CONSTRUCTIVE TRUSTS

A CONSTRUCTIVE LOOK AT CONSTRUCTIVE TRUSTS: WITH PARTICULAR ATTENTION TO THE POSITION OF BANKS

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1. INTRODUCTION

In **Powell v Thompson**[1] I ventured to affirm that a constructive trust is one of the most productive concepts by which equity reverses the unconscionable.[2] So it is. But it is also one of the most confusing. The case law is in chaotic disarray, and attempts to clarify the essential principles by reference to past authorities are destined to disappoint the investigator. All too often a faulty analysis and appreciation of the equitable concepts involved has resulted in seemingly learned decisions adding to the general confusion.

It is contended in this paper that it is necessary to revert to the underlying principles of equity to determine the essence of this equitable entity, the constructive trust. Certainly, decided cases must take second place in an inquiry which favours principle over precedent. Nor is a touch of reason and commonsense amiss.

One would be unduly optimistic to think, however, that this principle-oriented approach will magically dispel all confusion.[3] Sir Robert Megarry V-C adopted such an approach in **Re Montagu's Settlement Trusts**[4]. He said:

> "There is today something of a tendency in equity to put less emphasis on detailed rules that have emerged from the cases and more weight on the underlying principles that engendered those rules, treating the rules less as rules requiring complete compliance, and more as guidelines to assist the court in applying the principles."[5]

Yet, having adopted that approach in **Powell v Thompson**, I reached diametrically different conclusions from those of that most distinguished Judge. Our appreciation of the underlying principles differed in critical respects. This early conflict, however, should not be allowed to damage the exercise. Scrutiny and debate still needs to be focussed on the underlying principles. Only when that is done, and it is accepted that the relevant law cannot with confidence be extracted from the case law, will the law relating to constructive trusts be placed on a sound footing and some measure of certainty and predictability be returned to the subject.

The objective of this paper, therefore, is to examine the equitable principles underlying constructive trusts and extend and apply those principles to the problems which have been regularly identified. Must the recipient of property subject to a beneficial interest

have actual knowledge of the trust before being required to account, or will constructive knowledge suffice? Must the recipient know of the breach of trust on the part of the donor or will knowledge of the trust itself be sufficient? Should the recipient be exempt from liability unless a want of probity can be sheeted home to him or her? Should an agent through whose hands the trust property has passed be liable to account? Where a third party has facilitated a breach of trust must that party know of and intend to promote the guilty trustee's fraudulent or dishonest design? Is it enough, in such circumstances, for his or her knowledge to be constructive? Will it suffice that their conduct is negligent? These questions inevitably confront the examiner of constructive trusts.

It is not suggested that the principle-oriented approach will provide definitive answers to all of these questions. It is claimed, however, that the law relating to constructive trusts would become more coherent.

Following greater coherence the answers, or the direction of the answers, suggest themselves. They become the logical and sensible outcome of the stated first premise. At the same time, much of the deadwood which has beset the subject can be discarded; cases and commentaries which have proceeded on a faulty analysis or perception of the underlying principles need trouble us no longer.

2. THE CONSTRUCTIVE TRUST IN OUTLINE

Notwithstanding the confusion, or possibly because of it, the development of constructive trusts has been spectacular. In most common law jurisdictions it has outgrown the traditional institutional model created by English law. It is now extensively available as a vehicle for equitable proprietary relief providing aggrieved beneficiaries with a remedial trust against third parties or strangers who meddle in the original trust. Associated with this development, and notwithstanding the ancient principle that the doctrine has no place in commercial transactions,[6] the doctrine of constructive trusts has been increasingly applied to certain classes of professional and business relationships. The relationship of banker and customer is one favourite; that of solicitor and client another. It is the readiness of the courts to entertain the claim that, if the banker or solicitor did not actually know, then they **ought** to have known of their customer's or client's nefarious plans that has enlarged the remedy. Professor Goode has observed that it is no exaggeration to say that a bank's potential liability as a constructive trustee has become even more formidable than its better known exposure to common law claims in contract and tort.[7] If there is now a tendency to curb the situations in which a duty of care may arise following the decisions of the House of Lords in **Caparo Industries plc v Dickman**[8] and **Murphy v Brentwood District Council**,[9] this disposition may become even more pronounced.

It is commonly said that there are two categories of constructive trust, the knowing receipt or dealing category (which I will call "knowing receipt") and the knowing assistance class of case. In fact, they are better regarded as two heads of liability rather than two related categories of constructive trust.[10] Liability in the knowing receipt class of cases arises when the third party receives property from another knowing of the trust attaching to it or, being in possession of trust property, deals with it in a manner contrary to the trust. In such circumstances the third party will be held liable to return the property or, if that is not possible, compensate the beneficiary for his or her loss. Liability in the knowing assistance class of case arises where the stranger knowingly assists the trustee in committing a breach of the trust. For his pains in participating in the breach, he is held liable to account to the aggrieved beneficiary as a constructive trustee.

Both forms of liability will therefore need to be examined. In addition, I will touch upon the concept of the trustee *de son tort* which, although not strictly a constructive trust as the third party expressly assumes the obligations of the trustee, serves to shed some light on the basis of liability for the constructive trust in the knowing receipt class of case.

3. THE RELATIONSHIP OF THE BANK AND ITS CUSTOMERS

The particular vulnerability of banks to the imposition of constructive trusts is due in part - and it is no doubt a pragmatic part - to the fact that they are likely to be of greater financial substance than the impecunious or insolvent trustee who is primarily responsible for the wrongdoing in issue. Moreover, where the defendant is the insolvent trustee, the plaintiff will be much more likely to recover his or her loss if they can formulate the claim as a proprietary claim than if it is based in, say, tort or contract where they will rank with other unsecured creditors. The constructive trust has therefore become a potent factor in determining the priority of claims against an insolvent debtor. However, the banks' vulnerability also follows from their relationship with their customers. Acting as agents they become seized of property subject to trusts, or privy to information relating to the activities of their customers. It is this transient receipt of property, generally in the form of funds, or the acquisition of knowledge suggesting that something may be amiss, which provides the springboard for the aggrieved beneficiary's claim to establish a constructive trust.

Traditionally, the bank's relationship with its customers is that of debtor and creditor. This relationship remains fundamental in so far as money deposited to the credit of the customer's account is concerned. Subject to its banker's right of set-off, the bank is obliged to pay the customer an amount equivalent to the customer's outstanding deposit together with any agreed interest. Because no element of agency is involved in this simple transaction, the customer has no right to question any profit the bank may make in investing the customer's money elsewhere.[11] To utilise Lord Scarman's words: it is "business for profit so far as the bank ... [is] concerned."[12]

However, the relationship of agent and principal arises in respect of the bank's obligation to make payments on cheques drawn by the customer on his or her account, or to collect from other banks cheques drawn by others in favour of the customer. The debtor/creditor relationship does not therefore preclude the existence of an express or implied contract of agency.

To this basic contractual relationship must be added the characteristics of modern banking. Traditional consumer banking; making loans and taking security, holding deposit accounts, and extending lines of credit, has been supplanted by a much more complex range of financial services. Banks today undertake a far greater degree of involvement with their customers and the manner in which their customers use their services to achieve a business objective. Whether involuntarily or otherwise, the bank's services often become an integral step in the complex commercial operation which the customer is undertaking. Corporate banking is as complex as the corporate activity it serves. Advice and investment services are provided, and provided promptly, in a competitive banking market. The modern bank is constantly putting "deals" to the customer designed to attract the customer's investment and facilitate his or her business. In all, the bank has become a "one stop financial shop".[13]

The bank is more often than not in a position to obtain a benefit at the expense of the customer or a third party. We are not concerned here with the more direct benefits which might result from such wrongful conduct as the misuse of the customer's confidential information, but rather with the benefit which accrues to the bank in shifting its own risk to the customer or to other customers. For example, as a condition of accepting the

customer's money it may combine the accounts of that customer and set-off the credit in one account against the debt in another. In this way the bank is able to apply the customer's funds to its own benefit. Similarly, a bank typically obtains from one customer a security, or greater security, to secure the debt of another customer. A guarantee of a loan or overdraft serves this purpose. In such circumstances, the bank shifts the risk of one customer's default from itself to the customer providing the security.[14] It is this extensive involvement by the modern bank, particularly in commercial or corporate transactions, and its potential or ability to obtain a benefit personal to the bank (apart from its agreed commission or remuneration) which has attracted and will continue to attract the vigilant attention of equity.

These particular facets of banking do not mean that there is or should be a separate law of constructive trusts relating to banks. Professor Tettenborn has suggested that banks and solicitors are in a special position and that they should be treated differently from other classes of people who participate in breaches of trust.[15] Private individuals would escape liability where banks and solicitors would not.[16] No such distinction can be countenanced. Unless there is some underlying principle which sets banks and solicitors apart it is illogical to apply a principle in the one case but decline to apply the same principle in another case which, but for the status of the parties, is identical.

In fact, no imperative principle sets banks and solicitors apart. Banks may have special and peremptory obligations to meet cheques drawn on them, they may be subject to special legislation, they may be providing a professional service and required to comply with a professional standard of care, and they may be, by virtue of modern banking activities, frequently immersed in commercial situations which give rise to a disappointed beneficiary's plea for the imposition of a constructive trust, but this does not mean that the basic principles on which their liability will be founded differ from those which are applicable to other persons. If a particular bank should be judged liable in circumstances where a private individual would not, the outcome is the result of applying the same criteria to the facts, not applying a different law.

I therefore reject any suggestion that a separate law should be developed for banks and solicitors with the same force as I rejected the notion in **Powell v Thompson**[17] that commerce, to function properly, requires a special latitude when determining the application of a constructive trust.

4. AN EQUITABLE REMEDY

To discern the principles underlying the concept of the constructive trust, it is instructive to return to its equitable roots. These roots can point to the nature of the current doctrine and assist to find the formula through which the conscience of equity may find its modern expression.[18] Moreover, as we shall see, the inquiry is fruitful in revealing that, in the debate as to how the constructive trust is to be expressed, there is a tendency for lawyers to seek to graft the concepts of the common law on to the equitable principles which they are expounding. For example, in the knowing receipt situation there is a tendency to introduce the notion of fault liability into what is essentially a form of equitable proprietary relief. In respect of the knowing assistance head of liability there is a propensity to perceive the necessary involvement of the third party as being akin to the contribution of a co-conspirator. Neither perception is correct.

Equity was historically a court of conscience. The Court of Chancery derived its jurisdiction from the ability of a suitor to persuade the Chancery Judges that the remedies provided by the common law were inadequate to achieve justice. So it was that trusts were recognised only by the Court of Chancery, and it carved out for equity an exclusive jurisdiction in all matters relating to trusts. The Judges in the Chancery

Courts worked out the scope and nature of the trust concept and determined when it might apply, notwithstanding that there was no express trust.

The relationship between trustee and beneficiary was therefore the earliest form of "fiduciary relationship" dealt with by equity. From about the turn of the nineteenth century the Courts of Equity, as Chancery was widely known, began to apply the term "fiduciary relationship" to circumstances other than those involving an express trust and to hold that persons in the position of a fiduciary were subject to the same, or much the same, obligations as trustees. It was the ability of Courts of Equity to characterise established common law relationships as fiduciary which enabled equity to make remedies available to beneficiaries complaining of a denial of justice in circumstances where there would otherwise have been no remedy. The fiduciary obligations of employees, solicitors, and agents were defined in this way.

Two related features of an express trust informed the Court's thinking. The first was that the trustee was vested with title to specific property for which he was required to account to the beneficiary. It followed that, where a person who was not an express trustee was charged with or became entitled to property subject to a trust, it was a small step to require that person to account to the beneficiary. The second feature was that the trustee was discharging a task for the exclusive benefit of the beneficiary. By analogy this concept could readily be extended to all persons who put their skills at the service of others in circumstances where the recipient relied upon their integrity and diligence.[19]

In this way equity supported or supplemented the common law. With few exceptions it did not set aside common law relationships or deny them the effect which they would have in law. Rather, the Courts of Equity mitigated the painful absence of adequate remedies and the harshness of too rigid rules. Whenever it was necessary to secure justice the Courts of Equity were prepared to apply the obligations which it had imposed on an express trustee to persons who had by their conduct assumed such obligations or who had behaved in such a way as to warrant the trust obligations being imposed upon them. Other than that it is not now necessary in most jurisdictions to first establish a fiduciary relationship[20] this framework is still the basis for the imposition of a constructive trust.

5. LORD SELBORNE'S FAMOUS DICTA

Up to three categories of trust have been discerned in Lord Selborne's famous passage in **Barnes v Addy**.[21] Widely quoted, it is almost an affront to reiterate it, but I do so for convenience:

> "Those who create a trust clothe a trustee with a legal power and control over the trust property, imposing on him a corresponding responsibility. 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 agents of trustees in transactions within their legal powers, transactions, perhaps of which a Court of Equity may be 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 and design on the part of the trustees."[22]

6. TRUSTEE DE SON TORT

The first concept, then, is that of trusteeship *de son tort*. It is centuries old, deriving from the concept of executor *de son tort* used to describe the person who, although not duly appointed as executor, acted in the administration of a deceased's estate as though he or she had been so appointed. He or she was treated as if they had been appointed executor if they acted in a way which was contrary to law and to the detriment of the beneficiary. Having meddled in the estate they were held liable, as a duly appointed executor would be held liable, for any loss caused or gain acquired regardless of whether they were honest in the administration of the estate. The trustee *de son tort* is a parallel concept.[23] By stepping into the shoes of the trustee, the third party accepts the responsibilities of the trustee. Once they have voluntarily, although possibly under a mistake of fact or law, undertaken to hold property for another as trustee, equity will hold them to their undertaking in the same manner as it would a regularly appointed trustee.

It is wholly acceptable that a third party who assumes the office of a trustee should become accountable as if he or she were the trustee. No self-respecting bank which got itself into this position would expect otherwise. This ready concession points to the foundation of the obligation of the trustee *de son tort* to account. It does not rest upon any benefit which the third party may have received, much less upon any unconscionable conduct on his or her part. Rather, it rests upon the notion that the third party has voluntarily assumed the office of trustee. It matters not that he or she may be mistaken and genuinely believe that they are the trustee; they are a pretender. But in voluntarily purporting to exercise the powers and duties of a trustee they will be held to account for their exercise of those powers and duties just as if they were an express trustee. Equity's enduring concern for the welfare of beneficiaries will not allow such a "trustee" to resile from or deny the obligations which they have undertaken.

7. THE KNOWING RECEIPT HEAD OF LIABILITY

As already indicated, the knowing receipt or dealing category of constructive trusts applies where the third party receives trust property knowing of the trust attaching to it or, being in receipt of the trust property, deals with it in a manner which is inconsistent with the trust. Whether by way of a gift or for value the third party receives the property, in effect, as a successor in title to the trustee who has given or sold it to that third party. In the words of Lord Selborne, they have "become chargeable with some part of the trust property".[24] Thus, they must account for that property to the beneficiary as if they were the trustee.

(i) Unjust enrichment

What, then, is the basis of this obligation? Without doubt, it is the unjust enrichment of the third party at the expense of the beneficiary.[25] The third party gains the property; the beneficial owner is deprived of it. The unjust element of the enrichment lies both in the third party's arrogation to him or herself of another's property[26] and the undeserved loss to the beneficial owner of property which is rightfully his or hers.

This latter aspect is to be stressed; that is, the inequity of involuntarily being deprived of a property interest without consideration or compensation. It is encompassed in the words in the short formula for the principle of preventing unjust enrichment which I have given above - "at the expense of the beneficiary". In the formulation of Dickson J in **Pettkus v Becker** it is the "corresponding deprivation" to the enrichment.[27]

(ii) Equitable fraud

Unjust enrichment is not, however, the only moral foundation for the obligation to account for property knowingly received or dealt with inconsistently with a trust affecting the property. To utilise property for one's own use and benefit knowing that it belongs to another, and to thereby intend to disregard the property rights of that other person, is deserving of its own reprobation. This notion is the basis of the concept of equitable fraud. But equitable fraud is one of the less satisfactory concepts bequeathed to us by equity. It could almost be termed "fictitious fraud" for frequently there will be no true element of fraud present at all. Today the courts eschew fictions, and it seems unnecessary to deem conduct which does not amount to fraud to be fraudulent in order to achieve a just outcome.

More often than not there may be no lack of integrity or. the part of the recipient, even where property is received or dealt with after knowledge of a trust has been acquired. This will be so, for example, where the third party has acquired the property without actual knowledge of the trust and notice or knowledge must be imputed to him. Consider too the plight of a person who, having in good faith purchased a property for value, becomes aware that it is subject to a trust in favour of another. He or she is likely to consider that their claim is as good as that of the beneficiary of the trust and to resent the appellation of fraud, equitable or otherwise. While, therefore, there may be circumstances where the conscience of equity is disturbed by the action of the third party in deliberately arrogating the property of another to him or herself, it is not a principle sufficiently universal to provide a ground for a broad restitutionary remedy designed to ensure justice in all but the hardest of cases.

(iii) Voluntary assumption of trust

A further principle on which the knowing receipt class of case in part rests is to be found in the notion that the third party, in taking or dealing with the property knowing of the trust, has voluntarily assumed the obligations of the trustee and must therefore be held to account. As we have seen, this is the principle underlying the trustee *de son tort's* obligation to account to the beneficiary for any loss caused or gains acquired regardless of whether the trustee *de son tort* was honest in the administration of the trust or not. The essence of the liability is the third party's assumption of the office of the trustee. In traditional terms, his or her status as trustee precedes the occurrence of the incident constituting the alleged breach of trust.[28]

In **Powell v Thompson**, however, I said that persons who knowingly receive or deal with trust property make themselves trustees *de son tort*.[29] Perhaps I should have said that they "effectively" make themselves trustees *de son tort*; perhaps I should not have said it at all. The point I wished to stress was that the trust attaches to the property and a third party cannot take or deal with the property knowing of the trust without taking the obligations of the trust with it.[30] In other words, in the act of taking or dealing with the trust property they assume the role of trustee and cannot escape the trustee's obligation to account.

To distinguish the two forms of liability on the ground that the trustee *de son tort* has previously assumed the office of trustee in a way which is significantly different from the third party's acquisition of the trust by knowingly taking or dealing with the trust property is a fine distinction. But I acknowledge that the distinction is real; in the one case the third party has consciously, if mistakenly, undertaken the responsibilities of trustee and, in all probability, held himself out as such; in the other case, the last thing the recipient of the property wishes to be is a trustee. The difference is between assuming the obligation of the trust in the one case and asserting a title to the property in a way which is

inconsistent with the trust in the other. But although there is a difference, the analogy is close. It illustrates the type of liability which the third party assumes on taking or dealing with property in the knowledge that it is subject to a trust. Recipients of property in such circumstances should not be permitted to disavow the obligations of a trust which they know attaches to the property they have acquired. They assume the burden of the trust when assuming the benefit of the property. No want of probity should be required.

Unjust enrichment prevails

Neither of these last-mentioned principles, however, can explain the law's response to the situation where the third party is an innocent volunteer; one who has acquired property without notice or knowledge of any trust attaching to it. In such circumstances equity permits the beneficiary to trace the property. The beneficiary may even do so in accordance with favourable rules when the property has become mixed. The law similarly permits a beneficiary to trace the property or the proceeds of the property in the case of a *bona fide* purchaser for value **with notice** of the trust. In such circumstances, it is possible to say that the beneficiary's title to the property was not extinguished because the *bona fide* purchaser had notice of the trust. But that cannot be said of the innocent volunteer. Nor can it be said that the innocent volunteer has taken the property after assuming the obligations of the trustee (by analogy with a trustee *de son tort*) for he or she did not know of the trust. Some principle other than these must therefore be found to explain why the acquisition of trust property by an innocent volunteer does not extinguish beneficial title.[31] It is contended that the underlying principle can only be the prevention of unjust enrichment.

It is appreciated, of course, that the consequences of tracing and a constructive trust in the knowing receipt class of cases differ. The third party who happens to have trust property in his or her possession is immediately susceptible to the tracing remedy but not personally liable to account. The constructive trustee, on the other hand, is liable to restore the property or account to the beneficiary for its value. But this distinction does not weaken the argument for recognising the common basis underlying liability; preventing the unjust enrichment of the third party at the expense of the beneficial owner.

Adopting unjust enrichment as the cardinal principle of this form of equitable proprietary relief allows the courts to pursue the same flexible approach as the Courts of Equity of old. I stressed this advantage in **Powell v Thompson**.[32] Knowledge of the trust does not in itself defeat the claim of the third party as notice would defeat the claim of a *bona fide* purchaser for value at common law. The enrichment must be unjust. In making this determination, a Court of Equity will have regard to all the circumstances relating to the transfer of the trust property. Its decision will depend not only on the third party's knowledge, but on all the circumstances relating to the acquisition of the property as well as the factors relating to the deprivation of the innocent beneficiary. I put it this way in **Powell v Thompson**:

> "In other words, acting inconsistently with a trust knowing of it does not in itself necessarily establish that the defendant's enrichment is unjust. Rather, it opens the way for an inquiry into all the circumstances as a result of which the Court will be in a position to determine whether it would be inequitable not to require the defendant to account to the plaintiff."[33]

Strict liability rejected

On this basis, therefore, knowledge of the trust is in the nature of a threshold requirement opening the way to a more extensive examination of all the circumstances

of the case in order to "achieve a result consonant with good conscience".[34] It is an approach which provides a contrast with the contention of Professor Birks to the effect that, once knowledge is established, liability for misdirected funds is essentially a strict liability.

Under Birks' theory the knowing recipient is *prima facie* liable by virtue of the receipt of the property.[35] Clearly, such an argument cannot proceed on the basis of the principle of preventing unjust enrichment, unless it is assumed that all transactions are unjust where the recipient has notice of the trust. Nor can it rest on the notion that the recipient has voluntarily assumed the obligations of the trust, for he or she may not have done that in fact. Rather, Birks' theory can only be justified by close adherence to the concept of equitable fraud. Every recipient, it seems, irrespective of whether he or she paid good value for the property, irrespective of the extent of their knowledge and how that knowledge was gained, and irrespective of any blemish in the innocence of the beneficiary, is to be liable to account as a trustee. The unsatisfactory nature of equitable fraud as a principle on which to found liability in this class of case is confirmed.

Birks' theory suffers from the predisposition of lawyers to cast the law in terms of rules rather than principles.[36] Indeed, his argument is dictated by past decisions rather than a consideration of policy or principle. As such, it introduces a rigidity into the application of the law which is the antithesis of the spirit of equity.

Fault liability rejected

Where Birks' theory and mine coincide is in rejecting the notion that liability is fault-based. With Birks' theory of strict liability, the elimination of fault is straightforward (other than the extent to which it is encompassed in the underlying notion of equitable fraud). My approach, however, has caused some puzzlement. It is thought that, having accepted that constructive knowledge is applicable, it may re-introduce an element of fault in requiring the court to search for an "unjust factor" before the obligation to account as a constructive trustee arises.[37] I do not see it that way.

The inquiry relevant to this basis of liability is directed at the **inequity** of the defendant retaining the benefit of the property received at the expense of the plaintiff and not at the conduct of the defendant. While it is often said that equity will not assist a third party unless his or her conscience is affected by knowledge of the competing equitable interest, it is not the third party's conscience which is primarily in issue. It is whether, in all the circumstances, the conscience of equity is offended by the enrichment of the defendant at the expense of the plaintiff.

Of course, a third party who has acted in a blameworthy way may be said to be at "fault" and this may quicken the hand of equity in intervening. But more often than not in this class of case the issue will not turn on the apportionment of blame or fault. There will be no wrongdoing. What will be involved for the court might be called the balancing of equities; the equity in the claim of the recipient and the equity in the claim of the beneficiary. While it is probable that the claim of the innocent beneficiary will outweigh the claim of the recipient with clear knowledge of the trust, that need not be the invariable outcome. Sufficient flexibility to deal equitably with the manifold circumstances which are prone to arise in the course of human affairs is imperative. Fault as a basis of liability is therefore rejected.

However, in **Re Montagu's Settlement Trusts**[38] Sir Robert Megarry V-C adopted the view that a third party is required to account as a constructive trustee only if a lack of probity is shown on his or her part. Moreover, he held that the recipient must have been seriously at fault. While the Vice-Chancellor's view is not unsupported by precedent, it

falls foul of any examination based on principle. Clearly, it is not based upon the principle of preventing the unjust enrichment of the third party at the expense of the beneficiary for the enrichment may be intolerably unjust without the conduct of the third party being unconscionable. Nor can it be based on any notion of equitable fraud for mere knowledge of the trust need not constitute dishonesty. Nor can it be founded on the notion that the third party has assumed the obligations of the trustee in taking or dealing with the property contrary to the trust as there may be no lack of integrity in such conduct.

What, then, is the principle which Megarry V-C would invoke? It can only be the wrongful conduct of the third party. As Birks has observed: "The fit is hard even within equity."[39] I agree. The notion of fault in this sense has no place in the framework of an equitable remedy designed to achieve the restitution of the trust property or the imposition of a constructive trust requiring the recipient to account where an accounting is required to serve the interests of justice. It confuses the basis of this head of liability with the basis of liability where the third party knowingly assists the trustee to perpetuate a breach of trust on the beneficiary. But more of that anon.

The divide between those who insist upon some lack of rectitude on the part of the knowing recipient or knowing dealer and those who have perceived any such moral lapse as largely irrelevant may, in part, be explained by their basal analysis of the remedy. The want of probity school of thought are adamant that the constructive trust is a personal and not a proprietary remedy. As such, they look for some "justification" for imposing a constructive trust on the third party and find that justification in his or her improper behaviour in receiving or dealing with the trust property. The thinking is analogous to my own reasoning in the knowing assistance type of case where the "justification" for imposing a constructive trust is the unconscionable conduct of the stranger. In this latter class of case, however, no trust property need be involved; in the knowing receipt category of case trust property is inevitably involved.

It is reactionary to proscribe the characteristics of a constructive trust, and found liability, in the knowing receipt class of case by reference to the classification of the remedy. The analysis of the remedy then dictates the description of the liability. For my part, I am not overly concerned to determine in advance whether the knowing receipt constructive trust is an action *in rem* or *in personam*. What is important, and what cannot be ignored, is the fact that trust property is received or dealt with by the third party in a manner which is inconsistent with the trust. The genesis of the remedy, however it may be described, exists in the misdirection of trust property and it is that fact which then defines the basis and nature of the resulting liability.

Where the trust property has been misdirected, a constructive trust may not always be necessary for the beneficiary to recover the property. Restitution may be obtained by way of tracing. Where, however, that remedy does not lie or the property cannot be returned or the recipient has disposed of it, a constructive trust will be required if the third party is to be held liable to account to the beneficiary for its misuse. But the imposition of a constructive trust in such cases does not mean that the "proprietorial" nature of the remedy is entirely dissipated. The third party simply accounts to the beneficiary in lieu of restoring the property.

Even though, therefore, the constructive trust in the knowing receipt class of case may be perceived as a personal remedy, the basis of liability is anchored in the receipt and disposition of the trust property. It is not sensible for the law to insist that, if the trust property can be traced or restored no want of probity need be shown, but that if it cannot, so that a constructive trust is required to permit an accounting, lack of probity then becomes a pre-requisite. The role or responsibility of the third party will not have

changed. Whether the property is held for the third party's benefit or has been disposed of, the third party has knowingly asserted a title to the trust property which is inconsistent with the trust and has thus enriched him or herself at the expense of the beneficiary.

The preferable view, therefore, is to accept that the principle of preventing unjust enrichment is at the heart of the constructive trust where a third party knowingly receives or deals with the trust property in a way which is contrary to the trust. Inconsistently asserting a title to the property will in itself suffice for this purpose. As we have seen, other equitable principles surround and complement this core principle. It is, however, the concept of preventing unjust enrichment which ultimately provides the doctrine of constructive trust with flexibility, which is consistent with the position of the innocent volunteer, and which best accommodates the notion that constructive knowledge of the trust ought to suffice.

Mixed support from the authorities

It is acknowledged that this line of reasoning does not yet have widespread judicial support other than in Canada. In a series of decisions the Supreme Court of Canada has recognised the principle of preventing unjust enrichment as the foundation of a duty to make restitution. The constructive trust has been utilised as a means of enforcing that duty.[40] In that jurisdiction the principle of preventing unjust enrichment does not automatically give rise to a constructive trust. Rather, it is perceived as the source of a duty on the part of the person who is enriched to make restitution and a corresponding right on the part of the person who is deprived to receive restitution. The constructive trust is, however, not regarded as the only means by which the right may be enforced.[41] It is a discretionary remedy, and where a personal remedy is adequate or it would be unjust to impose the trust on the recipient, the remedy may be withheld.[42]

The English view, which traditionally regarded the constructive trust as a substantive institution, that is, something akin or similar to an express trust, has not endorsed the principle of unjust enrichment in this context. Indeed, it was expressly rejected by the English Court of Appeal in **Re Diplock; Diplock v Wintle**.[43] Lord Diplock later said: "No general doctrine of unjust enrichment [is] recognised in English law."[44] However, in the recent decision of **Lipkin Gorman v Karpnale Ltd**[45] the House of Lords has unequivocally held that a claim for money had and received is based on the principle of preventing unjust enrichment. Lord Templeman, without reference to Lord Diplock's earlier dictum, simply cited the even earlier and equally well- known assertion of Lord Wright: "It is clear that any civilised system of law is bound to provide remedies for cases of what has been called unjust enrichment."[46]

Civilised or not, in Australia the law is not so enlightened. As the law stands in that country, there is no general principle requiring restitution in cases of unjust enrichment of the third party at the expense of the beneficiary and, even if there were, it is not thought that it would necessarily follow that the constructive trust is the appropriate remedy to express that right to restitution.[47]

Other than in **Powell v Thompson**, the principle of preventing unjust enrichment has not been articulated as the basis of the constructive trust for the knowing receipt class of cases in New Zealand. However, the New Zealand Court of Appeal has recognised the constructive trust as a device for imposing a liability to account on persons who cannot in good conscience be permitted to retain a benefit in breach of their legal or equitable obligations.[48] There has been a happy intermingling of law and equity in New Zealand[49] with the result that the constructive trust has become a broad equitable

remedy for reversing that which is inequitable or unconscionable. With this approach it is likely that the courts in New Zealand will eventually follow the lead set in Canada.

8. KNOWLEDGE IN THE KNOWING RECEIPT CASE

Common to any inquiry into the knowing receipt cases is the question of what knowledge is required before liability will attach to the third party. Is knowledge of the trust sufficient or must there be knowledge of the breach of trust? Then, must such knowledge be actual knowledge, including wilfully shutting one's eyes to the facts, or will constructive knowledge suffice? Identifying the underlying basis of liability in this class of case, as above, serves to suggest the answer to these questions.

Knowledge of the trust

The knowledge required must surely be knowledge of the trust as distinct from knowledge of a **breach** of trust. Although it may be accepted that the two are different in kind and that the former does not imply the latter,[50] more often than not knowledge of the trust would as a matter of fact include knowledge of the breach of that trust. In other words, in knowing of the trust the third party will also know that his or her receipt of or dealing with the property contravened the trust attaching to it. If, however, a case should occur in which knowledge of the trust is established, but the recipient is unaware that there is any breach of that trust, knowledge of the trust should suffice. Such knowledge is sufficient elsewhere in the law to repel the defence of a *bona fide* purchaser for value. It is also consistent with the notion that the trust attaches to the property and that the third party takes the property with the trust attaching to it. To go further and require knowledge of the breach is to embark upon a quest to find fault on the part of the recipient.

I therefore suggested in **Powell v Thompson** that there was a danger in stipulating a test which is too high in the knowing receipt class of case. To do so will prevent a Court of Equity from being able to intervene to assist an innocent plaintiff where, in the overall circumstances, it might consider such assistance justified. It is therefore sensible that the knowledge required should be no greater than that necessary to permit the court to examine the circumstances of the case with a view to deciding whether or not the defendant's retention of the trust property is inequitable.[51]

Moreover, once it is accepted that the basis of liability in this class of case is the principle of preventing unjust enrichment, knowledge of any **breach** of trust is unnecessary. With notice of the trust, the third party benefits unjustly by asserting a title or otherwise acting in a way which is inconsistent with the trust. He or she will know, in other words, that they are benefiting at the expense of the beneficiary. No knowledge of a breach of trust committed by the trustee who has transferred the property to them is therefore needed to define the claim which the beneficiary has against the third party. The requirement for such knowledge is better restricted to the knowing assistance cases where the third party's knowledge of the breach is likely to be a critical factor in establishing that his or her conduct was unconscionable.

Constructive knowledge

Similarly, the basis of preventing unjust enrichment dictates the kind of "knowledge" which is appropriate to initiate the court's inquiry. For the purpose of determining whether the third party is unjustly enriched at the expense of the beneficiary, it must suffice if the third party either had actual knowledge of the trust or **ought** to have had knowledge of it. Constructive knowledge is acceptable in an inquiry aimed at the prevention of unjust enrichment. It would be illogical to exclude it.

In this context it is customary to refer to Peter Gibson J's classification of the various kinds of knowledge in **Baden Delvaux & Lecuit v Société Générale pour Favoriser le Développement du Commerce et de L'Industrie en France SA.**[52] These are:

(i) actual knowledge;

(ii) knowledge which is attainable but for shutting one's eyes to the obvious;

(iii) knowledge obtainable but for wilfully and recklessly failing to make such inquiries as an honest and reasonable person would make;

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

(v) knowledge attainable from inquiries which an honest and reasonable person would feel obliged to make, being put on inquiry as a result of his or her knowledge of suspicious circumstances.[53]

This much-quoted classification is unfortunate and has contributed to the confusion in this area of the law. It has been referred to in both the knowing receipt and knowing assistance categories of liability with resulting uncertainty as to which applies to which.[54] Not only does it lead to a mechanical approach to the topic of constructive trusts but it results, on the one hand, in the view endorsed by some that the requisite knowledge to found a constructive trust in a knowing receipt class of case must contain some element of moral improbity.[55] It has prompted others, on the other hand, to suggest that the knowledge required of a stranger who is a party to a breach of trust in the knowing assistance type of case should be the same as it is for a knowing receipt type of case.[56]

Moreover, as with all attempts to reduce the law to comprehensive classifications, it is confused and confusing.[57] For example, there is no substantial difference between categories (ii) and (iii). Both are instances of "Nelsonian" knowledge. Wilfully shutting one's eyes to the obvious must in practice include wilfully failing to make the inquiries an honest and reasonable man would make when faced with the obvious. Then, there is a subtle difference, but only a subtle difference, between categories (iv) and (v). Certainly, it was a difference accepted by the High Court of

Australia in **Consul Development Pty Ltd v Estates Pty Ltd,**[58] a case in which the High Court wished to ensure that a person who knows all the facts, but does not recognise the fraud inherent in those facts, is nevertheless liable. Such circumstances, however, can just as readily be fitted into categories (i) or (ii). Brindle and Hooley have asserted that the true distinction is between categories (ii) and (iii) on the one hand, and (iv) and (v) on the other.[59] One could equally claim that the true distinction is between class (ii), that is, "Nelsonian" knowledge, and categories (iii), (iv) and (v), which put the recipient upon inquiry.

In truth, the categories overlap and merge into one another. They generally illustrate the futility of endeavouring to pigeonhole the law, particularly a flexible concept such as constructive knowledge. It would be preferable to abandon Gibson J's description and the artificial and confused approach it has generated and revert to a simple formula to the effect that a constructive trust may be enforced where the third party receiving or dealing with the trust property either knows or ought to have known of the trust.

Moreover, the words "honest and" in the phrase "honest and reasonable person" in categories (iii) to (v) are misplaced.[60] They include the honest person who quite

unreasonably fails to make inquiries where inquiries would seem imperative. Nor is honesty, or dishonesty, a necessary ingredient of a constructive trust founded on the unjust enrichment of one at the expense of another. The test for constructive knowledge can only be objective; both honesty or the want of honesty indicates a subjective element. It must be enough that the circumstances are such that a reasonable person would be put upon inquiry. Equipped with this broad objective formula, the courts can better undertake the task of determining whether the enrichment is unjust or not.

The "windfall" cases

In **Powell v Thompson** I did not preclude the possibility that in certain circumstances a Court of Equity might be persuaded to examine the equities of the competing claims even though the third party was not aware that he or she was receiving or dealing with the property in a way which was inconsistent with a trust. Because liability in this class of case does not stem from any particular conduct or misconduct on the part of either the trustee or the third party, but from equity's unwillingness to accept the enrichment of the third party at the expense of the beneficiary, knowledge may not be necessary in order to activate equity's jurisdiction. This should be so if the objective is to ensure a result which is consonant with good conscience.[61]

At base, the courts are examining competing claims to a right or interest in the property in contention. They are concerned with the allocation or distribution of wealth. There is no reason in principle, therefore, why a beneficiary who has been deprived of an interest in the property should not be able to maintain a claim for the return of that property or an accounting if the property cannot be restored without first showing that the defendant knew of his or her interest. Is an innocent recipient, for example, to retain property which on the facts of a particular case may be indisputably a windfall? Cases arise in which the plaintiff and defendant are both innocent, or equally "innocent", and an approach which therefore favours the "innocence" of one party may not lead to the most equitable result. It is possible that neither should succeed entirely to the exclusion of the other.

I have suggested elsewhere[62] that in such cases it is open to the courts to develop a wide range of remedies within the framework of the constructive trust short of requiring the third party to account in full for the acquisition of the property. Moreover, the courts could require the beneficiary to first exhaust his or her remedies against the errant trustee or other culpable parties before seeking to hold the innocent recipient liable for the balance. To protect the latter where it would be inequitable to require him or her to make full restitution, the courts may need to mitigate their liability by way of making a reduction or variation in the compensation payable. Further, it may be necessary to recognise and develop a defence where the innocent recipient has changed his or her position[63] or the property cannot be identified and it would be unfair to require redress or any substantial redress.[64]

9. THE LIABILITY OF THE AGENT FOR KNOWING RECEIPT

It remains to deal with the position of agents under this particular head of liability. In short, agents will not be liable for knowing receipt in respect of property passing through their hands as agents unless they receive the trust property **for their own benefit**. If the agents have received the trust property for their own benefit with knowledge of the trust, and dealt with it in a manner inconsistent with the trust, their status is irrelevant. They will then be unjustly enriched at the plaintiff's expense. If, on the other hand, the trust property is received or dealt with by the agents in their capacity as agents, they cannot be held liable. The unjust enrichment resulting from the transfer or handling of the property accrues to their principal, not to them. Their involvement falls to be dealt with, if at all, under the second head of liability of knowing assistance.[65]

This distinction was identified by Sir Clifford Richmond in **Westpac v Savin.**[66] Quoting Brightman J in **Karac Rubber Company Ltd v Burden (No 2),**[67] the learned Judge included the agent of the trustee who is in receipt of trust property solely by virtue of the existence of the agency in the second category of constructive trusteeship. The agent, Sir Clifford held, does not receive the property for "his own benefit". He concluded: "So it can be argued that an agent who receives trust funds from the trustee will be within the first category **only if he is setting up a title of his own to the funds which he has received** and is not acting as a mere depository or, as Lawson J, put it ... merely as a channel through which money is passed to other persons."[68] (Emphasis added)

The conclusion that agents cannot be held liable in knowing receipt cases unless they have set up title to the trust property or funds is generally accepted by commentators, although the analysis on which such an exemption is based may vary.[69] It also has some judicial support apart from **Westpac v Savin.**[70] In all, agents who act merely as conduits through which trust funds pass cannot be held liable for knowingly receiving or dealing with trust property.[71]

Professor Tan has criticised this conclusion. He suggests that to permit an agent to receive property knowing of a breach of trust is tantamount to condoning an act which facilitates the breach of trust. He postulates the situation where the agent knows of the breach of trust, but there is no **fraudulent** breach of trust on which to predicate a claim for knowing assistance. In such circumstances, he suggests, the agent receiving the property is allowed to shelter behind the fact that he is an agent acting in the course of his agency.[72] The mistake in this thinking is the assumption that the breach of trust must be fraudulent before the agent can be held liable for knowing assistance. Later in this paper I argue that the accessory may be held liable if he or she has acted unconscionably so that the terms of the trust should be imposed upon them. Unconscionable conduct in these circumstances may fall short of fraud. There need be, therefore, no concern that an agent who has received trust property as an agent knowing of a breach of trust, but not of any fraudulent design, may shelter securely behind the fact that he or she is an agent. If they have acted unconscionably they will be liable for assisting the defaulting trustee; if they have not, they will not be liable. And so it should be.

However, Tan also makes a more trenchant criticism. He contends that it is anomalous to say that an agent may be liable for knowing receipt in respect of any fees or commissions received for his own benefit, but is not liable for the loss of the amount passing through his hands when he has chosen to facilitate that loss in order to earn his fees or commission.[73] Once the principle of preventing unjust enrichment is applied, however, the error in this view is manifest. The agent is not being enriched by the receipt of the trust property at the expense of the beneficiary. In receiving fees or commissions the agent is not setting up a title of his or her own to the trust funds unless the fee or commission is paid directly from the trust funds. Any material benefit which the agent obtains will, for the most part, have been incidental to their handling of the trust property, such as the receipt of costs and disbursements as in **Carl Zeiss Stiftung v Herbert Smith (No 2).**[74]

In the **Carl Zeiss** case no allegation was made that the defendant's solicitors lacked integrity, but it was alleged that they had knowledge that the funds which they had held on behalf of a client were trust funds because they were aware of a claim to that effect brought by the plaintiff. But the plaintiff failed in its submission that the solicitors should be subject to the imposition of a constructive trust. The Court of Appeal held that the solicitors only had knowledge of a disputed claim and did not therefore have knowledge that the funds were **in fact** trust property. However, no more was required in the **Carl Zeiss** case than that the court recognise that the defendant's solicitors were to be

judged in accordance with the principles attaching to the knowing assistance head of liability and not the first and that, having regard to the doubt attaching to the equity in question, the conduct could not be described as unconscionable so as to require them to account to the plaintiffs as constructive trustees. The solicitors, as agents, deserved no special treatment as such.[75]

If this approach were to be adopted, it would put paid to much unnecessary litigation relating to the liability of persons who handle trust property as agents for a defaulting trustee. The agents would only be liable under this head where they benefited by being enriched at the expense of the beneficiary in circumstances that were unjust. If, however, they possessed knowledge of the trust or the breach of trust, their agency would be irrelevant. The only question then would be whether their conduct was unconscionable so that they should in conscience be fixed with the responsibilities of the trustee. I will now turn to that head of liability.

10. THE KNOWING ASSISTANCE HEAD OF LIABILITY

To found liability in the knowing assistance class of case the third party must participate in or facilitate the breach of trust. It is this element of assistance which leads a court to conclude that the obligations of the trustee should be imposed upon the stranger. He or she then becomes a constructive trustee.

Liability in this category of case is based on the notion that the third party has acted unconscionably. But it is not that the stranger has acted unconscionably at large or in the round; rather, it is that he or she has acted unconscionably in assisting the trustee commit a breach of trust **in such a way that they should have the obligations of the trust imposed upon them** which counts. In such circumstances equity demonstrates its intolerance of their behaviour by requiring them to account to the beneficiary whom they have assisted to defraud. Unless it serves to render the stranger's conduct excusable, it matters not that his or her involvement may have been at the periphery of the breach of trust; they have assisted the trustee and that is enough. Nor does it matter that trust property may not have been received or dealt with. The court focuses not on the transfer of any property but the conduct of the third party in facilitating the breach.

The key question under this head of liability, therefore, is whether the stranger's behaviour was such that the obligations of the trust should be imposed upon him or her. The language of imposition is now apt. The trust obligations are imposed, not because the third party has received and benefited from the receipt of property which is subject to a trust, but because he or she has acted in such a way that they deserve to be treated as if they were a trustee in respect of the trust in issue. They too, along with the trustee, can be called to account for the abuse of trust.[76]

A flexible approach to knowledge

In **Powell v Thompson** I argued that commonsense suggested that the test to be applied in determining a third party's knowledge of the trust and his or her involvement in its breach before a constructive trust is imposed should also be as flexible as possible. I said:

> "No single or universal test can possibly suffice if justice is to be assured in each individual case and the chosen yardstick is not to be constantly battered by strained interpretations. In some cases the circumstances will no doubt be such that the court will look for some overt connivance by the stranger in the commission of the breach of trust; in other circumstances the defendant's knowledge of what is transpiring and his or her passive acceptance of the

> position or failure to prevent the breach may decree that they should have the obligations of the trust imposed upon them. As in so many other areas of the law, it is ultimately a question of fact and degree, namely, whether in the circumstances of the particular case, the conduct of the defendant may properly be described as unconscionable to the point that he or she should be required to assume the obligations of a constructive trustee and account to the plaintiff."[77]

Adopting a flexible approach along these lines means that it is unnecessary to exclude constructive knowledge, or all forms of constructive knowledge, when examining the conduct of the third party. Obviously, the stranger will have some knowledge. What knowledge that is, and whether it should have prompted him or her to make further inquiries, will be matters which form part of the overall conduct which is to be looked at by the court in determining whether they have acted unconscionably. Consequently, where a third party facilitates a breach of trust without knowing of all the facts constituting the breach or knowing of the trustee's devious intention, the question will still be whether, in all the circumstances, his or her conduct was unconscionable and justifies the imposition of the obligations of the trust upon them.

It follows from the acceptance of this test that knowledge, in the sense of notice of the trust, will seldom, if ever, be sufficient to render the stranger liable, certainly in the absence of the transfer of trust property. But there is no reason why the failure of a stranger to make further inquiries when he or she has some knowledge should have to be in the order of a "wilful and reckless" default. Much will always depend on the circumstances, with the court adjusting the yardstick to accord with the level of involvement and knowledge which is appropriate before the stranger's conduct can be said to be unconscionable.[78]

It has to be acknowledged, however, that, this flexible approach runs counter to the weight of authority. The stranger, it is frequently said, must have knowledge of the dishonest and fraudulent design of the trustee. The requirement goes back to **Barnes v Addy**.[79] The formulation, we are told, "has stood for more than a hundred years".[80] But we should refuse to be daunted. Lord Selborne, I am sure, did not intend to issue a statutory-like proclamation which would remain unmoving and immutable for all time. The Law Lord purported to speak for his times and would no doubt have accorded those following him in the judiciary the same right to speak for the tenor of theirs.[81]

Ungoed-Thomas J's attempt to introduce some measure of flexibility into the exercise in **Selangor's** case should be admired and emulated. He said:

> "It seems to me unnecessary and, indeed, undesirable to attempt to define 'dishonest and fraudulent design' since a definition *in vaccuo*, without the advantage of all the circumstances that might occur in cases that might come before the court, might be to restrict their scope by definition without regard to, and in ignorance of, circumstances which should patently come within them. The words themselves are not terms of art and are not taken from a statute or other document demanding construction. They are used in a judgment as the expression and indication of an equitable principle and not in a document as constituting or demanding verbal application and, therefore, definition. They are to be understood 'according to the plain principles of a court of equity' to which Kidersley V-C referred in **Bodenham v Hoskins** (1852) 21 LJ Ch 864, 873, and these principles, in this context at any rate, are just plain, ordinary commonsense."[82]

This flexible approach was, however, neither admired nor emulated by the English Court of Appeal in **Belmont Finance Corporation Ltd v Williams Furniture Ltd.**[83] In that case it was claimed that the defendants were accountable as constructive trustees. The pleading alleged a criminal act, but not dishonesty, and was promptly challenged by the defendants. Allowing only that in this context the words "fraudulent" and "dishonest" have the same meaning, the court applied **Barnes v Addy** and held that the pleading was defective in that it did not assert dishonesty.[84]

The contention that nothing less than knowledge of a dishonest design is sufficient to make a stranger a constructive trustee in respect of the consequences has now been repeatedly upheld in England,[85] although there is also considerable authority to support the contrary conclusion.[86] Nor has this rigid approach been endorsed in New Zealand. However, as promised, this paper does not seek to reconcile the authorities. A principle-oriented approach is preferred over the futile endeavour to derive a sensible theory of constructive trusts from the case law.

The "fraudulent and dishonest design" formula

If, therefore, there is nothing in principle which dictates that the knowledge of the stranger must be knowledge of a fraudulent and dishonest design upon the part of the trustee, why is the more flexible approach so widely resisted? Part of the reason no doubt rests in the courts' longstanding desire not to shackle commerce with an unduly onerous concept. Commerce requires, it is thought, the latitude inherent in the fraudulent and dishonest design formula. But this notion is logically unacceptable.[87] The law cannot accept two standards, one for commerce and the other for ordinary citizens. Nor should the threshold of equity's tolerance be raised to meet some purported commercial need if the conduct in question is otherwise unconscionable.

There is, indeed, something unwholesome in the suggestion that equity's conscience should be diluted to conform with the conscience of the commercial community. The preferable option is to require the court, in determining whether or not any particular conduct is unconscionable, to pay due regard to the commercial realities. A full appreciation of the commercial difficulties which arise in any business situation is likely to lead to a superior determination of whether the conduct in question is such as to call for the imposition of a constructive trust. The conduct of the stranger can be assessed having regard to all the circumstances of the particular case, of which the commercial situation will be critical.

Part of the reason why a more flexible approach is resisted no doubt also lies in the court's related concern for the position of those persons acting as agents. Many, if not most, of the cases on the subject of constructive trust relate to the alleged liability of agents.[88] I have dealt with this concern in respect of the knowing receipt class of case and will return to it in Section 12 of this paper in relation to liability for knowing assistance.

The other reason for the resistance, possibly, is the inability of lawyers to cope with broad criteria such as "unconscionability". The difficulty which some judges experience in defining what is unconscionable is evident from the observations of Tipping J in **Marshall Futures Ltd (In Liq) v Marshall.**[89] The learned Judge observed:

> "If conduct which is less reprehensible than that which can be described as fraudulent and dishonest but which is nevertheless properly to be described as unconscionable is to be sufficient I am not sure how one is to identify such conduct. Is negligence to be enough? Are we going to have to consider degrees of negligence?"[90]

These observations, which were made in the context of an application to strike out certain causes of action, illustrate the folly of seeking to define conduct which is unconscionable in the abstract. Close attention to the facts in any given case will generally serve to identify behaviour deserving of the opprobrium of being branded unconscionable. Be that as it may, the task should not cause anxiety. Judges and lawyers regularly confront the task of deciding whether or not the conduct of a party is unconscionable in other circumstances, such as when determining whether a bargain is unconscionable or whether to enforce a claim based in promissory estoppel as in **Walton Stores (Interstate) Ltd v Maher.**[91] In these contexts the test of unconscionability is not thought to be judicially unmanageable.

Moreover, to claim that only conduct which is fraudulent and dishonest can be unconscionable is to restrict the meaning of the word "unconscionable". In effect, the words "fraudulent and dishonest" are substituted for the word "unconscionable". It is to say that conduct which is less than fraudulent and dishonest may never be unconscionable nor affect equity's conscience. Equity certainly never intended to limit the meaning of the word unconscionable or its conscience in this fashion. Cases where relief is given in equity in respect of unconscionable bargains, for example, sometimes show fraud, but other elements have also afforded a recognised ground for relief; the inequality of the parties, the intrinsic unfairness of the bargain, ignorance, poverty, undervalue, lack of independent advice, and so on. There is, then, no need to enumerate the range of matters which may point to unconscionable conduct when determining whether or not a stranger may be held liable to account as a constructive trustee.

Ultimately, it seems, the protagonists of this restricted view are searching for the false security of a rule.[92] If the question is whether the stranger has been fraudulent or dishonest, or a party to fraud or dishonesty, the question is a relatively straightforward question of fact. It is much easier to determine whether the stranger's conduct is fraudulent or dishonest than whether it is negligent and, if that is the case, whether it is so negligent that he or she should be held liable as a constructive trustee. With the fraudulent and dishonest formula an important principle of equity can be applied mechanically, as if it were a rule. But this is to do the law a disservice. It is to adopt an approach which is essentially immature.

In truth, the vital question is not even whether the defendant's conduct is "unconscionable", for that is just a label. As already outlined, the key question is whether, **as between** the beneficiary and the stranger, the stranger's conduct is such that he or she should be required to assume the obligations of a trustee and be held responsible for the consequences of the breach of trust perpetrated upon the beneficiary. When the question is framed in this way, there is no reason why conduct which falls short of fraudulent or dishonest behaviour may not in some circumstances be perceived as sufficiently unconscionable to require that person to be held accountable as if he or she was the trustee. While it is unlikely that negligent conduct would ordinarily attract the remedy, it should not be excluded.

11. THE CASE FOR NOT EXCLUDING NEGLIGENT CONDUCT

Neither in **Powell v Thompson**, nor in this paper, have I suggested that the liability of third parties in the knowing assistance class of case should be extended to **all** or **any** negligent conduct. Far from it. I have simply argued that conduct other than that which may be described as fraudulent or dishonest should not be entirely precluded from consideration. Negligent behaviour, it is suggested, may properly at times and in certain circumstances be regarded as unconscionable. It remains to marshal the reasons why this should be so.

In the first place, those who reject negligent conduct invariably seem to proceed on the assumption that the trustee's breach of trust **must** be of a fraudulent and dishonest character. But this is not so. To assert, therefore, that there must be something wrong with the law if negligence is sufficient to incur the opprobrium of liability for participation in a fraudulent or dishonest design,[93] is to overlook the fact that the trustee may have had no such design when committing the breach of trust. Few would deny that a trustee does not owe a duty of care, collateral to his or her fiduciary obligation, to the beneficiary's of the trust, or that a trustee cannot breach his or her fiduciary obligations with behaviour that could not be characterised as dishonest. Yet, once it is accepted that, to be liable, the trustee need not be dishonest, the fallacy in asserting that "there is no sense in requiring dishonesty on the part of the principal while accepting negligence as sufficient for his assistant", as Millett J did in **Agip (Africa) Ltd v Jackson**,[94] is plain. The fact that dishonesty is not a prerequisite to a breach of trust on the part of a trustee is one reason why negligent conduct may, in certain circumstances, suffice. In other words, in terms of Millett J's own reasoning, it is hardly sensible to hold that knowledge of dishonesty is required on the part of the assistant while accepting that negligence is sufficient for the principal. Nor would it be logical to hold that the knowledge required on the part of the stranger must be knowledge of dishonesty when the trustee is dishonest but may be negligence when the trustee is negligent.[95]

The error in Millett J's reasoning arises from a failure to appreciate that the claim to hold the stranger liable as a constructive trustee is an action by the beneficiary **against** the stranger. The court looks at the stranger's conduct. Irrespective of the degree of impropriety in the trustee's conduct, the remedy lies directly against the third party. The beneficiary is not alleging that there has been a conspiracy;[96] the beneficiary is alleging that the **stranger** him or herself acted unconscionably in respect of their involvement in the commission of the breach of trust.

Secondly, it is illusory to think that fraud and dishonesty on the one hand, and negligence on the other, divide into two neat, water-tight categories. In reality the two will frequently overlap or merge one into the other. For example, a third party who dutifully asks the question which reveals the planned breach of trust might be said to be dishonest if he or she persists in helping the trustee with it. And what of the stranger who refrains from asking the damaging question simply because he or she believes or suspects that the answer will result in them hearing what they do not want to know, that is, that there is a proposed breach of trust? There is in this conduct a moral element which is akin to dishonesty but which yet cannot be divorced from an obligation to take care. The subjective and the objective combine to render the conduct unacceptable.

Nor, when considering what is unconscionable, can a person's conduct be easily divorced from his or her motives. The fact that the stranger may have apparently failed to ask the obvious question or draw the obvious inference or accept an obviously implausible explanation, may appear no more than remiss - until it is known that the stranger will obtain a considerable benefit from the breach. In all, the courts should be able to look at the total conduct of the third party and, standing back from it, decide in equitable terms whether that conduct is unconscionable without having to pause to eliminate the activity which might be strictly described as negligent.

It is possibly because the courts will, in order to do justice on the facts of the instant case, insist on looking at the totality of the third party's conduct that there are so many reported cases where the defendant has been held liable as a constructive trustee in respect of conduct which was not fraudulent or dishonest. **Selangor United Rubber Estates v Cradock (No 3)**[97] and **Karak Rubber Co Ltd v Burden (No 2)**[98] are just two, but there are many more.[99]

In **Selangor's** case the plaintiff company sought to recover monies misapplied by its directors in financing the purchase of its own shares. Two circular cheque transactions were involved. It was alleged against the bank that it had paid out the plaintiff company's monies in circumstances in which it ought to have known of the director's ulterior purpose. It was held that, although the bank's officers did not appreciate that this was the purpose of the payment, a reasonable banker, knowing what the bank in fact knew, would have known that its purpose was to enable the directors to purchase the company's own shares. The bank was therefore held liable. In the **Karak Rubber Co** case the bank was involved in a similar scheme to that in issue in **Selangor's** case. Again the bank was held liable. In this case it was not aware of the facts, but it was held that it should have made further inquiries and that it would then have discovered the facts.

In both cases the banks concerned were held liable for knowing assistance without any obsessive concern for the fraudulent and dishonest formula. The courts, in cases such as these, have simply concluded that the conduct of a defendant, however described, warranted the imposition of a constructive trust.

Thirdly, in deciding whether or not negligent conduct should be ousted from consideration, it is relevant to have regard to the nature of the trust institution. Its key feature, perceived as a virtue, is the manner in which it separates the burden of managing property from the advantages of owning it. In order to achieve this separation enormous power is concentrated in the hands of the trustee.[100] It is a concentration of power which invites abuse and, indeed, much of the law of trusts has evolved to prevent or control abuses of that power. The highest standards of integrity and diligence are required of the trustee. It does not seem inconsistent, therefore, to expect third parties who come into contact with a trust to exhibit a standard of behaviour which may be higher than the mere avoidance of fraud and dishonesty. By imposing liability on strangers, equity is extending the mechanism by which the trustee's powers are supervised and controlled. Equity's purpose is not therefore necessarily well-served by adopting a rigid and restrictive regime for third parties who know of and meddle in a trust to the detriment of the beneficiary. It is, of course, worse if that meddling is undertaken to advance the prosperity of the stranger.

Fourthly, it is well to bear in mind that, because it depends on the unconscionability of the defendant's conduct and not on the receipt of a benefit, liability in knowing assistance cases is not restitutionary in character. Rather, it is analogous to liability in tort in that it is designed to compensate the plaintiff for the loss he or she has suffered at the hands of the third party.[101] Of course, the obligation which equity imposes on the third party is not the same as the duty prescribed in tort. The significant point is that once it is recognised that the constructive trust provides an aggrieved beneficiary with a remedy to recover his or her loss, the cause of action need not require any higher standard than that which is unacceptable to the conscience of equity.

The fifth, and consequential point, arises from an examination of the question from the point of view of the beneficiary into whose hands the right of action has fallen. Equity has always safeguarded the interests of those who are at a disadvantage or otherwise vulnerable. The beneficiary has been particularly favoured. Outstanding developments in the law relating to fiduciary relationships is clear evidence of this concern. Consequently, notwithstanding the court's resolve not to burden third parties, be they bankers, solicitors or other groups engaged in commerce, with an impossibly high or impractical standard of conduct, the beneficiary's presence will be undoubtedly felt. Their competing interests will, overtly or otherwise, be duly acknowledged by the courts whenever circumstances arise in which it is thought that the beneficiary was entitled to expect that the stranger would carry out his or her duties with diligence and care as well

as honesty. A beneficiary facing substantial loss as a result of the heinous conduct of a trustee will find it no less galling that the trustee was assisted in his or her devious plan by the professional ineptitude of their banker, solicitors, or other agent, even though there was no dishonesty on their part. Whatever the trustee's designs, and whatever the character of the stranger's assistance, the beneficiary is the loser.[102]

Another consideration may be mentioned in this context. Often today the determination of questions of liability are perceived as being exercises in risk allocation. Regard is had to the interests of the community and economic efficiency in determining which party can best bear the loss. Because of the absence of reliable research and data, these questions are never easy to answer. But in the contest between an innocent beneficiary who has no reason to anticipate the incidence of loss and agents such as banks or solicitors, which provide essential services in implementing commercial transactions which may damage the interests of beneficiaries, it is the beneficiary who would seem to present the more tenable claim for consideration.

Finally, perhaps, these points can be reinforced by reference to a hypothetical example. Let us take the case of a bank honouring a cheque wrongfully drawn on an account which was subject to a trust. The bank's officers were not dishonest, but their conduct failed to measure up to the standards expected of a reasonable bank. The beneficiary had earlier written a letter to the bank drawing attention to her interest in the account. When the bank honoured the cheque the letter was overlooked by a new staff member not familiar with the bank's file. Moreover, whereas a bank does not ordinarily derive, or expect to derive, a benefit by honouring the cheques of its customers, in this case the cheque was used to discharge a mechanic's lien on the property over which the bank held a security. Thus, the bank obtained a direct benefit from its negligent act in honouring a cheque which, but for the fact that its behaviour slipped below the standard of care expected of banks, it would not have obtained.[103]

I suggest that in this hypothetical example the bank's conduct would be regarded as unconscionable even though it had no actual knowledge of the trust and had not consciously sought to obtain the advantage which ultimately accrued to it. But the conduct is not unconscionable because the bank obtained a benefit;[104] it is unconscionable because the bank negligently facilitated the breach of trust in circumstances where it stood to benefit. It is that factor which decrees that the bank take particular care. Consequently, in my view, the obligation of a bank, fairly stated, when entering upon transactions which may operate to provide it with a benefit, and confronted with circumstances which would put a reasonable bank upon inquiry, is to assure itself that the contemplated transaction is not part of a fraud or breach of trust. It is the failure to take that positive step in those circumstances which is unconscionable.[105]

I do not suggest that situations where the stranger stands to benefit from the transaction are exhaustive of the occasions when a party's negligent conduct may be regarded as unconscionable. Factual situations which daily arise in the course of commercial affairs are too varied and diverse for that sort of prediction. The point of the example is to demonstrate that negligent conduct cannot automatically be excluded from the scope of the knowing assistance kind of case with any assurance that justice will be done.

The example also illustrates the other points advanced in support of this contention. It demonstrates how the focus of the court's attention is properly on the conduct of the defendant. The culpability of the trustee and the character of his or her conduct is largely irrelevant. The case also confirms the difficulty of separating fraudulent and dishonest conduct from negligent conduct, even in a relatively straightforward case.

This difficulty must, of course, be even greater where the facts are more complex. Further, the need, as a matter of policy, to ensure that the trustee's extensive powers are checked to prevent abuse is also evident from this example. It is a simple matter for a trustee to present a cheque on the trust account to the detriment of the beneficiary. The scope for such abuse must be curtailed as far as is reasonably and practically possible. Finally, the vulnerability of the beneficiary's position is highlighted. On the facts of this hypothetical case the beneficiary took active steps to ensure that the bank was aware of the trust. Even apart from that, the beneficiary might be said to have a legitimate expectation that the bank would act in accordance with recognised standards of banking practice. The bank did not do so, and the innocent beneficiary suffered a loss as a result. I do not doubt that in such circumstances Courts of Equity will find amenable a solution which favours the beneficiary.

One final point remains to be made under this heading. It is in response to the question of why, if negligent conduct is not excluded from consideration in knowing assistance cases, there is any necessity to distinguish between this head of liability and liability in negligence. Many commentators have been prepared to equate the two forms of liability.[106] But they are distinct, and the reasons why they should be kept distinct follows from the different consequences which result from a finding of liability in each. In the tortious action, a breach of the duty of care places the defendant in jeopardy of damages to make good the plaintiff's established loss. With the imposition of a constructive trust the implications are much more extreme. No question of causation, foreseeability or remoteness arises. The liability of the constructive trustee corresponds with the liability of the express trustee who has committed a breach of trust; he or she is liable to place the trust estate in the same position as it would have been but for the breach of trust. If the property is in existence it may be restored, and any improper profit or gain which the constructive trustee has obtained may be recovered even though it is unrelated to the beneficiaries' actual loss. Because, therefore, the consequences of liability as a constructive trustee are potentially more serious and extensive than those arising in negligence, there is good reason to require a higher threshold of liability.[107] This requirement is met if the negligence which will suffice to render a stranger liable as a constructive trustee must be also such as to deserve the opprobrium of unconscionable conduct.

I would not wish, however, to inhibit the development of a more flexible approach to the remedies made available to a plaintiff who has succeeded in establishing a constructive trust. Irrespective of whether the liability of a trustee who has committed a breach of trust should remain severe, the position of a constructive trustee is less absolute. He or she is having a trust imposed upon them and it is conceivable that in some circumstances the full rigours of trust liability would not be wholly appropriate or just. Circumstances may well arise, for example, in which the plaintiff's behaviour has been less than blameless in leading to the breach of trust and where it would be just and equitable to reduce the constructive trustees liability to meet or offset the contribution of the plaintiff.[108]

Such a development would be consistent with the more flexible approach I have recommended in respect of the issue of liability itself. It is also consistent with the notion that the courts have a discretion, as in Canada,[109] to withhold the equitable remedy in certain circumstances until other remedies have been first considered. Above all it would allow justice to be done in the instant case, particularly where the full implications of trusteeship would be unduly harsh.

12. THE LIABILITY OF THE AGENT FOR KNOWING ASSISTANCE

The question remains as to whether this approach raises yet "another shadowy liability" to "haunt commercial life",[110] particularly in respect of its impact upon banks, solicitors and other agents who play a critical role in commercial activity. Without question, the position of the agent is difficult. It is contractually bound to act as directed by the trustee. Unless the agent is prepared to breach its contracts, it has no choice in the matter but to do what the trustee tells it to do. This leads to the response exemplified by Sullivan:[111]

> "It is one thing to tell an agent that he must breach his contract rather than participate in a fraud on the part of his principals. It is quite another to tell him that he must breach his contract any time he believes his principal's instructions are contrary to the terms of the trust. This is to tell the agent that he must first of all master the terms of his principal's undertaking and, secondly, enforce his own understanding of what that undertaking entails."

How real this distinction is in fact, however, must be questioned. Why is it any easier for an agent to detect fraud on the part of its principal than to discern that the instruction is contrary to the terms of a known trust? If anything, one would think that the latter inquiry would be the easier to discharge, particularly as a fraudulent trustee would be likely to conceal his wrongdoing. Moreover, I doubt that the inquiry can be divided into the neat categories suggested by Sullivan. In most cases some awareness of the possibility that the trustee was committing a breach of trust would be the first real involvement of the bank. At that point it might decide to make further inquiries or to ignore the possibility and hope for the best. In neither case would it be likely to advance its information to the point where it would be able to assess whether or not the trustee was acting fraudulently.

Nor is it a matter of the agent enforcing "his own understanding" of the principal's trust undertaking. The agent's obligation is not to be seen as an obligation to breach its contract with the trustee, but an obligation imposed by law to make further inquiries in certain circumstances. If those inquiries are made, and the explanation given satisfies the agent that no breach is involved, the agent will have discharged its obligation in law. If, on the other hand, the inquiry should reveal a breach of trust, or a probable breach of trust, it would be a strange law that required it to proceed to carry out the principal's wrongful instructions. In such circumstances it would not be in breach of contract for declining to do so.

Nevertheless, the feeling persists that agents who are generally on the fringe of the transaction should not be put in the position of having to decide whether or not an inquiry is called for. Banks, for example, would wish to classify their involvement as purely ministerial and to obtain, as a result, some sort of "agent's immunity". The hope is a forlorn hope. The courts will always approach the question of an agent's role much more realistically. No liability will attach to the bank where the bank has acted in a ministerial capacity and no more could be reasonably expected of it. Where, however, the bank's involvement is greater than this and it has, voluntarily or involuntarily, assisted the commission of a breach of trust, its actions will inevitably be scrutinised by the court.

In the course of carrying out this scrutiny in various cases, the courts are not likely to provide a definitive answer as to when an agent should feel constrained to make such further inquiries. The answer will always depend on the facts having regard to questions of commercial efficiency and convenience. But, as I have suggested, the one thing that is certain is that the agents' wish to remain aloof will not prevail. Banks and solicitors may seek to distance themselves from the transaction which has deprived the beneficiary

of his or her interest, but they are not in fact distant from it at all. They are vital cogs in the wheels of commerce. It is, indeed, in addition to the desirability of checking the abuse of trust power, the fact that banks and solicitors are very much involved in facilitating the manifold transactions and dealings of their commercial customers and clients which justifies the imposition of a separate and individual responsibility upon them. It is a responsibility which, in its commercial context, cannot be subsumed in the office and province of an agent. In such circumstances the claim by agents that they are under no obligation to make further inquiries when the circumstances could reasonably have been expected to put them upon inquiry will seem uncomfortably like an admission that they could not be bothered to inquire further, or a plea for an immunity to protect them against their own acknowledged misconduct.

Accepting that a bank is under an obligation to inquire further into a transaction in certain circumstances will not impose an unduly harsh or unreal burden on banks. If the bank suspects that something foul is afoot, it should inquire further. If it does not, it is appropriate that it be judged by the standards of the reasonable bank in determining whether it ought to have made further inquiries. If it makes further inquiries and, as a result, is satisfied that all is well, and its decision is again measured against the standards of the reasonable bank, that will be the end of the matter. If on making inquiries, however, it learns that a breach of trust is involved, the transaction should not proceed. If, notwithstanding reasonable diligence on its part, its inquiries are inconclusive and do not justify defying the customer's instructions, the bank can hardly be criticised for doing what it is contractually bound to do.

In all these cases it is a question of fact and degree, and the banks will, of necessity, have to rely upon the courts to approach the question in a commercially realistic fashion having full regard to the difficult position of agents. I believe that they can be confident that the courts will do so. The sensitivity of the courts to the needs of commerce and the agent's situation is well-established. It was evident in **Barnes v Addy** when Lord Selborne observed with a measure of overstatement that the courts should go no further than is necessary to ensure that the transactions of mankind can safely be carried through.[112] The same or similar sentiments have been frequently reiterated. Such a consideration is undoubtedly real. It does not, however, necessitate the conclusion that the agent acting in the course of its agency should be automatically exempt from liability. Rather, it is for the courts to examine the agent's conduct in the light of the commercial and professional realities confronting agents, such as banks and solicitors, and reach a conclusion which conforms with those realities in determining whether or not the conduct of the agent is unconscionable.

Another situation in which agents may feel disgruntled about accepting liability in this class of case is where they have employed or utilised the services of an agent themselves and it is that agent who knows of the trustee's intended breach of trust. The unconscionable conduct is perceived to be that of their agent, not them. In **Powell v Thompson** I suggested that the court's readiness to impute the agent's knowledge to the principal is likely to be much more inhibited than if the conduct was that of the principal. I observed that it would generally be critical to ascertain the extent of the principal's personal knowledge and concluded that, while imputing the knowledge or dealings of the agent to the principal for the purpose of determining whether the defendant's conduct was unconscionable could not be absolutely excluded, the occasions when it would be appropriate to do so would be likely to be rare.[113]

On reflection I may have spoken too hastily, and even incautiously. The doctrine of imputed knowledge is too firmly imbedded in the law to be diminished with a side wind of this kind. In modern conditions, the principal's knowledge is seldom likely to be

personal and, more often than not, it will be derived from the knowledge of employees and agents alike. Imputing the agent's knowledge to the principal is likely to be necessary. As Watts has suggested, the rules about imputing knowledge are sufficiently flexible to cope with situations of this kind without adding a distinction along the lines suggested in **Powell v Thompson**.[114] Moreover, restricting to "rare" occasions the occasions when imputing the knowledge or dealings of an agent to the principal for the purpose of determining unconscionability does not sit comfortably with the reasons I have given above for departing from a purely subjective test when determining unconscionable conduct in the context of a knowing assistance case.

13. CONCLUSION

Reference need only be made to the conflicting and confusing case law and commentaries to at once demonstrate the need for a coherent theory relating to the liability of third parties as constructive trustees. It is suggested that the thesis advanced in this paper provides a coherent theory. It does so because it advances in accordance with basic principles and does not seek to extract a theory from the existing case law. That task is abandoned as futile.

Once a principle-oriented approach is adopted, it is necessary to inquire into the basis of liability for both the knowing receipt and knowing assistance classes of case. The underlying principles on which liability is based in these two classes of constructive trust are found to be fundamentally different, so much so that they are better regarded as different heads of liability rather than different categories of constructive trust.

There are a number of underlying principles of liability for the knowing receipt class of case. One is the concept of equitable fraud, utilising property for one's own use and benefit knowing the property interest of another and intending to disregard that other's property right. Another is the obligation to act as a trustee and account for the administration of the trust where one has assumed the obligations of the trust. But the primary and core principle is the classical equitable doctrine of preventing unjust enrichment; the unjust enrichment of the third party at the expense of the beneficiary. This principle best achieves flexibility in the application of an equitable concept and consistency with the innocent volunteers right of tracing. It also best accommodates the various degrees of constructive notice or knowledge which are likely to be present where a person arrogates trust property to him or herself.

Once this basis of liability is identified the irrelevance of any question of requiring moral probity becomes plain. An impure intention on the part of the third party may, of course, bear directly on the question of whether the enrichment is **unjust**, but it is not essential to found liability. Lack of probity is to be reserved for the knowing assistance type of cases.

The principle of preventing unjust enrichment also defines the kind of knowledge which will suffice to establish liability. Apart from actual knowledge, all forms of constructive knowledge must be accepted. The essential question is whether the third party knew or ought to have known of the trust. Once such knowledge is established the court can then examine whether the third party's enrichment at the expense of the beneficiary is unjust, not by determining fault, but by balancing the merits or equities of the case. Factors relating to both the third party's acquisition or use of the property as well as the beneficiary's deprivation will be relevant to this exercise.

The knowing assistance type of case is of a different ilk. In this class of case the essence of liability is the stranger's unconscionable behaviour. No property need pass,

and this cause of action is therefore less a restitutionary claim than a claim *in personam* for the imposition of a constructive trust so as to require the stranger to account. The question of whether the stranger has acted unconscionably, therefore, is to be determined in the context of the larger question: has this stranger acted in such a way as to justify the court imposing on him or her the obligations and responsibilities of the trustee? The knowledge of the stranger becomes a matter to take into consideration when determining whether his or her conduct was unconscionable.

In pursuing this question, negligent conduct, especially when it merges into or overlaps with conduct which might be said to import an element of moral improbity or where the stranger stands to gain a benefit as a result of his or her negligence in the course of assisting or facilitating the breach of trust, may in some circumstances amount to unconscionable conduct. Equity's conscience will, of course, be more quickly disturbed by fraudulent and dishonest behaviour. That is clear. But conduct falling short of this degree of culpability is not to be precluded or placed beyond the reach of equity's conscience.

The conclusion that conduct which is not fraudulent and dishonest may nevertheless be unconscionable is the logical outcome of a number of considerations; the fact that the trustee may be guilty of a breach of trust without having a fraudulent and dishonest design; the need to recognise that the beneficiary's remedy lies directly against the stranger and is not in any sense "derived" through the trustee; the impossibility of rigidly separating fraud and dishonesty from negligence, particularly in complex business situations, and of divorcing the stranger's motives from a determination of what is unconscionable; the need to have regard to the nature of the trust institution and the policy considerations which suggest that a higher standard of behaviour on the part of the stranger is required in order to deter abuses of trust power; the regard which equity traditionally has for the vulnerable position of the beneficiary; the strong possibility that the stranger will obtain a benefit from his or her participation in the breach of trust; and, especially in respect of the most common category of agents, banks and solicitors, the vital role agents play in the implementation of commercial transactions.

The position of agents is fully acknowledged under this theory. Agents would only be liable in the knowing receipt category of case if and when they set up a title of their own to the property or funds which they had received as an agent. In such circumstances they cannot be said to have personally benefited at the expense of the beneficiary. Any fee or commission which they may have charged does not have that character. Then, irrespective of whether or not property has been received, agents will be only liable to become a constructive trustee under the knowing assistance head of liability if their conduct, be it fraudulent, dishonest or negligent, can be described as unconscionable to the point that they should be required to shoulder the burdens of trusteeship.

It is urged that the recognition and application of this theory of constructive trust will provide the subject with a coherence which is lacking at present. It is also contended that the law will be simplified and correspondingly susceptible to less uncertainty than a law which is confused and inconsistent. Both theory and experience have confirmed[115] that the closer the issues to be resolved are to the merits of the case, the greater the ease and certainty with which the outcome can be predicted. Where equity's conscience is involved that is exactly how it should be.

FOOTNOTES

1. [1991] 1 NZLR 597.

2. *Ibid*, at p605.

3. For a dissertation on the principle-oriented approach, see the author, "A Return to Principle in Judicial Reasoning and the Acclamation of Judicial Autonomy" (1992).

4. [1987] 1 Ch 264.

5. *Ibid*, at p278.

6. **Manchester Trust v Furness** [1895] 2 QB 539, per Lindley LJ at p545.

7. R M Goode, "Twentieth Century Developments in Commercial Law" (1983) 3 *Leg Stud* 283, at p292.

8. [1990] 2 WLR 358.

9. [1990] 3 WLR 414.

10. *Supra* n 1, at p607; see also Millett J in **Agip (Africa) Ltd v Jackson** [1990] Ch 265.

11. Donovan Waters, "Banks, Fiduciary Obligations and Unconscionable Transactions" (1986) 65 *Can Bar Rev* 37, at p56.

12. **National Westminster Bank plc v Morgan** [1985] AC 686, at p701.

13. Waters, *supra* n 11, at p57.

14. *Ibid*, at p43.

15. A Tettenborn, "The Fiduciary Duties of Banks" (1980) *JBL* 10.

16. *Ibid*, at p16. See also *Underhill's Law Relating to Trusts and Trustees* (13th Ed) at p334.

17. *Supra* n 1, at p614.

18. Cardozo J's much cited dictum: "A constructive trust is the formula through which the conscience of equity finds expression": **Beatty v Guggenheim Exploration Co** 225 NY 380, at p386, (1919). Lord Denning issued similar dicta, but more often.

19. Waters, *supra* n 11, at p54.

20. Query England, see **Agip (Africa) Ltd v Jackson** [1991] 3 WLR 116, at p131.

21. [1874] 9 Ch App 244 (CA).

22. *Ibid*, at pp251-2.

23. Donovan W M Waters, "Where is Equity Going? Remedying Unconscionable Conduct" (1988) 18 *UWALR* 3, at p70; Charles Harpum, "The Stranger as Constructive Trustee" (1986) 102 *LQR* 114, at pp114- 115 and pp127-130.

24. *Supra* n 21.

25. *Supra* n 1, at pp607-610.

26. "There is no stronger instance of unjust enrichment than arrogating to oneself another's property"; P G Watts "Restitution" [1990] *NZRLR* 330, at p333.

27. (1980) 117 DLR (3d) 259, at p273-4.

28. *Underhill's Law Relating to Trusts and Trustees*, *supra* n 16, at p330. See also Ungoed-Thomas J in **Selangor United Rubber Estates Ltd v Cradock (No 3)** [1968] 1 WLR 1555, at p1579.

29. *Supra* n 1, at p609.

30. *Ibid*.

31. See also Ruth Sullivan, "Strangers to the Trust" (1986-1988) 8 *Es and Trusts Quart* 217, at p264.

32. *Supra* n 1, at pp607-8.

33. *Ibid*, at p608.

34. Per Dickson J in **Rathwell v Rathwell** (1978) 83 DLR (3d) 289, at p306.

35. Peter Birks, "Misdirected Funds: Restitution from the Recipient" (1989) *LMCLQ* 296.

36. *Supra* n 3.

37. Eg, C E F Rickett, "Strangers as Constructive Trustees in New Zealand", (1991) 11 *Ox Jour Leg Stud* 598, at pp601 and 603.

38. *Supra* n 4. **In re Montagu's Settlement Trusts Duke of Manchester v National Westminster Bank Ltd** [1987] 1 Ch 264 has since been followed by Alliott J in **Lipkin Gorman v Karpnale Ltd** [1987] 1 WLR 987; and Hirst J in **Allied Arab Bank v Hayjer** [1988] 2 WLR 33.

39. Peter Birks, "Misdirected Funds" (1989) 105 *LQR* 352, at p353.

40. Eg, **Rathwell v Rathwell**, *supra* n 30; **Pettkus v Dickson** (1980) 117 DLR (3d) 257; and see **Sorochan v Sorochan** (1986) 29 DLR (4th).

41. **Sorochan v Sorochan**, *ibid*, at pp7-12.

42. **Ruff v Strobel** (1978) 86 DLR (3d) 284, at pp292-4; **Rawluk v Rawluk** [1990] 1 SCR 70, at p100 and pp103-104. See also Sullivan, *supra* n 31, at p266. For an excellent article confirming the approach of the Canadian Courts, see C E F Rickett, "The Remedial Constructive Trust in Canadian Restitution Law: Discordant Notes in a Performance Better Forgotten?" (1991) *The Conveyancer* 125.

43. [1948] Ch 465, at pp520-1.

44. In **Orakpo v Manson Investments Ltd** [1977] 3 WLR 229, at p234.

45. [1991] 3 WLR 10.

46. *Ibid*, at p15 referring to **Fibrosa Spolka Akcyjna v Fairburn Lawson Combe Barlow Ltd** [1943] AC 32, per Lord Wright at p61. See also Lord Goff's comments at p32-33.

47. See Gummow J in **Stephenson Nominees Pty Ltd v Official Receiver on Behalf of Official Trustee in Bankruptcy; Ex parte Roberts** (1987) 76 ALR 485, at p502.

48. **Elders Pastoral Ltd v Bank of New Zealand** [1989] 2 NZLR 380, per Somers J at p193.

49. **Day v Mead** [1987] 2 NZLR 443; **Gillies v Keogh** [1989] 2 NZLR 327; and **Acquaculture Corporation v NZ Green Mussel Co Ltd** [1990] 3 NZLR 299.

50. Y L Tan, "Agent's Liability for Knowing Receipt" (1991) *LMCLQ* 357, at p359.

51. *Supra* n 1, at p608.

52. [1983] BCLC 325.

53. *Ibid*, at p407.

54. *Supra* n 1, at p607.

55. Eg, Megarry V-C in **Re Montagu's Settlement Trusts** viewed the categories as "useful guides" in determining whether the conscience of that party had been affected. (at p278).

56. Eg, David Hayton, "The Stranger as Constructive Trustee" (1987) *CLJ* 395, at p398; and J K Maxton, "Equity" (1990) 1 *NZRLR* 89, at pp93-95.

57. See M J Brindle and R J A Hooley, "Does Constructive Knowledge Make a Constructive Trustee?" (1987) 61 *ALJ* 281, at p289.

58. (1975) 132 CLR 373.

59. *Supra* n 57, at p289.

60. *Supra* n 1, at p609.

61. *Ibid*, at p608.

62. *Supra* n 3.

63. See **Lipkin Gorman v Karpnale Ltd** *supra* n 45, per Lord Templeman at p15, and Lord Goff at pp32-35 respectively.

64. See David Hayton, "Developing the Law of Trusts for the Twenty-First Century" (1990) 106 *LQR* 87, at p99.

65. *Supra* n 1, at pp613-614.

66. **Westpac Banking Corporation v Savin** [1985] 2 NZLR 41, at pp65 and 69.

67. [1972] 1 All ER 1210, at pp1234-1235.

68. *Supra* n 66, at p69.

69. See Austin, "Constructive Trusts", in Finn (Ed) *Essays in Equity* (1985) at pp228-229; Harpum, *supra* n 23, at p267; Birks, "Misdirected Funds" (1989) 105 *LQR* 352; McEndrick, "Tracing Misdirected Funds" (1991) *LMCLQ* 378.

70. Eg, **Agip (Africa) Ltd v Jackson**, *supra* n 20.

71. See also, Sir Peter Millett, "Tracing the Proceeds of Fraud" (1991) 107 *LQR* 70, at p83.

72. *Supra* n 50, at pp358-359.

73. *Ibid*, at p359.

74. [1969] 2 Ch 276.

75. *Supra* n 1, at p614.

76. *Ibid*, at p610.

77. *Ibid*.

78. *Ibid*, at p611.

79. *Supra* n 21.

80. See Buckley LJ and Orr LJ in **Belmont Finance Corporation Ltd v Williams Furniture Ltd** [1979] 1 Ch 250, at pp267 and 270 respectively.

81. *Supra* n 1, at p611.

82. *Supra* n 28, at p1591.

83. *Supra* n 80. What is absent from the judgments in the **Belmont Finance** case is any attempt to explain the underlying principles and different policy considerations which attach to the knowing receipt and knowing assistance categories of liability.

84. *Ibid*, per Buckley LJ at p267.

85. See, eg, **Re Montagu's Settlement Trusts**, *supra* n 38; and **Agip (Africa) Ltd v Jackson**, *supra* n 70.

86. Eg, **Selangor's** case, *supra* n 28; the **Karak Rubber** case, *supra* n 67.

87. *Supra* n 1, at p614.

88. Eg, **Re Blundell** [1888] 40 Ch D 370; **Williams v Williams** [1881] 17 Ch D 437; **Carl Zeiss Stiftung v Herbert Smith (No 2)**, *supra* n 74; **Lipkin Gorman v Karpnale Ltd**, *supra* n 63; **Eagle Trust Plc v SBC Securities** [1991] BCLC 438.

89. [1991] MCLR 358.

90. *Ibid*, at p367.

91. (1988) 76 ALR 513.

92. *Supra* n 3.

93. See Brindle and Hooley, *supra* n 53, at p286.

94. *Supra* n 70, at p1389.

95. *Supra* n 1, at p613.

96. *Supra* n 93.

97. *Supra* n 28.

98. *Supra* n 67. Contrary to numerous commentaries both the **Selangor** and **Karak Rubber** cases were correctly classified as knowing assistance cases. The banks did not receive trust funds for **their own benefit** and would therefore not, as agents, have been liable.

99. Eg, **Rowlandson v National Westminster Bank** [1978] 1 WLR 798; **Baden Delvaux & Lecuit v Société Générale**, *supra* n 52.

100. Sullivan, *supra* n 31, at p249.

101. P G Watts, "Restitution" (1990) 1 *NZRLR* 330, at p337.

102. J K Maxton, "Equity" (1991) 2 *NZRLR* 117, at p138.

103. The facts are not too dissimilar from the facts in **Bank of Nova Scotia v Bank of Montreal** (1982) 38 OR 723, where the defendant Bank was held liable.

104. *Contra*, Sullivan, *supra* n 31, at p250.

105. See Harpum, *supra* n 23, at p138.

106. Eg, Tettenborn, *supra* n 15, at p10; David Hayton (1983) 4 *Co Law* 177, at p178.

107. See Harpum, *supra* n 23, at pp124-125.

108. **See Day v Mead** [1987] 2 NZLR 443, per Cooke P at pp451-452; **Mouat v Boyce** (1991) (Unreported, CA 265/91), per Cooke P at pp5-6; **Canson Enterprises Ltd et al v Brighton & Co et al** (1991) 85 DLR 129, per La Forest J at pp147-153; but see Stevenson J at pp165-166.

109. See *supra* nn 40, 41 and 42.

110. Birks, *supra* n 39, at p355.

111. Sullivan, *supra* n 31, at p246.

112. *Supra* n 21, at p252.

113. *Supra* n 1, at p618.

114. Watts, *supra* n 26, at p338.

115. *Supra* n 3.