecessary Complexity?" [1997] NZ Law Rev 668; cf P Birks, Property and Unjust Enrichment: Categorical Truths" [1997] NZ Law Rev 623.)

Another view of knowing receipt liability seeks to argue that its true doctrinal link is with common law receipt liability, rather than with equitable dishonest assistance liability. Accordingly, recovery is said to be restitutionary and is justified by the principle of reversal of unjust enrichment at the expense of the plaintiff, and, most significantly, liability is strict. The defendant is then permitted to plead defences in mitigation, most notably in a banking context, change of position and ministerial receipt. This analysis, which, as indicated, would divorce knowing receipt from dishonest assistance on doctrinal grounds, is supported widely by academic proponents of the law of unjust enrichment: notably P Birks, "Misdirected Funds: Restitution From the Recipient" [1989] LMCLQ 296; P Birks, "Trusts in the Recovery of Misapplied Assets: Tracing, Trusts and Restitution" in E McKendrick (ed), *Commercial Aspects of Trusts and Fiduciary Obligations* (1992), 149; C Harpum, "Knowing Receipt and Knowing Assistance: the Basis of Equitable Liability" in P Birks (ed), *Frontiers of Liability, Volume 1* (1994), 9. There are some decisions which have paid lip service to the theory, while actually applying a compromise position as discussed herein under point 3C: see *Equiticorp Industries Group Ltd v Attorney General* [1996] 3 NZLR 586, [1998] 2 NZLR 481, 539-540, 629-641; *Powell v Thompson* [1991] 1 NZLR 597, 608 (possibly the closest decision yet to adopting strict liability); *Nimmo v Westpac Banking Corporation* [1993] 3 NZLR 218, 224-225; *Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd*

[1998] 3 VR 16 (an especially full discussion of the cases and other authorities). It is important to note also that in *Royal Brunei Airlines v Tan*, at p 386, Lord Nicholls made a comment that implied that receipt-based liability in equity should be restitution based. His Lordship returned to, and developed in full, this theme in an important essay published recently: see "Knowing Receipt: The Need for a New Landmark" in WR Cornish, R Nolan, J O'Sullivan and G Virgo (eds), *Restitution: Past, Present and Future* (1998), 231. His Lordship suggests that, although strict liability should be the order of the day, a dishonest receiver may well find himself subject to wider "fiduciary" duties than an innocent receiver. Certainly, a knowing receiver would struggle to establish an effective defence, but this suggestion goes further than that, to suggest a more potent or extended form of liability. See also C Harpum's comment on the paper in the same volume, at p 247.

On this restitutionary approach, the term "knowing" in knowing receipt would need to be dropped as being a false addition. Other important consequences would be:

(a) the onus on the plaintiff would be minimised considerably, to establish only (i) that he had an equitable property right, and thus value, (ii) which value was received by the defendant when the relevant asset was received (even if the defendant received a good title), and (iii) that there was unjustness (ie, that so far as the plaintiff was concerned the defendant's receipt of the asset was without effective intention or basis);

(b) the onus on the defendant would be increased considerably, to establish either (i) that one of the liability pillars in the plaintiff's case was not established (either legally or on the facts), or (ii) that there was an applicable defence or some possibility of relief (especially change of position, where in New Zealand it now appears that the defence under s94B Judicature Act 1908 has been subsumed by a much wider "equitable" defence or relief jurisdiction – see *The National Bank of New Zealand Ltd v Waitaki International Processing (NI) Ltd*, unreported, CA54/97, 12 November 1998 (discussed by R Grantham and C Rickett, "Change of Position in New Zealand" (1999) 5 NZBLQ 75); or ministerial or agency receipt. In respect of both defences, the defendant's knowledge will be highly

relevant, since only a bona fide defendant can press the defences. The onus will be, it seems, on the defendant to establish his or her bona fides.);

(c) the primary remedy would be monetary, but its basis would be restoring to the plaintiff the gain made by the defendant (restitutionary damages), not compensating for loss.

C *Is knowing receipt a form of equitable wrongdoing requiring only constructive knowledge?*

Here I shall focus on the New Zealand position. The Australian position will no doubt be outlined to by my commentator. I call the New Zealand position a "compromise position". The courts flirt with unjust enrichment, but seem unhappy to jump into the strict liability bed. On the other hands, being driven back into a knowledge requirement to avoid strict liability, they are unhappy to exclude "worthy" claimants on the basis that the defendant receiver was not dishonest. So, there is a large number of New Zealand decisions which adopt a position whereby receipt liability does not require dishonesty by the recipient (although dishonesty obviously suffices), but where in effect a *negligent* failure to establish the true position suffices: see, for example, *Westpac Banking Corp v Savin* [1985] 2 NZLR 41; *Marr v Arabco Traders Ltd* (1987) 1 NZBLC 102; *Powell v Thompson* [1991] 1 NZLR 597; *Equiticorp Industries Group Ltd v Hawkins* [1991] 3 NZLR 700; *Nimmo v Westpac Banking Corp* [1993] 3 NZLR 218. This was, in effect, also the position adopted by Smellie J in *Equiticorp Industries Group Ltd v Attorney General* [1996] 3 NZLR 586, [1998] 2 NZLR 481. The negligence measure is dressed up in the language of constructive knowledge, by a regular use of the five-fold categorisation of knowledge approved by Peter Gibson J in *Baden v Societe Generale du Commerce SA* [1992] 4 All ER 161:

(i) actual knowledge;

(ii) wilfully shutting one's eyes to the obvious;

(iii) wilfully and recklessly failing to make such inquiries as an honest and reasonable man would make;

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

(v) knowledge of circumstances which would put an honest and reasonable man on inquiry and failure to make such inquiries.

It is generally said that categories (i)-(iii) are cases of actual knowledge, which can *roughly* be equated with dishonesty or want of probity, and categories (iv)-(v) are cases of constructive knowledge (but not, it would appear, constructive notice – see S Gardner, "Knowing Assistance and Knowing Receipt: Taking Stock" (1996) 112 LQR 56).

The result of the New Zealand decisions cited above appears to be that any one of these five types of "knowledge" by the recipient will found liability. In so far as it is possible to say with any level of certainty what the present favoured position is in New Zealand, this appears to be it. However, the compromise position based on a constructive knowledge / negligence test is not immune from challenge. The following two points are particularly pertinent:

(a) On the basis that *Savin* is the leading case, the judgments therein are not unequivocal as to the requirements of liability. Furthermore, *Savin* was decided before the enormous explosion of cases on the issue, and it is not unlikely that the decision will not be the last word in New Zealand.

(b) The speech of Lord Browne-Wilkinson in *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669 contains important comments about the conscience-based approach regarded by his Lordship as fundamental to equity (but compare the critique of the extent to which his Lordship's view can be sustained by W Swadling, "Property and Conscience" (1998) 12 TLI 228); and there is a growing awareness even in the context of knowing receipt cases that we are dealing not with trusts and trusteeship, but with personal liability in equity as a wrongdoer. His Lordship stated (at p 707, emphasis in original, although it is to be regretted that he retained the language of "constructive trusteeship"):

> "The bank contended that where, *under a pre-existing trust*, B is entitled to an equitable interest in trust property, if the trust property comes into the hands of a third party, X (not being a purchaser for value of the legal interest without notice), B is entitled to enforce his equitable interest

against the property in the hands of X because X is a trustee for B. In my view the third party, X, is not necessarily a trustee for B: B's equitable right is enforceable against the property in just the same way as any other specifically enforceable equitable right can be enforced against a third party. Even if the third party, X, is not aware that what he has received is trust property B is entitled to assert his title in that property. If X has the necessary degree of knowledge, X may himself become a constructive trustee for B on the basis of knowing receipt. But unless he has the requisite degree of knowledge he is not personally liable to account as trustee: ... Therefore, innocent receipt of property by X subject to an existing equitable interest does not by itself make X a trustee despite the severance of the legal and equitable titles."

When the time comes for the New Zealand Court of Appeal to re-examine knowing receipt liability, and when therefore the compromise position (which, as stated, appears presently to be the established law in New Zealand) is compared with the favoured positions in other jurisdictions, it may well be that the compromise position will not be confirmed, but will give way. The compromise position should be clearly understood as defining knowing receipt as a wrong. One alternative for the future is that knowing receipt will still be defined as an equitable wrong, but one which requires dishonesty rather than a form of negligence dressed up in the language of constructive knowledge. This is certainly the position taken most recently in England by Rix and Carnwath JJ, as indicated above. Perhaps, as a true alternative, it will be defined as a liability arising out of the need to reverse an unjust enrichment? Much, one suspects, will depend upon whether the House of Lords has spoken before then. Much will also depend, in my view, upon whether an alternative understanding of knowing receipt, which is beginning to be articulated, commands attention in the meantime. This alternative understanding, which I believe has the capacity to decide the troublesome question about the nature of (and therefore requirements for) knowing receipt, arises out of recent scholarship on the crucial issue whether claims founded on property rights have a status of their own which does not require their being collapsed into either wrongs or unjust enrichment: see herein under point 3E.

It should be reiterated, however that the compromise position, being the law of New Zealand at present, requires a plaintiff to prove the following requirements for a "knowing receipt" cause of action to succeed:

(a) The existence of a trust (or possibly fiduciary duty) which is breached by the fiduciary;

(b) "[T]he beneficial receipt by the defendant of [trust property or] assets which are traceable as representing the assets of the plaintiff" (per Hoffmann LJ, as he then was, in *El Ajou v Dollar Land Holdings* [1994] 2 All ER 685, 700);

(c) "[K]nowledge [within *Baden* (i)-(v)] on the part of the defendant that the assets he received are traceable to a breach of [trust or perhaps] fiduciary duty" (also per Hoffmann LJ) (note that this requirement incorporates knowledge of two matters - the existence of the trust or fiduciary duty, and the breach of that trust or fiduciary duty); and

(d) Loss suffered by the plaintiffs as a result of the knowing receipt.

Note that Hoffmann LJ's test in *El Ajou*, upon which the above requirements are based, was approved and applied by the English Court of Appeal in *Brown v Bennett* (Unreported, 1 December 1998).

D Knowing receipt and the need for "beneficial receipt" by the defendant

Having already adverted to requirements (a) and (c), something now needs to be said about requirement (b), that of "beneficial receipt" by the defendant. In most cases, of course, a person receiving assets will be intended, and will intend to receive those assets for his own benefit. But the bank as receiver is in a slightly different category.

As we have already seen, when a bank receives funds on deposit, those funds themselves become at the moment of receipt *the property of the bank*. At common law, in respect of an action for money had and received to reverse an unjust enrichment, *the*

bank receives at law when it factually receives, even though when we say funds were deposited directly into an account, we mean no more than to assert the acknowledgment of a debt owed to a customer by the bank. The common law then permits a defendant bank to raise the defence of ministerial receipt (or agency), whereby the bank effectively points to the customer as the "real" recipient: see *Agip (Africa) Ltd v Jackson* [1990] 1 Ch 265; affd [1991] Ch 547; *Australia and New Zealand Banking Group Ltd v Westpac Banking Corp* (1988) 164 CLR 662; *Nimmo v Westpac Banking Corporation* [1993] 3 NZLR 218; WJ Swadling, "The Nature of Ministerial Receipt" in P Birks (ed), *Laundering and Tracing* (1995), 243. This reasoning achieves the appropriate balance between the bank's potential liability to two parties – the payer and its customer. It accords priority to the contractual accounting obligations of the bank to its customer, by requiring the plaintiff to proceed against the customer rather than the bank.

Advocates of knowing receipt as a restitutionary liability argue that the same analysis in respect of receipt should be applied in respect of that liability. However, at present that is not the position, and there is no receipt for the purposes of knowing receipt, until there has been what is called a "beneficial receipt", which is *more than the factual receipt of funds by the bank*. In practice, "beneficial receipt" amounts to saying that if an account is in credit at the time of receipt, the bank does not receive for its own benefit so as to amount to receipt for the purposes of knowing receipt.

The notion of "beneficial receipt" does, however, give rise to difficulties in the context of overdrawn bank accounts. The situation was discussed by Millett J in *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 292 (although unfortunately still using the terminology of constructive trust) (my emphasis):

> "The ["knowing receipt " class] is concerned with the person who receives for his own benefit trust property transferred to him in breach of trust. ... *The essential feature of [this] class is that the recipient must have received the property for his own use and benefit.* This is why neither the paying nor the collecting bank can normally be brought within it. In paying and collecting money for a customer the bank acts only as his agent. *It is otherwise, however, if*

the collecting bank uses the money to reduce or discharge the customer's overdraft. In doing so it received the money for its own benefit."

Two points can be discussed. First, it seems that the "beneficial receipt" requirement reflects to some extent the operation of the ministerial receipt or agency defence in the common law receipt claims. For example, Millett J's reasoning was applied in *Nimmo v Westpac Banking Corporation* [1993] 3 NZLR 218, 225, where Blanchard J held that, even though the payment in breach of trust had been by cheque payable to the bank itself, the bank, on the facts, had not received beneficially, *but only ministerially*. The fraudulent fiduciary had paid the principal's money to the bank; the bank had then, within a short time, put the fraudster in possession of bank cheques and travellers cheques. This was held not to constitute beneficial receipt by the bank because (it was said) the bank acted merely as a conduit or agent for its customer in passing on the funds.

It should be recognised, of course, that ministerial receipt, certainly at common law and probably in equity, can only succeed as a defence if the funds received by the bank have been effectively paid out or credited to the customer *before* the bank acquires notice of any claim: see *Australia and New Zealand Banking Group Ltd v Westpac Banking Corp*, above, and *Bank of New Zealand v Westpac Banking Corp* (1991) 3 NZBLC 102,442. If not, the bank is the receiver for the purposes of liability.

Secondly, in view of Millett J's analysis, the issue of overdrawn accounts needs to be treated with care. Professor Cranston, as he then was, states in his recent book, *Principles of Banking Law* (1997) (at p 208) (emphasis added):

"There is a need to bring the legal analysis of beneficial receipt into line with banking practice. [Here, Cranston is referring to the fact that 'as soon as money is paid into a bank it is, generally speaking, the bank's, to use as it wishes' - his p 207; see above para 4.3.] There is also a need to bear in mind that if 'beneficial receipt' is widely defined, banks are exposed to huge potential liabilities - apart from any other liability they have as accessories. Consequently, beneficial receipt

cannot be equated with the bank being benefited in the ordinary way through a payment in. *It must be confined to situations of real benefit, for example, to the bank pressing the customer to reduce its indebtedness under a facility when the customer is of doubtful solvency.*"

While Millett J's comments in *Agip*, quoted above, suggest an all or nothing approach, Cranston's view is more banker-friendly in that it suggests a distinction between ordinary overdrafts and closely monitored overdrafts. In fact, Cranston's position is supported by Lord Millett writing extra-judicially (see "Tracing the Proceeds of Fraud" (1991) 107 LQR 71, 83 fn 46):

> "The mere continuation of a running account in overdraft should not be sufficient to render the bank liable as recipient; there must probably be some conscious appropriation of the sum paid into the account in reduction of the overdraft."

The cases are suggestive of the legitimacy of such a distinction. In New Zealand, in cases where knowing receipt liability (with payments received into overdrawn accounts) has been upheld, including *Westpac Banking Corp v Savin*, above, *Anderson v Chilton* (1993) 4 NZBLC 103,375, and *Westpac Banking Corp v Ancell* (1993) 4 NZBLC 103,259, the banks were beneficially receiving because, on the facts, they could be said to be really and personally benefiting. Such benefit followed as a result of the banks' close monitoring of the relevant accounts because they were concerned about their exposure. As such, in Richardson J's words in *Ancell* (at 103,272), "[t]he inference [in such circumstances] that the bank was consciously benefiting from the resulting use of the funds of the [customer's beneficiaries] is inescapable".

E Is knowing receipt a cause of action for vindicating a still existing equitable proprietary interest?

We have seen that there are some doubts about the proper characterisation of knowing receipt liability. Is it founded on wrongdoing? Is it founded on unjust enrichment? Or is there another explanation? In my view, there is a better way of

approaching knowing receipt, as a consequence of which either or both of the wrongdoing and unjust enrichment bases are placed in a more coherent framework. A claim in knowing receipt (analogously to the action in conversion in respect of common law property rights, or some cases of the action for money had and received, where the enforcement of those common law property rights is mediated through actions which are ostensibly wrong-based) functions as an *indirect means* of protecting a plaintiff-beneficiary's equitable proprietary interest. This analysis is fully developed in C Rickett and R Grantham, "Property and Unjust Enrichment: Categorical Truths or Unnecessary Complexity?" [1997] NZ Law Rev 668.

That the law is responding to that property right is clear, since a subsisting equitable proprietary interest is a prerequisite to such a claim. It will be recalled that Hoffmann LJ in *El Ajou*, as quoted earlier, stated that the beneficial receipt must be "of assets which are traceable as representing the assets of the plaintiff". Merely to assert a breach of fiduciary duty which does not consist of the misappropriation of property belonging in equity to the plaintiff will not found an action in knowing receipt. This point was reinforced by Rattee J in *Brown v Bennett* [1998] 2 BCLC 97: discussed further in RB Grantham and CEF Rickett, "Liability for Interfering in a Breach of Trust" (1998) 114 LQR 357. (In *Brown v Bennett*, unreported, 1 December 1998, Morritt LJ speaking for the Court of Appeal suggested that the point was arguable on the particular facts of that case – breach of fiduciary duty by a company director in respect of management of the company's affairs.) A focus on the plaintiff's property rights is also central in two recent Supreme Court of Canada decisions: *Gold v Rosenburg* (1997) 152 DLR (4th) 385 and *Citadel General Assurance Co v Lloyd's Bank Canada* (1997) 152 DLR (4th) 411, discussed in L Smith, "W[h]ither Knowing Receipt?" (1998) 114 LQR 394. In *Satnam Investments Ltd v Dunlop Heywood & Co Ltd*, The Times, 31 December 1998, Nourse LJ stated: "Before a case can fall into either category [knowing receipt or dishonest assistance] there must be trust property or traceable proceeds of trust property." Indeed, the case concerned a breach of fiduciary duty by the impartation of information, and the Court characterised the information as trust property for the purposes of dealing with the knowing receipt claim.

Whether the action in knowing receipt mediates the protection of the equitable property right through a wrong or through an unjust enrichment might be regarded as a matter of some doubt. While, as we have seen, some treat knowing receipt as concerned with equitable wrongdoing (or tort), others prefer to treat it as concerned with the unjust enrichment of the recipient. However, the action in knowing receipt arises *from the event of (equitable) property rights, and not from that of a wrong or an unjust enrichment*, and its concern is to mediate indirectly the enforcement of those equitable rights. That is, liability is triggered by an interference with the plaintiff-beneficiary's equitable proprietary right in the trust assets. Since the breach of trust constitutes a misappropriation of the property to the receiver, the plaintiff-beneficiary's equitable proprietary right survives the transfer to the receiver. That explains why an unjust enrichment analysis of knowing receipt is problematic. It is simply not necessary. See C Rickett and R Grantham, "Property and Unjust Enrichment: Categorical Truths or Unnecessary Complexity?" [1997] NZ Law Rev 668; and see also *Portman Building Society v Hamlyn Taylor Neck (a firm)* [1998] 4 All ER 202 (CA), discussed by R Grantham and C Rickett, "Trust Money as an Unjust Enrichment: A Misconception" [1998] LMCLQ 514.

Furthermore, when the fundamental focus of knowing receipt as the protection of equitable property is appreciated, an unjust enrichment analysis becomes untenable because it advocates ignoring knowledge. Knowledge, however, has a crucial role. If the action is concerned with equitable property rights, then liability cannot be strict. Where a common law property right is in issue, the liability of a recipient of the relevant asset will extend to both those who know and those who do not know of the property right. However, where an equitable proprietary interest is in issue, the knowledge of a recipient of the relevant asset is of fundamental significance to matters of liability. This is because the function of knowledge in the law of equitable property is to define the duration and priority of a person's equitable proprietary interest. See further K Gray, "Equitable Property" (1994) 47 CLP 157. Where equitable property is in issue, therefore, knowledge of a recipient of assets must have a role to play. That knowledge need not be actual knowledge (or dishonesty). Constructive knowledge is doctrinally sufficient. Indeed, the level of knowledge should logically be consistent with that required by other

equitable doctrines performing similar functions (eg, the bona fide purchaser for value without notice rule). Accordingly, the "knowledge" question may really be one about "notice". For further discussion, see R Grantham, "Civil Liability for Money Laundering" (1999) 18 NZULR 74.

This alternative analysis supports, of course, the position described at point 3C above as the compromise position. Indeed, it provides that position with intellectual coherence.