

# **Justice Robert Chambers, New Zealand Court of Appeal**

## **Dishonest Assistance**

### **DISHONEST ASSISTANCE**

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**with**

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**PRELIMINARY DRAFT: NOT AVAILABLE FOR CITATION UNLESS  
APPROVED IN WRITING BY CHAMBERS J**

### **Introduction**

In 1995, Lord Nicholls of Birkenhead, delivering the Privy Council's advice in *Royal Brunei Airlines Sdn Bhd v Tan*<sup>1</sup> began his judgment as follows:<sup>2</sup>

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\*This is very much a joint paper, but, in view of the imbalance of power in the authors' relationship, the former has magnanimously agreed to take responsibility for any errors or deficiencies in it.

<sup>1</sup> [1995] 2 AC 378 (PC).

<sup>2</sup> Ibid at 381.

The proper role of equity in commercial transactions is a topical question.

Increasingly plaintiffs have recourse to equity for an effective remedy when the person in default, typically a company, is insolvent. Plaintiffs seek to obtain relief from others who were involved in the transaction, such as directors of the company, or its bankers, or its legal or other advisers. They seek to fasten fiduciary obligations directly on to a company's officers or agents or advisers, or to have them held personally liable for assisting the company in breaches of trust or fiduciary obligations.

*Royal Brunei* was such a case. An insolvent travel agent company owed money to an airline. The airline sought a remedy against the travel agent's principal director and shareholder. The claim was based on the famous dictum of Lord Selborne LC in *Barnes v Addy*.<sup>3</sup> Under that dictum, there were two circumstances in which third parties (non-trustees) could become liable to account in equity. The first circumstance is generally referred to by the shorthand title "knowing receipt". The second circumstance is where liability arises from "knowing assistance". Lord Nicholls summarised the two limbs of Lord Selborne's formulation as follows:<sup>4</sup>

The first limb ... is concerned with the liability of a person as a *recipient* of trust property or its traceable proceeds. The second limb is concerned with what, for want of a better compendious description, can be called the liability of an *accessory* to a trustee's breach of trust. Liability as an accessory is not dependent upon receipt of trust property. It arises even though no trust property has reached the hands of the accessory. It is a form of secondary liability in the sense that it only arises where there has been a breach of trust.

Unfortunately, like most areas of judge-made law, these heads of equitable liability have become suffused with difficulties. That is amply demonstrated in the extremely useful compendium of English, Canadian, Australian, and New Zealand authorities summarised in David Ananian-Cooper's research memorandum, appended to Finn J's own illuminating paper. The divergence of authority is much to be regretted. Bankers and their lawyers – and I focus on them, given the audience for this conference – ought to be able to ascertain with reasonable certainty exactly what the relevant principles for knowing receipt and dishonest assistance are, particularly given that decisions in this area often have to be made quickly.<sup>5</sup> Whatever one thinks of the High Court of Australia's decision in *Farah Constructions Pty Ltd*

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<sup>3</sup> (1874) LR 9 Ch App 244 at 251-252.

<sup>4</sup> [1995] 2 AC 378 at 382.

<sup>5</sup> See for example the facts in *US International Marketing Ltd v National Bank of New Zealand Ltd* [2004] 1 NZLR 589 (CA).

*v Say-Dee Pty Ltd*,<sup>6</sup> one can at least agree with the proposition<sup>7</sup> that the New South Wales Court of Appeal's new approach had caused "great confusion" in Australia; new approaches in an area of this kind are not steps for intermediate courts of appeal. In *US International Marketing Ltd v National Bank of New Zealand Ltd*,<sup>8</sup> Tipping J referred to the obligation on the courts to respond to the "no win situation" in which banks often find themselves by stating rules that are "as clear and as straightforward to apply as possible".<sup>9</sup> We are, I think, still some distance away from achieving that laudatory aim.

The aim of this paper is to try to predict the principles that the Supreme Court of New Zealand might adopt when the first of these cases hits its docket. (None has so far.) I am not going to waste time in speculating on the course the New Zealand Court of Appeal is likely to take, as it remains bound by decisions of the Privy Council (here, *Royal Brunei*<sup>10</sup>) and by its own previous decisions (here, *US International Marketing*): see *R v Chilton*.<sup>11</sup> The Supreme Court, however, is bound by no one! No doubt relevant Privy Council decisions will be persuasive, but probably no more persuasive than relevant decisions from other superior courts elsewhere in the Commonwealth. In this paper, I concentrate on the "knowing assistance" limb, simply because of the time limitations.

It would be presumptuous of me to speculate whether the High Court of Australia will move from the position it reached in *Farah*. That decision was, with respect, surprising in two regards. First, its attack on the New South Wales Court of Appeal's reasoning was extravagant by Commonwealth standards.<sup>12</sup> Secondly, its decision was surprisingly reactionary in simply reiterating the continued applicability of its own 1975 decision, *Consul Development Pty Ltd v DPC Estates Pty Ltd*.<sup>13</sup> Notwithstanding the significant developments in this area of law by the Privy Council, the House of Lords, and the Supreme Court of Canada since *Consul* was decided, the High Court did not take the opportunity to re-evaluate it. Rather, their concern was simply to confirm *Consul* as "the law in Australia", to "be

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<sup>6</sup> (2007) 230 CLR 89.

<sup>7</sup> *Ibid* at [134]-[135].

<sup>8</sup> [2004] 1 NZLR 589 (CA).

<sup>9</sup> *Ibid* at [6].

<sup>10</sup> But not *Barlow Clowes International Ltd (In Liqn) v Eurotrust International Ltd* [2006] 1 WLR 1476, which was decided after the Privy Council ceased to be part of New Zealand's appellate structure.

<sup>11</sup> [2006] 2 NZLR 341 at [83]-[92] and [111]-[114].

<sup>12</sup> Its effect may perhaps be seen in Mason P's address to the Judicial Council of Australia conference in October 2007: see "Throwing Stones: Cost/benefit analysis of judges being offensive to each other" (2008) 82 ALJ 260. Mason P was a member of the panel determining *Farah* at Court of Appeal level.

<sup>13</sup> 132 CLR 373.

followed by Australian courts, unless and until departed from by decision of [the High Court]”<sup>14</sup> Finn J is in a much better position than I to assess likely Australian developments in light of *Farah*. Australian bankers and their lawyers need to keep reading, however, as they need to be aware their New Zealand subsidiaries and branches may have to make decisions utilising at least slightly different equitable principles.

In light of the time available, I intend to evaluate what I think will be the five most influential decisions, assuming this question comes before the Supreme Court within the next couple of years. Having discussed those cases, I shall try to predict what course the Supreme Court may take on this issue.

### **The five key cases**

#### Royal Brunei Airlines v Tan

*Royal Brunei* was a case in which an insolvent travel agent owed money to an airline. The airline appointed a company, Borneo Leisure Travel (BLT), to act as its general agent for the sale of passenger and cargo transport. BLT was required to account to the airline for all amounts received from sales of tickets. The agency contract expressly provided that BLT would hold ticket money on trust for the airline and account to the airline for such money. In practice the money received by BLT on behalf of the airline was not paid into a separate account, but was paid into BLT’s ordinary operating account and used to pay salaries and other expenses. Mr Tan was the principal shareholder and managing director of BLT (in effect, its alter ego) although he had signed all contracts as agent for BLT and not in his personal capacity. The airline claimed that Mr Tan was liable as a constructive trustee under the second limb of *Barnes v Addy*, on the basis that he had knowingly assisted BLT in a breach of trust.

The trial judge found Mr Tan was liable for knowingly assisting the breach of trust, as he had known BLT held the money on trust and he had authorised its use for purposes other than repaying the airline. He ordered Mr Tan to pay damages of B\$335,000. The Court of Appeal of Brunei Darussalam allowed Mr Tan’s appeal. The court held there had been no dishonest

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<sup>14</sup> Ibid at [178].

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and fraudulent design on the part of BLT. Accordingly, Mr Tan could not be liable, even though it was conceded he had assisted with actual knowledge of BLT's breach of trust.<sup>15</sup> The issue on appeal to the Privy Council was the circumstances in which a third party can be liable for knowingly assisting such a breach.

Lord Nicholls said it was necessary to take an overall look at the accessory liability principle, in particular at the state of mind of the third party.<sup>16</sup> The breach of trust by the trustee may be entirely inadvertent or innocent, although of course a trustee's liability is strict. Generally a person will be liable for assisting a breach of trust only if his or her conduct, when assessed objectively and in light of the surrounding circumstances, is dishonest. Telltale signs of dishonesty, Lord Nicholls said, might include acting in reckless disregard of others' rights, or becoming or staying involved where an honest person would flatly decline to become involved or would ask further questions.<sup>17</sup>

Lord Nicholls summarised the position as follows:

Drawing the threads together, their Lordships' overall conclusion is that dishonesty is a necessary ingredient of accessory liability. It is also a sufficient ingredient. A liability in equity to make good resulting loss attaches to a person who dishonestly procures or assists in a breach of trust or fiduciary obligation. It is not necessary that, in addition, the trustee or fiduciary was acting dishonestly, although this will usually be so where the third party who is assisting him is acting dishonestly. "Knowingly" is better avoided as a defining ingredient of the principle, and in the context of this principle the *Baden* [[1993] 1 WLR 509] scale of knowledge is best forgotten.<sup>18</sup>

The Privy Council held Mr Tan had assisted in a breach of trust because he caused his company to apply airline money in a way which he knew was dishonest. No doubt he hoped the airline would be repaid, but that was beside the point: he had no right to use the money for his business expenses. He was accordingly required to make good the airline's loss. The damages award was reinstated.

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<sup>15</sup> [1995] 2 AC 378 at 383.

<sup>16</sup> *Ibid* at 386.

<sup>17</sup> *Ibid* at 390-391.

<sup>18</sup> For this reason, I have taken the liberty of changing the title of this address from that provided by the organisers!

## Twinsectra v Yardley

*Twinsectra Ltd v Yardley*<sup>19</sup> was a case about a dishonest property developer, Mr Yardley. He negotiated a loan of £1m from Twinsectra for the purposes of buying property. The money was paid to a law firm (Sims) on its written undertaking that the money would only be released to Mr Yardley for the sole purpose of buying property. It was to be used for no other purpose. Sims did not honour its undertaking; on an assurance from Mr Yardley it paid the money to another solicitor, Mr Leach, who simply paid the money out on Mr Yardley's instructions. £358,000 was used by Mr Yardley for purposes other than buying property and the loan was not repaid. Twinsectra sued all the parties involved. The question for the House of Lords was whether Mr Leach's conduct, in receiving the money and paying it out without regard to whether it would be used to purchase property, could be said to have dishonestly assisted a breach of trust. The trial judge found that his conduct was "misguided" but not dishonest. The Court of Appeal reversed this finding and found Mr Leach had been dishonest and was thus liable for assisting a breach of trust.

Lord Hoffmann and Lord Hutton (with whom Lord Slynn of Hadley and Lord Steyn joined) agreed that the case required application of the principles set out in *Royal Brunei*. The question was whether Mr Leach's liability as an accessory to a breach of trust required it to be shown that he had acted dishonestly. In particular, in order for Mr Leach to be liable, did it need to be shown he had a conscious appreciation that his actions were dishonest? Lord Hoffmann characterised the test in *Royal Brunei* as requiring a "dishonest state of mind" and a "consciousness that one is transgressing ordinary standards of honest behaviour".<sup>20</sup> His Lordship was of the view that, because Mr Leach believed (albeit wrongly) that any undertaking was a matter purely between Sims and Mr Yardley and that the money was at Mr Yardley's disposal, it could be said he was misguided and had taken a blinkered approach to a lawyer's professional obligations, but it could not be said he was dishonest in terms of the *Royal Brunei* test.

Lord Hutton noted the distinction between subjective and objective dishonesty. He considered *Royal Brunei* required it to be shown that the third party knew that what he or she

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<sup>19</sup> [2002] 2 AC 164 (HL).

<sup>20</sup> *Ibid* at [20].

was doing would be regarded as dishonest by honest people.<sup>21</sup> (The third party will not escape liability by the “Robin Hood” defence - that is, by setting his or her own standards of honesty.) Lord Hutton described this as a “combined test” for accessory liability, incorporating both subjective knowledge and objective standards of dishonesty. The question in this case, Lord Hutton said, was whether Mr Leach realised his action was dishonest by the standards of responsible and honest solicitors.<sup>22</sup> There was no evidence, in Lord Hutton’s view, to justify the Court of Appeal substituting its own finding of dishonesty and Mr Leach was not liable for dishonestly assisting a breach of trust. The House of Lords restored the judgment of the trial judge.

Lord Millett dissented. He first distinguished between knowing assistance and knowing receipt. Recipient liability, Lord Millett said, does not depend on fault because it is a restitutionary cause of action. There will be no need to show the recipient had knowledge of the breach of trust, let alone dishonesty.<sup>23</sup> Liability as an assistant or accessory to a breach of trust, on the other hand, has an additional requirement of dishonesty. The decision of the Privy Council in *Royal Brunei*, Lord Millett said, firmly rejected negligence as a sufficient condition of accessory liability.<sup>24</sup> Dishonesty is required, or, in some rare cases, deliberately shutting one’s eyes to facts which one would prefer not to know.<sup>25</sup> In Lord Millett’s view, however, Lord Nicholls’s judgment in *Royal Brunei* firmly rejected the requirement for a dishonest state of mind as a condition for assistant liability. There is “no trace in Lord Nicholls’ opinion”, Lord Millett said, “that the defendant should have been aware he was acting contrary to objective standards of dishonesty.”<sup>26</sup> Lord Millett considered that the test was whether a defendant has attained that standard which would be observed by a honest person in similar circumstances, having regard to subjective considerations such as the defendant’s experience and intelligence, and his or her actual knowledge [of the material facts] at the relevant time.<sup>27</sup> It is an almost entirely objective standard.<sup>28</sup> It will not be necessary, Lord Millett would have held, for the third party to know the details of the trust or

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<sup>21</sup> Ibid at [35].

<sup>22</sup> Ibid at [49].

<sup>23</sup> Ibid at [105].

<sup>24</sup> Ibid at [113].

<sup>25</sup> Sometimes referred to as “Nelsonian knowledge”, because Admiral Nelson is famously (albeit inaccurately) believed to have disobeyed Admiral Sir Hyde Parker’s order of recall, during the battle of Copenhagen in April 1801, by holding his telescope to his blind eye and claiming to not see the signal: see *Baden v Société Générale SA* [1993] 1 WLR 509 at 576 (Ch) per Peter Gibson J.

<sup>26</sup> [2002] 2 AC 164 at [118] (HL).

<sup>27</sup> Ibid at [121].

<sup>28</sup> Ibid at [122] and [127].

even the identity of the beneficiary: it is enough that he or she knows the money is not at the free disposal of the principal.<sup>29</sup>

#### US International Marketing v National Bank

*US International Marketing Ltd v National Bank of New Zealand Ltd*<sup>30</sup> was a case about the duty of a banker faced with a demand for payment in circumstances where the bank was aware that a third party had a claim to the money. US International had two accounts with the respondent bank. The sole director of US International (a Mr Singh) purchased, using funds in one of the accounts, a bank cheque for \$15,073 payable to the High Court. Mr Singh offered the bank cheque to counsel appearing in liquidation proceedings against a third company (PE). Mr Singh was apparently anxious to stave off liquidation of PE and so offered the cheque in court as a means to pay off creditors of PE. An order for liquidation of PE was nevertheless made; the bank cheque was no longer required and it was resold by Mr Singh to the bank on 2 December 1997. At this point in time the account was \$17,905 in credit. On 3 December 1997 the manager of the bank branch at which US International's accounts were held received a fax from a firm of solicitors acting for PE's liquidators. The fax indicated that PE had said during the High Court hearings that it held a bank cheque for \$15,073 and that such funds belonged to PE. The solicitors then said "urgent application will be made to the High Court to secure those funds and we formally ask that those funds be frozen by the Bank in the interim."

The bank, acting on legal advice, froze the funds in US International's account and when Mr Singh and other family members attempted to withdraw money on 4 and 5 December 1997 they were told the account was frozen. Despite Mr Singh's remonstrations with the branch manager on 8 December, and a fax sent by Mr Singh to the bank on 10 December demanding the release of money from the account, no transactions were permitted. A preservation order was made in the High Court on 10 December and the funds were paid into Court in accordance with terms of the order. US International sued and alleged that because the bank had not paid on demand, it had lost \$731,000 in respect of a land contract in India on

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<sup>29</sup> Ibid at [135]

<sup>30</sup> [2004] 1 NZLR 589 (CA).

which a deposit was due.<sup>31</sup> The High Court held that the bank had acted honestly and reasonably in declining to release the funds until it knew the outcome of the liquidators' application for a preservation order. US International appealed to the Court of Appeal.

The Court of Appeal allowed the appeal. On the morning of 10 December 1997, the court held, there was no basis on which the bank should have known it might have been dishonest to meet US International's demand. The starting point, the court said, is that a bank has a clear duty to its customer to allow immediate access for whatever purpose the customer may wish to apply them. If the courts were too willing to undermine that relationship, third parties might too readily intervene in the banker/customer relationship for undeserving reasons.<sup>32</sup> A bank may only refuse to meet its customer's demand if to do so would, in all the circumstances, provide dishonest assistance. Each member of the court gave separate reasons.

Tipping J referred with approval to the decisions of the Privy Council in *Royal Brunei* and the House of Lords in *Twinsectra*. Dishonesty has both objective and subjective elements, and the person concerned must appreciate that their conduct is transgressing ordinary standards of honest behaviour.<sup>33</sup> Tipping J considered it helpful to introduce the concept of a reasonable banker and "look at the circumstances known to the bank in question through those objective eyes".<sup>34</sup> Tipping J's "reasonable banker" would only be entitled to freeze an account in circumstances where (1) in all the circumstances known to the bank, (2) a reasonable banker would know it was dishonest to pay the funds to or on the order of its customer, and (3) if the bank itself appreciates that to be the case.

In "relatively rare" cases, Tipping J said, a reasonable banker might realise without any further inquiry that it would be dishonest to meet a customer's demand. More often, further inquiry will be required and it should be made in an appropriate and timely manner. Tipping J considered that a failure to make such further inquiry would give rise to liability only if the failure was dishonest: in most cases this will be a deliberate closing of the eyes or not asking questions about a transaction.<sup>35</sup> In Tipping J's view such a test satisfactorily

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<sup>31</sup> US International's claim was for losses caused by a breach of contract by the bank in failing to pay on demand. In this regard the case was about "dishonest assistance" only in so far as the bank sought to use the doctrine as an excuse for freezing US International's account.

<sup>32</sup> Ibid at [6] per Tipping J.

<sup>33</sup> Ibid at [7].

<sup>34</sup> Ibid at [9].

<sup>35</sup> Ibid at [10].

reconciled the competing factors in the banker/customer relationship. Finally, Tipping J noted that freezing a customer's account ahead of any actual demand by the customer for payment of funds might well amount to an anticipatory breach of contract, although no loss would ensue unless a subsequent actual demand was received by the bank and not met. Tipping J then turned to the facts in this case. His essential reasoning merits reproduction in full.<sup>36</sup>

To this point I do not consider the solicitor's letter gave any basis for the bank pro tanto to freeze US International's account. Nor do I consider the circumstances were such that a reasonable banker should have felt obliged to make further inquiry to avoid being at risk of being regarded as dishonest if it met a demand by its customer in relation to the funds in question. The fact that an urgent application to the High Court to secure the funds was foreshadowed cannot, in my view, make any difference. A sufficient factual foundation must be laid for the contention that the funds concerned are trust funds. It follows that the bank acted at least in anticipatory breach of its contract with US International when it agreed to freeze the funds at the solicitor's request.

Anderson J commenced his discussion with a summary of Lord Nicholls's judgment in *Royal Brunei*. He expressed reservations about the requirement for actual knowledge by a defendant that his or her conduct was dishonest by the ordinary standards of reasonable people. Anderson J was of the view that in circumstances where it would be dishonest for a bank to pay on a customer's demand, the test should not be complicated by a consideration of whether a reasonable banker would know this.<sup>37</sup> Anderson J was "diffident" about equity recognising conduct as dishonest only if the defendant knew his conduct to be wrong. The better approach, in Anderson J's view, was that conduct by a banker which was unreasonable having regard to banking standards might in some circumstances suggest dishonesty. The nature of a customer's dealings and his or her business practices would be relevant, because an honest person would not ignore evidence of a breach of trust by the customer. Anderson J expressed the central issue as being whether in all the circumstances it would have been dishonest for the bank to meet its customer's demand.

Glazebrook J expressed herself as being in substantial agreement with Anderson and Tipping JJ. She indicated it was not necessary to decide on all the subjective elements of the test for dishonest assistance, although she considered Tipping J's "reasonable banker" concept

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<sup>36</sup> Ibid at [15].

<sup>37</sup> Ibid at [68].

reinforced the objective elements of the test while recognising that subjective concepts, such as experience and knowledge, might also be relevant. Glazebrook J had some reservations about whether the final subjective element from *Twinsectra* (Tipping J's third element) is necessary in New Zealand.

#### Barlow Clowes v Eurotrust

*Barlow Clowes International Ltd (In Liqn) v Eurotrust International Ltd*<sup>38</sup> was a case about a fraudulent offshore investment scheme. Mr Clowes incorporated a company in Gibraltar (Barlow Clowes) which purported to offer high investment returns. He attracted £140m from small UK investors, but rather than investing the money he spent it on extravagant living and personal business ventures. Mr Cramer was an associate of Mr Clowes. Mr Cramer instructed an independent company (ITC) in the Isle of Man to form a number of offshore companies which ITC was to administer on his behalf. In mid-1987 Messrs Clowes and Cramer decided to engineer a "reverse takeover" of Barlow Clowes using one of Mr Cramer's companies (JFH). To execute these plans, JFH needed working capital. Investor money was transferred out of Barlow Clowes (through the ITC client account) to a Cramer company called Ryeman Ltd in two steps, £1.9m on 3 March 1987 and £7m on 22 June 1987. Of this money, £6.6m was later transferred to Mr Cramer's personal account or paid by ITC on his order.

Unsurprisingly, the whole scheme collapsed. Barlow Clowes' liquidators sued ITC's directors, in particular a Mr Henwood, and alleged he had dishonestly assisted Mr Cramer to misappropriate investors' funds. The trial judge applied the test in *Royal Brunei* and found Mr Henwood liable for dishonestly assisting the misappropriation of the £6.6m paid to Mr Cramer's personal account or to his businesses. Mr Henwood appealed on the ground that a finding of dishonest assistance was not supported by the evidence. The intermediate appellate court of the Isle of Man allowed Mr Henwood's appeal. Barlow Clowes appealed to the Privy Council. The essential issue for the Privy Council was whether it had to be shown that Mr Henwood was not only dishonest but also "was aware that [his actions] would by ordinary standards be regarded as dishonest".<sup>39</sup>

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<sup>38</sup> [2006] 1 WLR 1476 (PC).

<sup>39</sup> *Ibid* at [12]-[13].

Lord Hoffmann gave the judgment of a unanimous Privy Council.<sup>40</sup> He referred to the speech of Lord Hutton in *Twinsectra*, and in particular the part of Lord Hutton’s judgment where the subjective knowledge requirement was emphasised: “dishonesty requires knowledge by the defendant that what he was doing would be regarded as dishonest by honest people.”<sup>41</sup> Lord Hoffmann firmly rejected counsel’s suggestion that this pointed to an additional subjective requirement on the part of the defendant. “There is an element of ambiguity in [Lord Hutton’s remarks]”, Lord Hoffmann conceded, but the Privy Council in *Twinsectra* did not depart from the law as previously understood.<sup>42</sup> There is no additional subjective element of dishonesty. The only knowledge required for dishonest assistance, the Privy Council held in *Barlow Clowes*, is “knowledge of the transaction...such as to render his participation contrary to normally acceptable standards of honest conduct. It [does] not require that he should have had reflections about what those normally acceptable standards were.”<sup>43</sup>

On the facts of *Barlow Clowes*, the Privy Council had no doubt that Mr Henwood was liable for dishonestly assisting a breach of trust. There was clear evidence to support this finding. Mr Henwood had entertained a clear suspicion that the transfers to Mr Cramer and his companies were of moneys held in trust, and it would be “quite unreal” to suppose that Mr Henwood would have to know every detail of the transactions before he suspected that Messrs Clowes and Cramer were misappropriating investors’ money.<sup>44</sup> Lord Hoffmann said that someone can know, and certainly suspect, that he or she is assisting in the misappropriation of money without knowing the money is held on trust or even what a trust means.<sup>45</sup>

The decision of the first instance judge was restored. This meant Mr Henwood was liable for the misappropriation of money in which he had dishonestly assisted.

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<sup>40</sup> The committee which heard *Barlow Clowes* included Lord Nicholls, who gave the judgment in *Royal Brunei*.

<sup>41</sup> *Barlow Clowes v Eurotrust* [2006] 1 WLR 1476 at [14], citing *Twinsectra Ltd v Yardley* [2002] 2 AC 164 at [36].

<sup>42</sup> *Ibid* at [15].

<sup>43</sup> *Ibid* at [15].

<sup>44</sup> *Ibid* at [28].

<sup>45</sup> *Ibid* at [28].

## Farah v Say-Dee

The two protagonists in *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* were development companies controlled by different families. They entered a contract to purchase a property at 11 Deane Street in Sydney as tenants in common in equal shares, with the intention of redeveloping the site as joint venturers. Mr Elias (a director of Farah) lodged a development application with the council, but was advised that the site was too narrow to develop without amalgamation with neighbouring sites. Mr Elias and members of his family then purchased some of the nearby properties, without Say-Dee's knowledge. He then withdrew the planning application in respect of no. 11, and made a concealed offer to purchase no. 11 in such a way that his identity remained secret.<sup>46</sup>

Say-Dee sued Farah and alleged that it and the Elias family had acquired the neighbouring properties in breach of fiduciary duties owed to the joint venture. Say-Dee contended that Mr Elias's wife and daughters (through another family company, Lesmint Ltd) had known of Farah's breach of trust, and that accordingly they held any interest in the properties acquired by themselves or Lesmint as constructive trustees for Say-Dee. Say-Dee alleged that Mr Elias's family were liable under the first limb of *Barnes v Addy* as recipients of trust property. The New South Wales Court of Appeal found that Mrs Elias and her daughters were liable as knowing recipients of the property and held it, and any profits, on a constructive trust for Say-Dee. Farah and the Elias family appealed.

The High Court of Australia unanimously allowed Farah's appeal. It firmly rejected the Court of Appeal's finding that the Elias family were liable as recipients of trust property under the first limb of *Barnes v Addy*.<sup>47</sup> There was no relevant receipt in this case because the "trust property" alleged to have been received by the Elias family, namely confidential information about the planning approval process for the Deane St properties and about what terms the local council was likely to require, was nothing of the sort. It was, the High Court held, public information and not trust property held by Mr Elias or Farah for the partnership.

The High Court emphasised that the first limb of *Barnes* (recipient liability) continues to apply in Australia. Recipient liability requires (i) receipt of trust property by a third party and

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<sup>46</sup> 230 CLR 89 at [20].

<sup>47</sup> *Ibid* at [115].

(ii) notice to the third party of the breach of trust.<sup>48</sup> In this case the Elias family members were separate individuals and could not be fixed with constructive knowledge of Farah's breach.

The High Court went on to discuss liability for assisting a breach of trust under the second limb of *Barnes v Addy*. The Court stated that a defendant will be liable if he or she "assists a trustee or fiduciary with knowledge of a dishonest and fraudulent design on the part of the trustee or fiduciary".<sup>49</sup> The High Court noted that the statement of accessory liability in *Barnes* is not exhaustive, and it is possible that a third party may be liable in circumstances where the trustee does not act for an improper or fraudulent purpose but the third party dishonestly procures a dishonest breach of trust: these cases are to be distinguished from the second limb of *Barnes*, which contemplates dishonesty on the part of the trustee and assistance by the third party.<sup>50</sup> The Court also noted that *Royal Brunei* appears to displace the rule in *Barnes* and instead substitutes a general principle of "accessory liability". The High Court was diffident about adopting *Royal Brunei* in Australia. On the facts in *Say-Dee* the High Court was not required to consider whether *Royal Brunei* had modified or restated the second limb of *Barnes*.<sup>51</sup>

The High Court then surveyed the requirements for a third party's knowledge of the dishonesty and fraudulent design on the part of the trustee. It expressly affirmed its earlier 1975 decision in *Consul*.<sup>52</sup> The Court said with reference to *Consul* that, "as a matter of ordinary understanding", an act may be dishonest without a person appreciating the act in question was dishonest by the standards of ordinary decent people.<sup>53</sup> This suggests the test in Australia for third party knowledge is an objective one. The Court then referred with approval to the *Baden* categories of knowledge:<sup>54</sup> the five categories, the Court said, provide "authoritative guidance" on the question of knowledge for the second limb of *Barnes*. Any of

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<sup>48</sup> Ibid at [122].

<sup>49</sup> Ibid at [160].

<sup>50</sup> Ibid at [161] and [163].

<sup>51</sup> Ibid at [164].

<sup>52</sup> 132 CLR 373.

<sup>53</sup> Ibid at [173].

<sup>54</sup> The five categories are (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. See *Baden v Société Générale SA* [1993] 1 WLR 509 at 575-6 per Peter Gibson J.

the categories would suffice except for category (v), namely, circumstances which would put an honest and reasonable person on inquiry.

The High Court concluded that, as stated in its judgment in *Consul*, liability for assisting a breach of trust under the rule in *Barnes v Addy* will arise only where the breach of trust or fiduciary duty is “dishonest and fraudulent.”<sup>55</sup> Not all breaches of trust will be deemed dishonest or fraudulent: some are well intentioned, and some are trivial.<sup>56</sup> In particular, where a trustee acts honestly and reasonably, then a breach might fairly be excused. It appears from the judgment in *Say-Dee* that the High Court considers assistant liability will arise under *Barnes v Addy* only where there is dishonesty and/or fraud on the part of the trustee. Where an innocent breach is procured by a dishonest third party, the third party may well be liable but not under the second limb of *Barnes v Addy*.<sup>57</sup> The High Court did not decide whether *Royal Brunei*, if adopted in Australia, would encompass both situations.

### **The likely course our Supreme Court will adopt**

Having set out what I consider to be the five cases most likely to influence our Supreme Court,<sup>58</sup> I now turn to consider what course our Supreme Court is likely to chart in these waters. Predictions such as these come with all the normal caveats!

1. The two heads of liability enunciated by Lord Selborne in *Barnes v Addy* are likely to remain distinct. The doctrines of receipt of trust property and dishonestly assisting a breach of trust or fiduciary duty, while both equitable doctrines, are distinct and almost certainly will be kept separate. Different considerations apply to each doctrine, as was noted by Lord Nicholls in *Royal Brunei*.<sup>59</sup>
2. The approach taken in *Royal Brunei* is likely to be followed here. The case was strongly relied on by the Court of Appeal in *US International Marketing*, in which Tipping J delivered the leading judgment. The short history of our Supreme Court and its current complement would suggest that Tipping J is likely to be a key member of

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<sup>55</sup> 230 CLR 89 at [179].

<sup>56</sup> *Ibid* at [184].

<sup>57</sup> *Ibid* at [161].

<sup>58</sup> Assuming a “dishonest assistance” case reaches the Supreme Court in, say, the next five years.

<sup>59</sup> [1995] 2 AC 378 at 386.

the court in this area, provided a case reaches the Supreme Court before August 2012.<sup>60</sup> It is unlikely our Supreme Court will move in a radical new direction, for the reasons given by the High Court of Australia in *Farah*: “change [in this area] would call for very careful examination of the possible consequences.”<sup>61</sup>

3. Assisting a breach of trust or other fiduciary obligation will be actionable by the beneficiary only if the assister’s conduct, when assessed objectively and in light of the surrounding circumstances, is dishonest. Knowing assistance is no longer an apt description of this head of liability.
4. An assister is dishonest if he or she had knowledge of the transaction such as to render his or her participation contrary to normally acceptable standards of honest conduct. That is judged objectively; it is not necessary for a claimant to prove that the assister had thought about what those normally acceptable standards are. The well known categories of knowledge set out in the *Baden* case are almost certainly no longer relevant in this area of New Zealand law. New Zealand law has probably diverged from Australia in this regard.<sup>62</sup>
5. Telltale signs of dishonesty include acting in reckless disregard of other’s rights, or becoming or staying involved in circumstances where an honest person would flatly decline to become involved or would ask further questions.<sup>63</sup>
6. The assister does not need to know that the money is trust money, the terms on which it is held, or even what a trust is.<sup>64</sup> All that is required is that the assister know, or suspect, that he or she is assisting in the misappropriation of money.<sup>65</sup> Knowledge of the facts of a particular transaction or circumstances will generally suffice.<sup>66</sup> In rare cases, a failure to inquire into the source of the money when an honest person would have asked questions will suffice.

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<sup>60</sup> Tipping J’s retirement date!

<sup>61</sup> 230 CLR 89 at [121].

<sup>62</sup> As noted above, the High Court of Australia expressly affirmed the utility of the *Baden* scale in respect of the knowing assistance limb of *Barnes v Addy*: at [175].

<sup>63</sup> *Royal Brunei* at 390-391.

<sup>64</sup> *Barlow Clowes v Eurotrust* at [28]

<sup>65</sup> *Barlow Clowes*, *ibid*.

<sup>66</sup> *Ibid*. In *Twinsectra Ltd v Yardley* [2002] 2 AC 164, Lord Millett at [135] characterised dishonesty as “knowing the money is not at the free disposal of the principal”, which may mean the same thing.

7. In relation to dishonesty in cases involving banks, Tipping J's concept of a reasonable banker will be informative. Future dishonest assistance claims involving banks will likely require a focus on what inquiries a reasonable banker ought to have made. This may encompass such information as expert evidence about banking best practice, statutory reporting requirements,<sup>67</sup> and the knowledge of the particular bank about a customer's business practices.<sup>68</sup>
8. The nature of the remedies for dishonest assistance remains very uncertain. Is the assister's liability a form of civil secondary liability analogous to common law secondary liability or is the assister's liability a primary liability? There has been much academic writing on this topic.<sup>69</sup> The answer to that question can have a bearing on types and quantum of remedies, causation and remoteness of damage, and also on possible defences, eg limitation.<sup>70</sup>

In my view, New Zealand law is likely to adopt a model of primary liability, leading principally to a compensatory remedy.<sup>71</sup> In most cases the compensation will be to the beneficiaries and will require the restoration of lost trust property. Given, however, this country's tendency since the 1980s to permit mingling of equitable and common law remedies,<sup>72</sup> I do not rule out the prospect that assisters could, in appropriate circumstances, be liable to account to the plaintiff for profits the assister may have made. Court of Appeal authority supports a distinction between a conventional approach to causation for breaches of a duty of care by a trustee, and a more stringent approach for breaches of fiduciary duty which involve an element of infidelity or

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<sup>67</sup> For example, the reporting requirements for suspicious transactions contained in the Financial Transactions Reporting Act 1996, s 11(2).

<sup>68</sup> *US International* at [69] per Anderson J.

<sup>69</sup> See, for example, Elliott and Mitchell "Remedies for Dishonest Assistance" (2004) 67 MLR 16 and Ridge "Justifying the Remedies for Dishonest Assistance" (2008) 124 LQR 445.

<sup>70</sup> Mitchell "Dishonest Assistance, Knowing Receipt, and the Law of Limitation" (2008) 72 Conv 226.

<sup>71</sup> Notwithstanding his comments in *Royal Brunei*, Lord Nicholls now appears to accept that both knowing receipt and dishonest assistance are two types of *primary* equitable wrong: Lord Nicholls "Knowing Receipt: The Need for a New Landmark" in Cornish and others (eds.) *Restitution: Past, Present and Future: Essays in Honour of Gareth Jones* (1998) at 244.

<sup>72</sup> See, for example, *Aquaculture Corporation v NZ Green Mussel Co* [1990] 3 NZLR 299 at 301 (CA) per Cooke P, emphasising that a full range of remedies (including monetary compensation) are available as appropriate, no matter whether the obligation is one of common law, equity or statute.

disloyalty engaging the trustee's or fiduciary's conscience.<sup>73</sup> In the latter type of case, gain-based or restitutionary remedies may well be appropriate. While the assister has not given an undertaking of loyalty, he or she has dishonestly interfered with the trust or fiduciary relationship for profit, thereby exploiting the claimant's vulnerability, and this may suggest that a gain-based remedy should be available to the claimant.<sup>74</sup>

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<sup>73</sup> *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 664 (CA), and see in particular at 687 per Tipping J.

<sup>74</sup> *Ridge* at 451; *Consul* 132 CLR 373 at 397; *Zhu v Treasurer (New South Wales)* (2004) 218 CLR 530 at 571.