EQUITABLE REMEDIES — RECENT DEVELOPMENTS

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Nothing in recent years has caused so much anxiety to bankers as their apparently ever-increasing vulnerability to equitable remedies. Perhaps the best known recent illustration of this potential vulnerability is the decision of the New Zealand Court of Appeal in *Liggett v Kensington*,[2] where a floating charge held by the Bank of New Zealand over the assets of a gold-dealer was postponed to an equitable proprietary claim to which the purchasers of non-allocated bullion were held to be entitled. The Privy Council has of course now reversed this decision and restored to the bank the priority for which it had contracted and which it was clearly entitled to expect to retain.[3] Nevertheless, not only has the decision of the New Zealand Court of Appeal received the extra-judicial approbation of Sir Anthony Mason, the recently retired Chief Justice of Australia;[4] the advice of the Privy Council has also, by all accounts, been received with something less than popular acclaim in New Zealand. It might therefore be premature to suggest that the risk of possible future losses of priority of this type has as yet been eradicated. More important for the present however, and even more striking in financial terms, have been the equitable remedies which the victims of corporate fraud have in recent years sought to impose on banks as the result of misapplications of property in breach of a fiduciary duty. Of the many remedies which are available, both at law and in equity, as the result of such misapplications,[5] there is no doubt at all that by far the most effective has been the imposition by equity of the obligations of trusteeship; such liability can be imposed on anyone who has assisted in bringing about a misapplication of property in breach of fiduciary duty, on the recipient of any property which has been so misapplied, and on anyone who has dealt inconsistently with property subject to a trust.[6] The existence of

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2 [1993] 3 NZLR 257.

3 *Sub nom. In re Goldcorp Exchange* [1994] 3 WLR 199.

4 In 110 LQR [1994] 238 (written and published prior to the reversal of the decision by the Privy Council).

5 These include, apart from the remedies mentioned in the text, proprietary claims, both at law and in equity, to trace the misapplied property into the hands of the recipients, personal claims at law for money had and received, and personal claims in equity against whoever was responsible for initiating the misapplication in question.

6 Virtually every legal periodical has contained a recent article on this subject. See, particularly: C Harpum: (1986) 102 *LQR* 114 and 267 and in *Frontiers of Liability* (Ed Birks) (1994) 9; DJ Hayton: (1985) 27 *Malaya Law Review*

these potential liabilities constitutes a very considerable risk for banks who have been involved in some way with a misapplication of property in breach of fiduciary duty, largely because they are inevitably more solvent and certainly easier to find than the persons who initiated the misapplication or received the misapplied property. It is the presumed solvency of banks (and, for that matter, of professional persons such as accountants and solicitors) which is the basic reason why this particular area of the law of trusts is so important today and why I have been asked to review it at this conference.

I. THE DISTINCTION BETWEEN LIABILITY FOR "KNOWING ASSISTANCE", LIABILITY FOR "KNOWING RECEIPT", AND LIABILITY FOR "INCONSISTENT DEALING"

The three situations in which equity is prepared to impose the obligations of trusteeship which are relevant for present purposes are generally known as "knowing assistance", "knowing receipt" and "inconsistent dealing". Liability for "knowing assistance" will be imposed on anyone who, with the requisite level of knowledge, has assisted in bringing about a dishonest and fraudulent misapplication of property in breach of fiduciary duty. Liability for "knowing receipt" will be imposed on anyone who, with the requisite level of knowledge, has received for his own benefit property which has been misapplied in breach of fiduciary duty. Liability for "inconsistent dealing" will be imposed on anyone who has received lawfully and not for his own benefit property subject to a trust but who has subsequently, with the requisite level of knowledge, either misappropriated it or dealt with it in some other manner which is inconsistent with the trust. Suppose that a bank manager has been duly notified that an account held at his branch in the name of an individual is in fact a trust account. If the bank permits a cheque drawn on that account to be credited in breach of trust to the account of a third party but acts merely as the conduit by means of which the funds are transferred from one account to the other, it will be potentially liable for "knowing assistance"; if the account of the third party is overdrawn at the time of the transfer, the bank may additionally be liable for "knowing receipt" to the extent that it has utilised the funds in reduction of the overdraft; if, on the other hand, the bank itself debits the balance of the account to cover an overdraft created in another account held in the name of the same individual, it will potentially be liable for "inconsistent dealing". Of these three liabilities. the greatest risk for banks is liability for "knowing assistance". Liability for "knowing receipt" and "inconsistent dealing" will merely restore the *status quo* in that any order for repayment of the trust funds will simply reconstitute the original overdraft. Liability for "knowing assistance", on the other hand, will be in respect of funds never beneficially received by the bank at all and can potentially be for enormous sums bearing no relation whatever to the fees and commissions earned for carrying out the instructions of the client in question. For this reason, this paper will concentrate principally on liability for "knowing assistance" and consider only briefly liability for "knowing receipt" and "inconsistent dealing".

II. LIABILITY FOR "KNOWING ASSISTANCE"

Although this form of liability[7] has been very greatly clarified by the recent relevant authorities in New Zealand and in England, there has been a surprising dearth of reported decisions in Australia; the leading authority is still the decision of the High Court in *Consul Development v DPC Estates*,[8] decided as long ago as 1975, recently applied without any discussion in the Supreme Court of Western Australia in *Biala Pty v Mallina Holding*[9] and considered by Kirby P in a dissenting

313; RP Austin in *Essays in Equity* (Ed Finn) (1985) 196; PL Loughlin: (1989) 9 *OJLS* 260; PBH Birks: [1989] *LMCLQ* 378 and [1993] *LMCLQ* 218; E McKendrick: [1991] *LMCLQ* 378; PD Finn in Equity, *Fiduciaries and Trusts 1993* (Ed Waters) (1993) 195.

7 C Harpum, in *Frontiers of Liability* (Ed Birks) (1994) 9, describes this as secondary liability.

8 (1975) 132 CLR 373.

9 (1993) 11 ACSR 783.

judgment in the New South Wales Court of Appeal in *Equiticorp Finance v Bank of New Zealand.*[10]

(a) Terminology

The vast majority of the decisions in which strangers have been held liable for having assisted in bringing about a misapplication of property subject to a trust describe such strangers as constructive trustees. However, the essential feature of such liability is the fact that property subject to a trust has, by virtue of the assistance provided, reached the hands of a third party, who may or may not be liable for "knowing receipt" under the rules which will be discussed later on. It is only necessary to attempt to impose liability for "knowing assistance" in respect of misapplied property which has not been received beneficially by the stranger in question; a beneficial recipient of misapplied property will be subject to the different, and probably more stringent, liability for "knowing receipt". Given that none of the misapplied property has finished up in the hands of a person held liable for "knowing assistance", it is therefore questionable to what extent he can correctly be described as a constructive trustee. Some commentators have contended that this liability is an example of a second type of constructive trust which can arise without any necessity for there to be any identifiable trust property.[11] However, it is in fact more appropriate to regard the decisions in which liability for "knowing assistance" has been imposed not as examples of the imposition of a constructive trust but rather as examples of equity imposing a quite distinct remedy - a personal liability to account in the same manner as a trustee.[12]

(b) The elements of liability for "knowing assistance"

Virtually every decision this century has used as its starting point the famous statement of Lord Selborne LC in *Barnes v Addy.*[13] He said that "strangers are not to be made constructive trustees merely because they act as the agents of trustees in transactions within their legal powers, transactions, perhaps, of which a Court of Equity may disapprove, unless those agents receive and become chargeable with some part of the trust property, or unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees".[14] The final phrase of this statement contains the elements of liability for "knowing assistance", which were analysed in *Baden v Société Générale*[15] by Peter Gibson J, who isolated four distinct elements: the existence of a trust, the existence of a dishonest and fraudulent design on the part of the trustee of the trust; the assistance by the stranger in that design, and the knowledge of the stranger.

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10 (1993) 32 NSWLR 50 at pp 101-106. His minority view that the transfer of the liquidity reserves of the plaintiff companies to the defendant back had constituted a breach of fiduciary duty obliged him to consider whether liability for "knowing assistance" or "knowing receipt" could be imposed on the bank. The majority (Clarke and Cripps JJA) held that there had been no such breach of fiduciary duty and so did not have to consider this point. An application to the High Court for special leave to appeal was refused, presumably because the essential difference between the majority and the minority view turned not on a question of law but on a question of fact. An opportunity for the High Court to carry out a much needed review of this area of the law was therefore lost.

11 DJ Hayton in Hayton and Marshall: *Cases and Commentary on the Law of Trusts* (9th ed) 466; HAJ Ford and WA Lee: *Principles of the Law of Trusts* (1st ed) 1018.

12 This was confirmed by Millett J in *Agip (Africa) v Jackson* [1989] 1 WLR 1367. Although the Australian and New Zealand judges now also seem to be adopting this more appropriate terminology (see, to for example, *Equiticorp Finance v Bank of New Zealand* (1993) 32 NSWLR 50 *per* Kirby P at pp 104-105; *Nimmo v Westpac Banking Corporation* [1993] 3 NZLR 218 *per* Blanchard J at p 226) it has to be admitted that the majority of the English judges have continued to describe strangers held liable for "knowing assistance" as constructive trustees (particularly in the English Court of appeal in *Agip (Africa) v Jackson* [1991] Ch 547 and in *Polly Peck International v Nadir (No 2)* [1992] 3 All ER 769).

13 (1874) 9 Ch App 244, 251-252.

14 The requirement for the existence of a dishonest and fraudulent design is not found in the authorities prior to *Barnes v Addy* so to this extent at least Lord Selborne's statement was not consistent with the pre-existing authorities; see C Harpum in *Frontiers of Liability* (Ed Birks) (1994) 9.

15 (1983) [1993] 1 WLR 509n, 573. The full name of this case is *Baden v Société Générale pour Favoriser le Developpement du Commerce et de l'Industrie en France SA.*

(i) The existence of a trust

This first requirement is extremely straightforward and never causes any problems in practice. "[T]he trust need not be a formal trust. It is sufficient that there should be a fiduciary relationship between the 'trustee' and the property of another person".[16] Nevertheless, it is this requirement which demonstrates the increasing importance of this area of the law today as remedies designed to deal with misfeasances in the administration of private trusts have been adapted to deal with the growing volume of corporate fraud. While the older cases, such as *Barnes v Addy* itself, largely concerned misapplications of trust property brought about as a result of agents following the instructions of trustees,[17] the majority of the recent cases have concerned illegal or unauthorised transactions carried out in accordance with the instructions of company directors.[18]

There has been a whole series of cases resulting from successful attempts to use the funds of companies to finance their own acquisition. In *Ninety Five Pty v Banque Nationale de Paris*,[19] the defendant bank was held to have permitted the plaintiff company to be purchased with its own money in breach of section 67 of the Western Australia *Companies Act* 1961 in circumstances which would have made any reasonable banker aware of what was happening. The bank was held liable to refund to the plaintiff the sum of AU$1,933,866.62 which had been utilised for this purpose, together with interest thereon of up to AU$7,235,072.35, substantial sums but comparatively modest in the light of the sums claimed in later cases. Similar successful claims have been brought in England, but rather longer ago, arising out of the breach of section 54 of the *Companies Act* 1948,[20] while in New Zealand in *Equiticorp Industries Group v Hawkins*[21] no less than NZ$564,000,000 was claimed from the various defendants, including Equiticorp Australia and a Hong Kong firm of solicitors (who were held not liable), for having knowingly assisted in a breach of section 62 of the New Zealand *Companies Act* 1965.[22]

Even more cases have concerned illegal or unauthorised transactions carried out in accordance with the instructions of company directors. I will mention only the cases brought against banks. The recent unsuccessful claim in *Equiticorp Finance v Bank of New Zealand*[23] concerned an application of AU$44,400,000, the liquidity reserves of the plaintiff companies, towards the discharge of the debt owed by a wholly owned subsidiary of another company in the Equiticorp Group to the Bank of New Zealand. The plaintiffs were similarly unsuccessful in England in *Baden v Société Générale*,[24] where the defendant bank had been holding to the order of a Luxembourg Bank funds of the plaintiff which had been deposited with it by a Bahamian Bank. The plaintiff unsuccessfully claimed that the defendant was liable for "knowing assistance" in having complied with the fraudulent instructions of the Bahamian bank to transfer to Panama US$4,000,000 on the strength of an assurance from the Luxembourg bank that it had no claim to these funds. Similarly in *Polly Peck International v Nadir (No 2)*[25] the liquidators of the plaintiff company unsuccessfully

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16 Ibid.

17 See also *Williams v Williams* (1881) 17 Ch D 437, *Williams-Ashman v Price & Williams* [1942] 1 Ch 219 and, for more modern illustrations. *Powell v Thompson* [1991] 1 NZLR 597 and *Lankshear v ANZ Banking Group (New Zealand)* [1993] 1 NZLR 481.

18 The "directors of a company are treated as if they were the trustees of the company's property under their control". *Baden v Société Générale* (1983) [1993] 1 WLR 509n at p 573.

19 [1988] WAR 132.

20 *Selangor United Rubber Estates v Cradock (No 3)* [1968] 1 WLR 1555, *Karak Rubber Company v Burden (No 2)* [1972] 1 WLR 602, *Belmont Finance Corporation v Williams Furniture* [1979] Ch 250. *(No 2)* [1980] 1 All ER 393. This statutory provision has now been repealed.

21 [1991] 3 NZLR 700.

22 These were interlocutory proceedings concerning objections as to the jurisdiction of the New Zealand courts by the two defendants mentioned in the text.

23 (1993) 32 NSWLR 50.

24 (1983) [1993] 1 WLR 509n.

25 [1992] 4 All ER 769.

claimed that the Central Bank of Northern Cyprus had knowingly assisted the plaintiff's former chief executive to misdirect £45,000,000 of the plaintiff's funds to Northern Cyprus. Finally in New Zealand in *Nimmo v Westpac Banking Corporation*[26] the bank was equally held not liable in respect of the embezzlement of AU$250,000 of the plaintiff's funds by a fraudulent currency trader from New Zealand who had passed the money through an account at its Sydney branch. Claims against persons other than banks have been more successful[27] and it was in one of these cases, *Agip (Africa) v Jackson*,[28] where Millett J emphasised[29] that "the embezzlement of a company's funds almost inevitably involves a breach of fiduciary duty on the part of one of the company's employees or agents" and he went on to hold that "there is a receipt of trust property when a company's funds are misapplied by a director and, in my judgment, this is equally the case where a company's funds are misapplied by any person whose fiduciary position gave him control of them or enabled him to misapply them". This principle is not of course confined to funds but applies to property of any type.[30]

Although many of the claims in the cases to which reference has just been made were unsuccessful, none actually failed on account of this first requirement. These cases thus emphasise the extent and scale of proceedings for "knowing assistance" and also the extent to which the victims of corporate fraud are increasingly looking towards the banks to compensate them for their losses.

(ii) The existence of a dishonest and fraudulent design on the part of the trustee of the trust

Although this requirement is said "to have leapt forth fully formed from the brow of Lord Selborne",[31] there is no question that it is at present an essential prerequisite of liability for "knowing assistance". The precise meaning of this second requirement is, however, a question on which the law of Australia seems to differ from the law of New Zealand (and that of England).

The Australian Courts have adopted the view of Ungoed-Thomas J in *Selangor United Rubber Estates v Cradock (No 3)*,[32] where he held that the adjectives "dishonest" and "fraudulent" must be understood in accordance with equitable principles for equitable relief and consequently conduct which is morally reprehensible suffices. In *Consul Development v DPC Estates*[33] Gibbs J agreed with this proposition, saying[34] that the expression "dishonest and fraudulent" is to be understood by reference to equitable principles and ... includes a breach of trust or of fiduciary duty. This also appears to have been the view of McTiernan J who, in the course of a dissenting judgment, said[35] "I do not think that I am going beyond what Lord Selborne LC said in *Barnes v Addy* but, were it necessary to do so, I would readily accept whatever extension of the doctrine that may be implicit in" *Selangor United Rubber Estates v Cradock (No 3)*. (The only other member of the High Court

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26 [1993] 3 NZLR 218.

27 See, for example, *Marshall Futures v Marshall* [1992] 1 NZLR 316 (interlocutory proceedings), *Gathergood v Blundell & Brown* [1992] 3 NZLR 643, *Biala Pty v Mallina Holding* (1993) 11 ACSR 783, *Springfield Acres (In Liquidation) v Abacus (Hong Kong)* [1994] 3 NZLR 502 (interlocutory proceedings).

28 [1989] 3 WLR 1367.

29 At p 1387.

30 Information in respect of which a manager owed a fiduciary duty to his company would have sufficed in *Consul Development v DPC Estates* (1975) 132 CLR 373.

31 C Harpum in *Frontiers of Liability* (Ed Birks) (1994) 9 at pp 11-13. This prerequisite of liability did not exist earlier in the Nineteenth Century; see *Fyler v Fyler* (1841) 3 Beav 550, *Attorney-General v The Corporation of Leicester* (1844) 7 Beav 176.

32 [1968] 1 WLR 1555 at pp 1582 and 1590.

33 (1975) 132 CLR 373.

34 At p 398.

35 At p 386.

who delivered a reasoned judgment, Stephen J (with whom Barwick CJ concurred), made no explicit reference to this requirement.) Recently, in his dissenting judgment in *Equiticorp Finance v Bank of New Zealand*[36] Kirby P, without making any reference to the judgments of the High Court in *Consul Development v DPC Estates*, said this:[37] "I see no reason why, to render a bank, the recipient of trust funds, liable to account, it should be shown that the breach occurred in furtherance of a 'dishonest and fraudulent design' involving the Bank of New Zealand. This appears to be the law in England and in New Zealand. However, such a rule inadequately protects beneficiaries. It fails to share risks equitably. And it provides inadequate stimulus to commercial morality of the kind referred to in *Northside*[38] (at 165). Obtuseness is no excuse for or exemption from involvement in a breach of fiduciary duty, especially where it is rewarded with the receipt of the funds the subject of the breach." At first sight Kirby P thus appears to have rejected this second requirement entirely, going even further than the members of the High Court in *Consul Development v DPC Estates* and Ungoed-Thomas J in *Selangor United Rubber Estates v Cradock (No 3)*; however, his subsequent reference to "involvement in a breach of fiduciary duty" seems to indicate that his view, like that of Gibbs J, is that a breach of trust or breach of fiduciary duty is all that is necessary. None of the other Australian authorities on "knowing assistance" has given any consideration to this requirement. Consequently, it seems that the law of Australia requires no more than a breach of trust or a breach of fiduciary duty.

On the other hand, as Kirby P indicated, New Zealand and England have taken a different view. In *Belmont Finance Corporation v Williams Furniture*[39] the English Court of Appeal rejected the view of Ungoed-Thomas J, holding that the adjectives "dishonest" and "fraudulent" have the same meaning and signify something more than mere misfeasance or breach of trust. In *Baden v Société Générale*[40] Peter Gibson J applied these statements of the Court of Appeal and held, quoting *R v Sinclair*[41] that what was required was "the taking of a risk to the prejudice of another's rights, which risk is known to be one which there is no right to take". This view has been adopted in all the subsequent English decisions[42] and also in New Zealand. In *Westpac Banking Corporation v Savin*[43] Sir Clifford Richmond said:[44] "My present view is, however, strongly in favour of that which has been taken by the English Court of Appeal" (in *Belmont Finance Corporation v Williams Furniture).* Subsequently, however, in *Powell v Thompson*[45] Thomas J took a contrary view:[46] "It does not matter whether the trustee's conduct was fraudulent or negligent, devious or foolish, heinous or indifferent. Once a breach of trust has been committed, the commission of which has involved a third party, the question which arises is one as between the beneficiary and that third party. If the third party's conduct has been unconscionable, then irrespective of the degree of impropriety in the trustee's conduct, the third party is liable to be held accountable to the beneficiary as if he or she were a trustee". However, this view, similar in effect (although not in formulation) to the Australian view, has since been expressly not followed on at least two occasions. In *Equiticorp Industries Group v Hawkins*[47] Wylie J, after referring to the judgment of

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36 (1993) 32 NSWLR 50. The majority (Clarke and Cripps JJA) did not have to consider this point and did not do so (see *ante*, n 10).

37 At p 105.

38 *Northside Developments Pty v Registrar-General* (1990) 170 CLR 146 at p 165.

39 [1979] Ch 250 at p 267.

40 (1983) [1993] 1 WLR 503n, 574.

41 [1968] 1 WLR 1246 at p 1249.

42 *Agip (Africa) v Jackson* [1990] Ch 265, *Eagle Trust v SBC Securities* [1992] 4 All ER 488 at p 497.

43 [1985] 2 NZLR 41.

44 At p 70.

45 [1991] 1 NZLR 597. This view was subsequently followed by Tompkins J in *Marr v Arabco Traders* (1987) 1 NZBLC 102, 732 at p 102,762.

46 At p 613.

47 [1991] 3 NZLR 700.

Sir Clifford Richmond in *Westpac Banking Corporation v Savin*, said:[48] "There is a strong indication in favour of the views expressed by Buckley LJ and accepted by the other members of the Court in *Belmont Finance*. I do not detect anything in what was said by Richardson or McMullen JJ to detract from that view". The same conclusion was reached by Tipping J in *Marshall Futures v Marshall*.[49] The weight of the New Zealand authority is thus substantially in accordance with the clearly established view of English law.

As will be seen shortly, the view taken as to the meaning of "dishonest" and "fraudulent" is crucial in determining the scope of the fourth requirement, what knowledge of the stranger is necessary for the imposition of liability for "knowing assistance". This difference between, on the one hand, the law of Australia and, on the other hand, the law of New Zealand and the law of England, is extremely significant.

(iii) The assistance by the stranger in that design

It is "a simple question of fact, whether there has been assistance".[50] It makes no difference whether the agent has previously advised against the course of conduct in question,[51] whether he has made the appropriate enquiries and reasonably come to what was in fact an incorrect conclusion,[52] or whether he has simply relied on the instructions given without checking relevant documents in his possession.[53] The fact of assistance in a significant way in a dishonest and fraudulent design is all that matters.[54]

(iv) The knowledge of the stranger

This is the aspect of liability for "knowing assistance" which has caused most controversy. Discussion of this question in recent years has focused on the five different categories of knowledge identified by Peter Gibson J in *Baden v Société Générale*:[55] "(i) actual knowledge; (ii) wilfully shutting one's eyes to the obvious; (iii) wilfully and recklessly failing to make such inquiries as an honest and reasonable man would make; (iv) knowledge of circumstances which would

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48 At p 725.

49 [1992] 1 NZLR 316 at p 325.

50 *Baden v Société Générale* (1983) [1993] 1 WLR 509n, 574.

51 As in *Barnes v Addy* (1874) 9 Ch App 244.

52 As in *Williams v Williams* (1881) 17 Ch D 437.

53 As in *Williams-Ashman v Price & Williams* [1942] 1 Ch 219.

54 In this connection, it should be noted that, although the vast majority of cases of "knowing assistance" inevitably involve agents of trustees or other fiduciaries, liability therefor also extends to strangers who have assisted in some other way in bringing about a misapplication of property subject to a trust. In *Eaves v Hickson* (1861) 30 Beav 136 a father produced a forged marriage certificate to the trustees of a settlement in order to convince them that his children were legitimate (he had married the mother of the children after their birth but at that time there was no doctrine of legitimation by subsequent marriage) and so entitled to the trust property, which was duly distributed to them. When those otherwise entitled to the property sued for its recovery, it was held that the father was personally liable to account as a trustee for such of the property as could not be recovered from the children. He was in no sense an agent of the trustees but he had by his conduct induced the misapplication of the trust property and so was clearly liable for "knowing assistance". However, this case was decided before *Barnes v Addy* introduced the requirement for the existence of a dishonest and fraudulent design on the part of the trustee of the trust. In New Zealand and in England, this requirement would not now be satisfied in *Eaves v Hickson* and it may therefore be that its absence would now cause the father to escape liability in those jurisdictions for "knowing assistance" (he would only be held liable if "knowing inducement" were regarded as a head of liability quite distinct from "knowing assistance" or if the requirement for a dishonest and fraudulent design were removed, both of which possibilities have been advocated by C Harpum in *Frontiers of Liability* (Ed Birks) (1994) 9.). However, the father would presumably still be liable for "knowing assistance" under Australian law since the requirement that there should have been a breach of trust would clearly have been satisfied. In any event, liability for any loss suffered could clearly be imposed on him on other grounds; in all of these jurisdictions he would today certainly be liable in the tort of deceit.

55 (1983) [1993] 1 WLR 509n at pp 575-576.

indicate the facts to an honest and reasonable man; (v) knowledge of circumstances which would put an honest and reasonable man on inquiry". A person in category (i) obviously has actual knowledge and, according to Peter Gibson J, a person in category (ii) or (iii) will be taken to have actual knowledge, while a person in categories (iv) or (v) has constructive notice only. These categories have been justifiably described as "unhelpful" and "unrememberable"[56] and warnings have been given "against over refinement or a too ready assumption that categories (iv) or (v) are necessarily cases of constructive notice only. The true distinction is between honesty and dishonesty".[57] Nevertheless, these five categories have been referred to in every single subsequent case. Which of them suffice for the imposition of liability for "knowing assistance"?

Consistent with the expressed primary concern of Lord Selborne in *Barnes v Addy*[58] to protect agents of a trust, the older English cases restricted liability for "knowing assistance" to strangers falling within what would later be classified as categories (i), (ii) and (iii).[59] However, a different view was taken by Ungoed-Thomas J in *Selangor United Rubber Estates v Cradock (No 3)*.[60] He held that an agent who has assisted in bringing about a misapplication of property subject to a trust will be liable for "knowing assistance" if he either knew or ought to have known of the misapplication in question.

The leading Australian authority is again *Consul Development v DPC Estates*.[61] McTiernan J, who dissented, approved and applied the view of Ungoed-Thomas J.[62] However, the majority adopted a more restrictive view. Gibbs J said this:[63] "It may be that it is going too far to say that a stranger will be liable if the circumstances would have put an honest and reasonable man on inquiry, when the stranger's failure to inquire has been innocent and he has not wilfully shut his eyes to the obvious. On the other hand, it does not seem to me to be necessary to prove that a stranger who participated in a breach of trust or fiduciary duty with knowledge of all the circumstances did so actually knowing that what he was doing was improper. It would not be just that a person who had

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56 *Per* Blanchard J in *Nimmo v Westpac Banking Corporation* [1993] 3 NZLR 218 at p 228.

57 *Per* Millett J in *Agip (Africa) v Jackson* [1989] 3 WLR 1367 at p 1389.

58 (1874) 9 Ch App 244.

59 In *Barnes v Addy* itself, solicitors had advised against the appointment as sole trustee of the husband of the tenant for life but nevertheless prepared the requisite deeds; they were exonerated on the grounds that they had had no knowledge or suspicion of any dishonest intention on the part of the trustee. In *Williams v Williams* (1881) 17 Ch D 437, a solicitor who had been instructed to sell lands and use the proceeds of sale to discharge the debts of the vendor, reasonably came to what was in fact an incorrect conclusion that the lands were not subject to any settlement. His conduct was classified as somewhat negligent but his bona fide conviction that there had been no settlement sufficed to avoid liability, although the court stressed that the case would have been very different if he had "wilfully shut his eyes". In *Williams-Ashman v Price & Williams* (1942) 1 Ch 219 trust solicitors who, following the instructions of the sole trustee, had paid out part of the trust funds to persons who were not in fact beneficiaries and invested the residue in unauthorised securities without first examining a copy of the trust deed which was in their possession, were similarly exonerated on the basis that they had acted honestly in the course of their agency without actual knowledge of any breach of trust.

60 (1968) 1 WLR 1555. This was the first of a number of cases resulting from successful attempts to use the funds of a company unlawfully to finance its own acquisition. The person promoting the takeover, Cradock, promised his bank manager that the company's account would be transferred to his branch and thus persuaded him to issue a banker's draft for the amount of the purchase price on the basis that it would be taken by a representative of the bank to the meeting at which the takeover was to be completed and exchanged for a draft for a higher sum payable to Cradock. At the meeting the representative of the bank was induced to release the draft without receiving anything in return. The takeover was then completed and the newly-elected board of directors, having duly transferred the company's bank account to Cradock's bank, agreed to lend the company's funds to a third party and drew the appropriate cheque on its new bank account. The third party endorsed this cheque in favour of Cradock, who paid it into his own account and so was able to cover the amount of the draft. Although the bank had clearly acted in good faith without any knowledge of the misapplication of company funds being perpetrated by the directors, Ungoed-Thomas J held that a reasonable banker would have realised that, by allowing the company's money to be paid into Cradock's account, he was enabling the latter to purchase the company with its own money; consequently, the bank was liable for "knowing assistance".

61 (1975) 132 CLR 373.

62 At p 386.

63 At p 398.

full knowledge of all the facts could escape liability because his own moral obtuseness prevented him from recognising an impropriety that would have been apparent to an ordinary man." Stephen J, with whose judgment Barwick CJ concurred, said this:[64] "In my view the state of the authorities as they existed before *Selangor* did not go so far, at least in cases where the defendant had neither received nor dealt in property impressed with any trust, as to apply to them that species of constructive notice which serves to expose a party to liability because of negligence in failing to make inquiry. If a defendant knows of facts which themselves would, to a reasonable man, tell of fraud or breach of trust the case may well be different, as it clearly will be if the defendant has consciously refrained from enquiry for fear lest he learn of fraud. But to go further is, I think, to disregard equity's concern for the state of conscience of the defendant." Thus the majority of the High Court concluded that liability for "knowing assistance" would be imposed on anyone falling within what would later be classified as categories (i), (ii), (iii) and (iv) but not on anyone falling within category (v). This was expressly confirmed by Kirby P in *Equiticorp Finance v Bank of New Zealand*.[65]

However, in England, although the decision in *Selangor United Rubber Company v Cradock (No 3)* was subsequently followed,[66] most significantly in *Baden v Société Générale*,[67] where Peter Gibson J accepted a concession by counsel that its effect was that strangers falling within all five of the categories of knowledge which he had identified would be liable for "knowing assistance", the more traditional approach was adopted in a number of other decisions,[68] most significantly by the Court of Appeal in *Carl-Zeiss Stiftung v Herbert Smith (No 2)*[69] and in *Belmont Finance Corporation v Williams Furniture*.[70] Despite the continued existence of these conflicting authorities, it seems now to be generally accepted in England that the more traditional approach is correct and that a stranger will only be liable for "knowing assistance" if he falls within the first three of the categories of knowledge identified by Peter Gibson J in *Baden v Société Générale*.[71]

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64 At p 412.

65 (1993) 32 NSWLR 50 at p 104.

66 In cases such as *Karak Rubber Company v Burden (No 2)* [1972] 1 WLR 602 and *Rowlandson v National Westminster Bank* [1978] 3 All ER 370.

67 (1983) [1993] 1 WLR 509n at pp 575-582.

68 Such as *Competitive Insurance Company v Davies Investments* [1975] 1 WLR 1240; *Re Montagu's Settlement Trusts* [1987] 2 WLR 1192 and *Lipkin Gorman v Karpnale* [1987] 1 WLR 987 (Alliott J); the question did not have to be decided in the Court of Appeal ([1989] 1 WLR 1340) and did not arise in the House of Lords ([1991] 3 WLR 10).

69 This case primarily concerned "knowing receipt" but both Sachs and Edmund Davies LJJ stated that an agent cannot be liable for "knowing assistance" unless he has actual knowledge of the misapplication in question.

70 [1979] 1 All ER 11 8, *(No 2)* [1980] 1 All ER 393. This case resulted from another successful attempt to purchase a company with its own money. The Court of Appeal first held, on a pleading issue, that liability for "knowing assistance" is restricted to the first three categories of knowledge later identified by Peter Gibson J and subsequently held, on the merits, that the agents had throughout genuinely believed that the transaction was a good commercial proposition.

71 In *Agip (Africa) v Jackson* [1989] 3 WLR 1367 Millett J considered the five categories of knowledge identified by Peter Gibson J and held (at p 1389) that the concession made by counsel in *Baden v Société Générale* that all five would ground liability for "knowing assistance" "was wrong and should not have been made .... In *Belmont Finance Corporation v Williams Furniture*, the Court of Appeal insisted that to hold a stranger liable for 'knowing assistance' the breach of trust in question must be a fraudulent and dishonest one. In my judgment it necessarily follows that constructive notice of the fraud is not enough to make him liable. There is no sense in requiring dishonesty on the part of the principal while accepting negligence as sufficient for his assistant. Dishonest furtherance of the dishonest scheme of another is an understandable basis for liability; negligent but honest failure to appreciate that someone else's scheme is dishonest is not." This extremely clear statement of the justification for the more traditional approach appeared to have settled the controversy. Unfortunately however, in the Court of Appeal [1991] 3 WLR 116 where the decision of Millett J was affirmed, Fox LJ stated (at pp 132-133) that the degree of knowledge required had been described by Ungoed-Thomas J in *Selangor United Rubber Company v Cradock (No 3)* and by Peter Gibson J in *Baden v Société Générale*. This reliance on authorities expressly rejected by Millett J reintroduced considerable confusion. However, in *Eagle Trust v SBC Securities* [1993] 1 WLR 484 Vinelott J said (at p 495) "it is, I think, implicit in his judgment that [Fox LJ] accepted Millett J's conclusion that in a 'knowing assistance' case something amounting to dishonesty or want of probity on the part of the defendant must be shown" and held (at p 496) that "constructive notice is not enough". This was confirmed in *Polly Peck International v Nadir (No 2)* [1992] 4 All ER 769, where Scott LJ said (at p 777) that "[t]here is a general consensus of opinion that if

This is also clearly the law in New Zealand. In the New Zealand Court of Appeal in *Westpac Banking Corporation v Savin*[72] Sir Clifford Richmond, in the passage which has already been cited,[73] was strongly in favour of the view taken by the English Court of Appeal in *Belmont Finance Corporation v Williams Furniture*. His dictum was applied at first instance in *Equiticorp Industries Group v Hawkins*,[74] *Marshall Futures v Marshall*[75] and *Nimmo v Westpac Banking Corporation*,[76] in the latter two of which the contrary, more stringent, view upheld by Thomas J in *Powell v Thompson*[77] was expressly not followed; in the most recent case of all, *Springfield Acres (In Liquidation) v Abacus (Hong Kong)*,[78] it was clearly stated that "the balance of authority ... favoured the view that the five types applied only to knowing receipt and dealing cases, but types (i), (ii), and (iii) only were relevant to knowing assistance cases, types (iv) and (iv) not displaying a sufficient want of probity to found equitable liability".

The existing difference between, on the one hand, the law of Australia and, on the other hand, the law of New Zealand and the law of England as to the categories of knowledge which will ground liability for "knowing assistance" is entirely explained by the different interpretation of the second requirement, the existence of a dishonest and fraudulent design on the part of the trustee of the trust, in the respective jurisdictions. In Australia, this requirement is satisfied by a breach of trust or a breach of fiduciary duty, while in New Zealand and in England what is required is the taking of a risk to the prejudice of another's rights, which risk is known to be one which there is no right to take. An observation by Millett J[79] that "[t]here is no sense in requiring dishonesty on the part of the principal while accepting negligence as sufficient for his assistant"[80] is entirely valid in New Zealand and in England; however in Australia, where only a breach of trust or breach of fiduciary duty is required on the part of the principal, there is no particular reason not to impose liability for negligence on his assistant. The existing law both in Australia and in New Zealand and England is wholly consistent. What is needed in Australia is a definitive review by the High Court to determine whether Australia should continue to impose a more stringent liability for "knowing assistance" or should instead fall into line with the approach that has been adopted in New Zealand and England.

(c) The liability of agents of invalidly appointed trustees

It has never been clearly established whether the protection conferred by *Barnes v Addy* is available to an agent employed by a trustee who has not himself been validly appointed but the better view is that protection should be available to such an agent.[81]

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liability as constructive trustee is sought to be imposed ... on the basis that the defendant has assisted in the misapplication of trust property (knowing assistance), 'something amounting to dishonesty or want of probity on the part of the defendant must be shown' (see per Vinelott J in *Eagle Trust v SBC Securities*). Vinelott J described as 'settled law' the proposition that 'a stranger cannot be made liable for knowing assistance in a fraudulent breach of trust unless knowledge of the fraudulent design can be imputed to him ...'. I respectfully agree." It is thought that this clear statement of the law by Scott LJ has dispersed any confusion caused by the remarks of Fox LJ in *Agip (Africa) v Jackson* and that in England it will from now on be generally accepted that a stranger can only be liable for "knowing assistance" if he falls within one of the first three categories of knowledge identified by Peter Gibson J in *Baden v Société Générale*.

72 [1985] 2 NZLR 41.

73 See *ante*, text to n 44.

74 [1991] 3 NZLR 700 at p 725.

75 [1992] 1 NZLR 316 at p 325.

76 [1993] 3 NZLR 218 at p 228.

77 [1991] 1 NZLR 597 at p 615.

78 [1994] 3 NZLR 502 at p 510.

79 In *Agip (Africa) v Jackson* [1989] 3 WLR 1367 at p 1389.

80 [1989] 3 WLR 1367 at p 1389.

81 This issue arose in *Mara v Browne* [1896] 1 Ch 199 where it was argued that an agent appointed by such a trustee must act as a principal and so would be deprived of the protection of *Barnes v Addy* - this would have meant that

(d) The liability of partners of agents liable for "knowing assistance"

There has been recent English authority on the question of whether, when an agent is held personally liable to account in the same manner as a trustee on the grounds that he has assisted in bringing about a misapplication of property subject to a trust, his partners are subject to the same liability. Until *Agip (Africa) v Jackson*[82] it was generally thought that no such liability arose on the grounds that it is not part of the implied authority of a partner to make his co-partners liable for "knowing assistance".[83] However, in that case both Millett J and the Court of Appeal, without citation or discussion of any of the previous authorities, imposed liability for "knowing assistance" both on the accountant who had been carrying out the money-laundering and on his partner. This decision of the Court of Appeal must obviously represent English law at present but the matter cannot be regarded as finally settled until the conflicting authorities have been the subject of a reasoned judgment. This question does not appear to have been expressly considered either in Australia or in New Zealand and is in any event not particularly relevant for banks.

(e) What should a suspicious agent do?

If an agent suspects that he may be assisting in a misapplication of property subject to a trust and it is too late for him to withdraw from the transaction (this would be the position of a solicitor or a bank who became suspicious about the provenance of funds being held to the order of a client), he is in England entitled to apply by originating summons to the High Court under Order 85 of the Rules of the Supreme Court for administration directions. In the event that there are sufficient grounds for his suspicions, any directions given by the court can, if necessary, override any legal or other professional privilege of confidentiality to which the client would normally have been entitled.[84] What a bank cannot do, however, is to refuse to comply with its customer's instructions merely because it has become suspicious; this can only safely be done where the bank has evidence of a dishonest and fraudulent design on the part of the customer. In the as yet unreported decision in *TTS International v Cantrade Private Bank*,[85] the Royal Court of Jersey went so far as to enter summary judgment against a bank who had refused to comply with instructions to transfer the balance of an account out of the jurisdiction; the court found, first, that at the relevant time there was no evidence of a dishonest and fraudulent design; secondly, that there was no evidence that the funds would be paid to anyone other than their true owners; and, thirdly, that the bank had taken an overly cautious view of its duties, appearing more concerned to protect itself against possible claims than to look after the interests of its account holders. Refusing to comply with the instructions of customers therefore appears only to be feasible in extreme

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the agent in question would have been treated as if he had been officiously acting as a fiduciary and so, under the principles which have already been discussed, would inevitably have been liable no matter what his motives and his state of knowledge. This argument succeeded at first instance before North J ([1895] 2 Ch 69) but the Court of Appeal found that the trustee in question had been validly appointed and so the issue did not have to be decided. However, Lord Herschell stated that the protection of *Barnes v Addy* would be available to such an agent. The latter view is preferable since it is unreasonable to expect an agent to carry out a detailed investigation into the status of his principal.

82 [1989] 3 WLR 1367 at p 1389 (Millett J), [1991] 3 WLR 116 (Court of Appeal).

83 In *Re Bell's Indenture* [1980] 3 All ER 425 liability for "knowing assistance" was imposed on a solicitor who had assisted the trustees of a settlement who were also life tenants thereof to distribute the whole of the trust property to themselves in breach of trust. The remaindermen sought to impose a similar liability on his partners, relying on *Blythe v Fladgate* [1891] 1 QB 337 where all the partners of a firm of solicitors who had officiously been acting as trustees were held liable to account to the trust. *Blythe v Fladgate* had been followed at first instance in *Mara v Browne* [1895] 2 Ch 69, where North J had imposed liability both on the agent employed by the invalidly appointed trustee and on his partner. However, in the Court of Appeal in *Mara v Browne* [1896] 1 Ch 199 (where the issue did not arise) all three members of the court had indicated that they would have held the opposite on the grounds that it is no part of the implied authority of a partner to make his co-partners liable for "knowing assistance". In *Re Bell's Indenture* Vinelott J followed and applied these statements of the Court of Appeal in *Mara v Browne* and exonerated the partners, distinguishing *Blythe v Fladgate* on the grounds that in that case the solicitors had been acting officiously as trustees.

84 *Finers v Miro* [1991] 1 All ER 182.

85 Noted in (1995) 4 *Journal of International Trust and Corporate Planning* 60.

cases. The precautions which banks *can and should* take in Australia and in New Zealand in order to avoid liability for "knowing assistance" will be the subject matter of the remarks of the two speakers who have kindly agreed to comment on this paper.

III. LIABILITY FOR "KNOWING RECEIPT"

(a) The different remedies available against the recipient

Liability for "knowing receipt" is only one of a number of claims which may be available to the person from whom the property has been abstracted. If the property or its product is still identifiable in the hands of the recipient or of any third party to whom it has been subsequently transferred, he will also have the possibility of bringing a proprietary claim, either at law or in equity, to enable him to follow the property into the hands of its present holder. Additionally he may be able to bring a personal action at law for money had and received against the recipient, a personal action in equity against whoever was responsible for initiating the misapplication, and a claim for the imposition of the obligations of trusteeship against anyone who has been guilty of "knowing assistance".[86]

The interrelation of these different claims makes proceedings of this type extremely complex. The principal difficulty is the existence of what have been described[87] as "arbitrary and anomalous distinctions" between the claims at law and the claims in equity. It is perhaps inevitable that the prerequisites of and defences to proprietary claims differ depending on whether the claim is being brought at law or in equity. But there are also distinctions between the different personal claims. An action at law for money had and received will succeed quite irrelevant of the state of mind of the recipient of the money; the only defences available to him will be bona fide purchase for value without notice and change of position.[88] On the other hand, liability in equity for "knowing receipt" depends on whether the recipient falls within the appropriate[89] categories of knowledge identified by Peter Gibson J in *Baden v Société Générale*[90] (this is also true of liability for "knowing assistance"). In other words, liability at law is strict, subject to defences, while liability in equity depends on the state of mind of the recipient. This (and other) distinctions have led commentators to question whether so many different remedies should continue to be available for the same misapplication of property.[91] For the moment, however, the existing distinctions between the different claims obviously continue.[92]

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86 In *Agip (Africa) v Jackson* [1989] 3 WLR 1367 (Millett J), [1991] 3 WLR 116 (Court of Appeal), the plaintiff sought the following relief: at law, a proprietary claim to follow the funds into the hands of the defendants and a personal claim for money had and received; and, in equity, a proprietary claim to follow the funds into the hands of the defendants and the imposition of the obligations of trusteeship for "knowing receipt" and "knowing assistance". In *Lipkin Gorman v Karpnale* [1987] 1 WLR 987 (Alliott J), [1989] 1 WLR 1340 (Court of Appeal) [1991] 3 WLR 10 (House of Lords), where a partner of a firm of solicitors had drawn from the firm's client accounts funds which he subsequently gambled away at a casino, the solicitors claimed that its bank was liable for conversion of cheques, for conversion of a draft, for breach of contract and for "knowing assistance" and that the casino was liable for money had and received, for negligence, for conversion of cheques, for conversion of a draft, and for "knowing receipt" and, additionally, was liable in equity to both proprietary and personal claims as a result of its receipt of the solicitors' funds.

87 By Millett J in *El Ajou v Dollar Land Holdings* [1993] BCLC 735, at p 757. Millett J contended that these distinctions should not be insisted upon.

88 *Lipkin Gorman v Karpnale* [1989] 1 WLR 1340 (Court of Appeal), [1991] 3 WLR 10 (House of Lords). See PBH Birks [1991] *LMCLQ* 473.

89 There is disagreement as to precisely which of the five categories suffice for this purpose.

90 (1983) [1993] 1 WLR 509n.

91 See n. 120 *post*. Millett J has recently commented in *El Ajou v Dollar Land Holdings* [1993] BCLC 735 at p 759 that he does not see "how it would be possible to develop any logical and coherent system of restitution if there were different requirements in respect of knowledge for the common law claim for money had and received, the personal claim for an account in equity against a knowing recipient and the equitable proprietary claim". The forthcoming Consultation Paper from the English Law Commission will undoubtedly make proposals for rationalising all the

For present purposes, it is important only to distinguish between, on the one hand, the possibility of following the misapplied property into the hands of its recipient and, on the other hand, the imposition of the obligations of trusteeship upon him. Where property subject to a trust has been misapplied, the interests of the beneficiaries in that property are, in accordance with the basic principles of property law, enforceable against the whole world unless and until the property in question reaches the hands of someone who takes it free of their equitable proprietary interests therein. Any recipient of misapplied property who is liable to such an equitable tracing claim will of course be a trustee of such property as is in his hands - this is simply because the equitable interests of the beneficiaries therein must necessarily take effect behind a trust of the legal estate. However, the fact that it is thus possible to trace the property into its product does not necessarily mean that the obligations of trusteeship will be imposed on the recipient in respect of all the property originally transferred to him. Indeed, only in three situations will it be necessary to seek the imposition of liability for "knowing receipt": first, where the recipient has dealt with the property in such a way that it can no longer be followed: secondly, where the property has depreciated in value while in the hands of the recipient; and, thirdly, where the recipient has obtained some incidental profit from the property. In these circumstances, the equitable tracing claim will only lead to the recovery of such property, if any, as remains in the hands of the recipient; the loss caused by any dealing with or reduction in value of the property and any incidental profit obtained will only be recoverable if the recipient is held to have been a constructive trustee of the whole of the property originally transferred to him. In the vast majority of the cases in which the imposition of liability for "knowing receipt" has been sought, the recipient has dealt with the property in such a way that it can no longer be followed.

(b) The elements of liability for "knowing receipt"

Liability for "knowing receipt" is not dependent on the existence of any dishonest or fraudulent design on the part of the person who misapplied the property; it is dependent purely and simply on the receipt, with the requisite level of knowledge, of property subject to a trust which has been misapplied. (The fact of receipt can sometimes be extremely difficult to establish; in such circumstances, it is determined by the application of the rules governing legal and equitable tracing claims.[93]) Further, the existence of the requisite level of knowledge has to be proved by the claimant, not disproved by the recipient.[94]

It is therefore apparent that a recipient who does not fall within any of the five categories of knowledge identified by Peter Gibson J in *Baden v Société Générale*[95] will not be liable for "knowing receipt". English authorities[96] establish that this is the case whether or not the recipient has given value.[97]

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available remedies and is expected (because of the identity of the Commissioner who is drafting it) to propose the introduction of a universal principle of strict liability for "knowing receipt" subject to clearly defined defences.

92 Even if the Consultation Paper from the English Law Commission eventually leads to the publication of a Report and a Draft Bill, the possibilities of its enactment are slim (few of the proposals of the English Law Commission relating to private, as distinct from public, trusts have ever been enacted). The most likely way forward is by means of judicial creativity rather than statutory reform. For this reason, because of the existing decision of the House of Lords in *Lipkin Gorman v Karpnale* [1991] 2 AC 548, the introduction of strict liability for "knowing receipt" remains the most probable way forward for English law.

93 The judgment of Millett J in *El Ajou v Dollar Land Holdings* [1993] BCLC 735, at pp 753-757, contains a good illustration of the difficulties which can arise and of the manner in which they can be resolved.

94 All these points were recently emphasised by Scott LJ in *Polly Peck International v Nadir (No 2)* [1992] 4 All ER 769 at p 777.

95 (1983) [1993] 1 WLR 509n. These categories have already been considered.

96 In *Re Diplock* [1948] Ch 465, volunteers who had no knowledge whatever of the breach of trust in question were held not liable for "knowing receipt". In *Cowan de Groot Properties v Eagle Trust* [1992] 4 All ER 700 directors of a company which lacked liquid funds sold five properties at a gross undervalue in order to make an urgent payment needed to keep an important company project in existence. Subsequently the company repudiated the sale and claimed that the purchaser was liable for "knowing receipt". Knox J held that the purchaser did not fall within any of

The crucial and controversial question which remains is, therefore, which of the five categories of knowledge identified by Peter Gibson J in *Baden v Société Générale* suffice for the imposition of liability for "knowing receipt". In this respect, the law is not particularly clear either in Australia or in England; however, in New Zealand it is now clearly established that any of the five categories identified by Peter Gibson J will suffice.

In Australia the leading authority is once again *Consul Development v DPC Estates*,[98] where the members of the High Court were primarily concerned with "knowing assistance" rather than "knowing receipt". Gibbs J said[99] that "Consul did not receive any property of DPC" while Stephen J said[100] that "Consul has not intermeddled with any trust property so as to make itself a trustee de son tort". Gibbs J made no comments whatsoever about the type of knowledge necessary for the imposition of liability for "knowing receipt". Stephen J, on the other hand, referred[101] to the following passage in the dissenting judgment of Jacobs P in the Court of Appeal of New South Wales:[102] "The point of the difference between the person receiving trust property and the person who is made liable, even though he is not actually a recipient of trust property, is that in the first place knowledge, actual or constructive, of the trust is sufficient,[103] but in the second place something more is required ...". Stephen J then went to comment that it was not clear to him "why there should exist this distinction between the case where trust property is received and dealt with by the defendant and where it is not". The rest of the relevant part of his judgment is concerned exclusively with liability for "knowing assistance".

The citation of this passage does suggest that Stephen J would have been prepared to impose liability for "knowing receipt" on the basis of constructive knowledge, that is to say on the basis of any of the five categories of knowledge which would later be identified by Peter Gibson J. This was undoubtedly the view of McTiernan J, who dissented.[104] Whatever the correct interpretation of the judgment of Stephen J, it is in any event inevitable that both Gibbs J and Stephen J would have imposed liability for "knowing receipt" on anyone falling within what would later be classified as categories (i), (ii), (iii) and (iv) since they held that knowledge within those categories sufficed for the imposition of liability for "knowing assistance". In *Equiticorp Finance v Bank of New Zealand*[105] Kirby P held[106] that "when the third party in question actually receives trust properties ... the stranger will become liable as a constructive trustee if any of the four first stated elements of knowledge identified by Peter Gibson J is established." He then went on to consider whether or not the fifth category would also suffice but, since he had found that the knowledge of the defendant was on any view within the first three categories, he did not reach a conclusion on this point. It therefore appears that at least the first four categories of knowledge identified by Peter Gibson J and possibly also the fifth category will lead to the imposition of liability for "knowing receipt" in Australia.

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the five categories of knowledge identified by Peter Gibson J and so was consequently not liable for "knowing receipt".

97 Whether or not he has given value will of course be highly relevant in relation to an equitable tracing claim, since only if he has will he be able to make out the defence of bona fide purchase for value without notice.

98 (1975) 132 CLR 373.

99 At p 396.

100 At p 408.

101 At p 410.

102 [1974] 1 NSWLR 443 at p 459.

103 Jacobs P was presumably referring in this passage to liability for "knowing receipt", although he did not actually say so.

104 (1975) 132 CLR 373 at pp 378 and 386.

105 (1993) 32 NSWLR 50.

106 At p 103.

Of the six recent Australian cases in which liability for "knowing receipt" has been imposed, only one concerns the liability of banks. In *Stephens Travel Service International v Qantas Airways*,[107] the proceeds of sale of Qantas tickets were paid by a travel agent into an overdrawn account at the ANZ Bank. By virtue of the contract between the travel agent and Qantas these sums were held by the former on trust for the latter. Following the appointment by the bank of receivers and managers pursuant to a floating charge, the bank utilised sums paid into the account in respect of Qantas tickets to reduce the overdraft. The Court of Appeal of New South Wales held that the bank was liable for "knowing receipt"; the account had been under continuous review during the immediately preceding months so there was no difficulty in establishing the actual knowledge of the bank that the sums in question belonged beneficially to Qantas. The remaining decisions comprise four cases of actual knowledge[108] and one case of wilful shutting of eyes.[109] To these must be added the minority decision of Kirby P in *Equiticorp Finance v Bank of New Zealand*[110] to impose liability for "knowing receipt" on the basis of knowledge which on any view fell within the first three categories. No Australian decision yet appears to have imposed liability for "knowing receipt" on the basis of knowledge within the fourth category and it is at present uncertain whether or not knowledge within the fifth category suffices. This question also requires urgent consideration by the High Court.

The present state of English law is even less clear because of the existence of two conflicting lines of authority. One line of authority[111] suggests that liability for "knowing receipt" will be imposed if the recipient has any of the five categories of knowledge identified by Peter Gibson J while the other line of authority[112] suggests that only the first three of those five categories should give rise to such liability. To make matters still worse, two recent cases[113] have adopted a *media via*, suggesting that the question of whether the fourth and fifth categories of knowledge suffice only arises in non-commercial transactions since in commercial transactions only the first three categories can possibly suffice for the imposition of liability. These conflicting lines of authority urgently require a considered review by the Court of Appeal.[114] It is to be hoped that at least one of the proceedings presently pending in which it is being sought to impose liability for "knowing receipt" reaches the Court of Appeal since any clearly expressed statement of the law would be preferable to the existing confusion.

In striking contrast to the somewhat uncertain state of Australian law and the wholly unsatisfactory state of English law, the courts of New Zealand have shown both unanimity and consistency. Every single authority decided in the last decade has concluded that liability for "knowing receipt" will be imposed on anyone falling within the five categories of knowledge identified by Peter Gibson J in *Baden v Société Générale*. In *Westpac Banking Corporation v Savin*[115] the proceeds of sale of two boats were paid by the selling agent into its overdrawn account with Westpac and

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107 (1988) 13 NSWLR 331.

108 *In the Marriage of Wagstaff* (1990) 14 Fam LR 78, *Ravinder Rohini Pty v Kriziac* (1991) 30 FCR 300, *Linter Group v Goldberg* (1992) 7 ACSR 580, *Oaheat Pty v Hannigan* (8 February 1994) Unreported.

109 *Lord v Spinelli* (1991) 4 WAR 158.

110 (1993) 32 NSWLR 50 at pp 101-106.

111 *Nelson v Larholt* [1948] 1 KB 339, as interpreted in dicta in *Belmont Finance Corporation v Williams Furniture (No 2)* [1980] 1 All ER 393 at p 405, *International Sales and Agencies v Marcus* [1982] 3 All ER 5515 at p 558, *Agip (Africa) v Jackson* [1989] 3 WLR 1367 at p 1388, was cited as authority for this proposition in *Cowan de Groot Properties v Eagle Trust* [1992] 4 All ER 700.

112 *Nelson v Larholt* [1948] 1 KB 339 as interpreted in *Carl-Zeiss Stiftung v Herbert Smith (No 2)* [1969] 2 Ch 276, *Re Montagu's Settlement* [1987] Ch 264, *Lipkin Gorman v Karpnale* [1987] 1 WLR 987, *Barclays Bank v Quincecare* (1988) [1992] 4 All ER 363.

113 *Eagle Trust v SBC Securities* [1993] 1 WLR 484, *Cowan de Groot Properties v Eagle Trust* [1992] 4 All ER 700.

114 In Polly Peck International v Nadir (No 2) [1992] 4 All ER 769 at p 777 Scott LJ did not consider an interlocutory appeal to be "the right occasion for settling the issue"; however, he left the question open by accepting that the third category of knowledge would lead to liability for "knowing receipt" while admitting to "some doubts" as to whether the fifth category of knowledge would also do so.

115 [1985] 2 NZLR 41.

neither owner was paid. The New Zealand Court of Appeal held the bank liable for "knowing receipt" on the basis of knowledge within the second or third category. Richardson J, while accepting that it was not necessary for him to express a final view, stated:[116] "In principle I cannot see any adequate justification for excluding categories (4) and (5) at least in the 'knowing receipt' class of case and I tend to favour for that class of case the comprehensive approach adopted by Peter Gibson J". In *Lankshear v ANZ Banking Group*,[117] a cheque for NZ$80,000 given by a partner to her co-partner as her contribution to a partnership building development was paid by the latter into an overdrawn account with ANZ. The bank was held liable for "knowing receipt" to the extent that this payment had discharged the overdraft,[118] Wallace J holding[119] that "[t]here seems to be substantial agreement that all five categories of knowledge as expressed by Peter Gibson J in [*Baden v Société Générale*] are relevant in a knowing receipt or dealing case". The same conclusion has been reached in number of other cases not involving banks.[120]

The present law governing liability for "knowing receipt" has been the subject of considerable criticism and of various proposals for reform.[121] Acceptance of any of these proposals would entail substantial changes in the law of all the legal systems which have been discussed. In so far as concerns the most popular proposal for reform, the introduction of strict liability for "knowing receipt" subject to the defence of change of position, none of the systems at present imposes liability on a recipient who does not fall within any of the five categories of knowledge identified by Peter Gibson J in *Baden v Société Générale*. The law of New Zealand comes closest to satisfying this proposal since it is absolutely certain that in New Zealand liability for "knowing receipt" will be imposed on anyone falling within any of these five categories of knowledge; however, there must be some doubt as to whether the statutory New Zealand defence of change of position actually applies to liability for "knowing receipt".[122] The law of Australia may well be equally stringent in the imposition of liability for "knowing receipt" - whether or not such liability would be imposed on someone falling within the fifth category of knowledge identified by Peter Gibson J is uncertain at present; however, the nascent defence of change of position envisaged by the High Court in *David Securities v Commonwealth Bank of Australia*[123] will presumably in the fullness of time be applied

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116 At p 53.

117 [1993] 1 NZLR 481.

118 Claims for "knowing assistance" and "inconsistent dealing" in respect of the surplus were dismissed on the grounds that the bank had had no means of knowing whether or not the cheques drawn on the account had been used for partnership business.

119 At pp 493-494.

120 *Powell v Thompson* [1991] 1 NZLR 597, *Equiticorp Industries Group v Hawkins* [1991] NZLR 700 (interlocutory proceedings), *Nimmo v Westpac Banking Corporation* [1993] 3 NZLR 218, *Springfield Acres (In Liquidation) v Abacus (Hong Kong)* [1994] 3 NZLR 502 (interlocutory proceedings).

121 PD Finn in *Equity, Fiduciaries and Trusts 1993* (Ed Waters, 1993) 195 argues for the abandonment of much, if not all, of the existing law and its replacement by the following three questions, all of which need to be answered in the affirmative before what he denominates "participatory liability" can be imposed: (1) Has a fiduciary committed a breach of fiduciary duty or breach of trust? (2) Has the third party participated in the manner in which the breach has occurred? (3) In so doing, did that party know or have reason to know that a wrong was being committed by the fiduciary on his or her beneficiaries? This view was cited with approval by Kirby P in *Equiticorp Finance v Bank of New Zealand* (1993) 32 NSWLR 50 at p 105. In England, Lord Hoffmann (a Lord of Appeal in Ordinary) writing extra-judicially in *Frontiers of Liability* (Ed Birks, 1994) 1 has advocated that liability for "knowing receipt" should arise, if at all, under the law of tort and in particular the torts of negligence and deceit and that all the forms of equitable liability should be abolished. Several commentators, including PBH Birks in [1993] *LMCLQ* 218 and C Harpum in *Frontiers of Liability* (Ed Birks, 1994) 9, have advocated strict liability for "knowing receipt", subject to the defence of change of position established in England by the decision of the House of Lords in *Lipkin Gorman v Karpnale* [1991] 2 AC 548. This view has been echoed by Millett J in *El Ajou v Dollar Land Holdings* [1993] BCLC 735 at p 759, where he said: "I do not see how it would be possible to develop any logical and coherent system of restitution if there were different requirements in respect of knowledge for the common law claim for money had and received, the personal claim for an account in equity against a knowing recipient and the equitable proprietary claim."

122 This provision, re-enacted as *Administration Act* 1969 s 50, is primarily applicable to claims by beneficiaries arising out of a misdistribution of the assets of an estate or an *inter vivos* trust; it is therefore not clear to what extent it is applicable in cases of "knowing receipt".

123 (1992) 66 ALJR 768 at pp 780-781.

to liability for "knowing receipt".[124] The law of England is at present in a state of total uncertainty; its one redeeming feature is that its newly created defence of change of position[125] almost certainly applies to liability for "knowing receipt". The law of New Zealand requires no judicial reconsideration; if any reform is introduced, it is clearly likely to be by statute. On the other hand, both the law of Australia and, particularly, the law of England are in urgent need of reconsideration by their respective appellate tribunals, whether or not any proposals for statutory reform are ever brought forward.

IV. LIABILITY FOR "INCONSISTENT DEALING"

Any person who has received lawfully and not for his own benefit property subject to a trust will be liable to account for that property as a constructive trustee if he subsequently either misappropriates it or deals with it in some other manner which is inconsistent with the trust. The decided cases on what is generally known as liability for "inconsistent dealing"[126] fall into two groups; there appear to be no relevant Australian authorities and only one relevant New Zealand authority.

Only the first group of cases concerns the liability of banks, which potentially arises where a bank has exercised its right of set off between different accounts held by the same customer, one of which is subsequently held to be a trust account. In *Barclays Bank v Quistclose Investments*,[127] Quistclose Investments had made a loan to Rolls Razor for the specific purpose of paying a dividend and the funds were paid into a new account at Barclays Bank opened by Rolls Razor specifically for the purpose. When Rolls Razor went into liquidation prior to the date on which the dividend was due to be paid, Barclays Bank claimed to offset the balance of this new account against the indebtedness of Rolls Razor in other accounts. The House of Lords held that Rolls Razor had been holding the funds in question on trust to pay the dividend and, subject thereto, for Quistclose Investments; since the bank had been made aware of the situation but had failed to draw the appropriate inference from facts known to it, it held the funds which it had sought to misapply on trust for Quistclose Investments. A similar claim failed recently in New Zealand in *Lankshear v ANZ Banking Group*[128] where, as has already been mentioned, a cheque for NZ$80,000 given by a partner to her co-partner as her contribution to a partnership building development was paid by the latter into an overdrawn account with ANZ. Although the bank was held liable for "knowing receipt" to the extent that this payment had discharged the overdraft, an attempt to impose liability for "inconsistent dealing" in respect of the surplus failed, Wallace J holding that the loan to the partnership had not been made "to pay specific persons in certain events".[129] More successful was a similar claim in England in *Neste Oy v Lloyds Bank*.[130] The plaintiff shipowner was accustomed whenever one of its vessels entered a United Kingdom port to transfer to the bank account of its agent at Lloyds Bank sufficient funds to enable the agent to discharge all liabilities incurred by the vessel. A number of such payments were made immediately before and immediately after the agent appointed a receiver. Lloyds Bank set off all the payments so made against the indebtedness of the agent. Bingham J held that there was no express trust of any of the payments and that, even if there had been a trust in respect of any of the payments made before the appointment of the receiver, the bank would have taken free of that trust on the

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124 For the same reason as in the case of the New Zealand legislation, the applicability of the statutory defences of change of position enacted in Queensland (*Trustee Act* 1973-1981 s 109) and in Western Australia (*Trustees Act* 1962, s 65(1)) to cases of "knowing receipt" is somewhat uncertain.

125 Adopted by the House of Lords in *Lipkin Gorman v Karpnale* [1991] 2 AC 548.

126 C Harpum, in *Frontiers of Liability* (Ed Birks, 1994) 9, describes this (along with liability for "knowing receipt") as "Restitutionary Liability".

127 [1970] AC 567.

128 [1993] 1 NZLR 481.

129 At p 497.

130 [1983] 2 Lloyd's Rep 658.

grounds that it did not fall within any of the categories of knowledge identified by Peter Gibson J in *Baden v Société Générale*. However, he held that the agent had become a trustee of the payment received after the appointment of the receiver; at the time of its arrival, the bank had already known of the appointment of the receiver and had therefore been placed upon enquiry. The bank was consequently bound by this trust and was not subsequently entitled to set off the payment. An agent will thus clearly be liable for "inconsistent dealing" if he knowingly misapplies property subject to a trust; whatever categories of knowledge suffice for the imposition of liability for "knowing receipt" should also apply to the imposition of liability for "inconsistent dealing" - this was indeed stated by Wallace J in *Lankshear v ANZ Banking Group*.[131]

The second group of cases concerns strangers who receive property subject to a trust which has been misapplied without sufficient knowledge to be held liable for "knowing receipt". If such a stranger subsequently acquires the necessary knowledge of the misapplication of the property in breach of trust, he will nevertheless be liable as a constructive trustee if he subsequently deals with the property in a manner inconsistent with the trust.[132]

V. CONCLUSION

While potential liability for "knowing receipt" and "inconsistent dealing" may cause banks to lose funds which they imagined that they had already successfully obtained, these liabilities will not place them in a worse position than that in which they were prior to receiving the payment in question. On the other hand, liability for "knowing assistance" will inevitably deprive banks of funds which they have never beneficially received and bears no relation whatever to the fees and commissions earned for carrying out the instructions of the client in question. In this respect, Australian law appears to be more stringent than the law of both New Zealand and England; both its definition of "a dishonest and fraudulent design" and its attitude as to the required categories of knowledge are more likely to lead to the imposition of liability on banks than is the case in New Zealand and England. While the law in the latter two jurisdictions is both clearly established and, despite the inherent risk which it poses for bankers, broadly satisfactory, in Australia a review of this area of the law by the High Court is urgently needed, not only in order to resolve the present uncertainties in the law but also in order to enable discussion of the desirability of the present potential liability of banks in this respect.

VI. POSTSCRIPT

Less than twenty-four hours before this paper was delivered, the Privy Council handed down its opinion in an appeal from Brunei Darussalam, *Royal Brunei Airlines v Tan*.[133] The airline sought to impose liability for "knowing assistance" on the managing director and principal shareholder of an insolvent travel agency which had paid into its ordinary current account the ticket moneys which, according to IATA regulations, it held on trust for the airline. The Court of Appeal of Brunei Darussalam had rejected this claim on the grounds that, while the evidence revealed what Lord Nicholls described as "a sorry tale of mismanagement and broken promises, ... it was not established that [the travel agent] was guilty of fraud or dishonesty".[134] This conclusion was based

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131 [1993] 1 NZLR 481 at p 497.

132 In *Sheridan v Joyce* (1844) 1 Jo & Lat 41. a trustee lent out trust funds in breach of trust. The borrower originally had no knowledge whatever of this breach of trust and so was clearly not liable for "knowing receipt". He subsequently discovered the true facts and thereafter made all the payments of interest to the beneficiary rather than to the trustee. Nevertheless, when the trustee subsequently sought repayment of part of the principal, the borrower made the repayment to him despite the contrary requests of the beneficiary and the money so repaid was lost. The borrower was held liable to repay the sum a second time on the grounds that he had dealt inconsistently with property which he knew to be subject to a trust. The categories of knowledge which suffice for the imposition of liability for "knowing receipt" should also apply to the imposition of liability for "inconsistent dealing".

133 (24 May 1995), partially reported in [1995] NLJ 888, to be reported in full in [1995] All ER.

134 Transcript, p 4.

on the decision of the English Court of Appeal in *Belmont Finance Corporation v Williams Furniture*[135] that the requirement for a dishonest and fraudulent design signifies something more than mere misfeasance or breach of trust. However, the Privy Council rejected this view and reversed the decision of the Court of Appeal of Brunei Darussalam, holding that "what matters is the state of mind of the third party sought to be made liable, not the state of mind of the trustee. ... *his* state of mind is essentially irrelevant to the question whether the *third party* should be made liable to the beneficiaries for the breach of trust. If the liability of the third party is fault-based, what matters is the nature of his fault, not that of the trustee. In this regard dishonesty on the part of the third party would seem to be a sufficient basis for his liability, irrespective of the state of mind of the trustee who is in breach of trust".[136]

This conclusion would in itself have been sufficient to dispose of the appeal; since it had been conceded that there had been a breach of trust in which the managing director had assisted with actual knowledge, he had necessarily been dishonest and was therefore inevitably liable for "knowing assistance". However, the Privy Council in fact went on to consider whether dishonesty alone or both dishonesty and negligence would lead to the imposition of liability (in the light of the concession already referred to, it is arguable whether or not this discussion forms part of the *ratio decidendi*). Having reviewed the existing authorities in England and in New Zealand discussed earlier in this paper[137] and the opinions of the commentators,[138] Lord Nicholls stated that "in the context of the accessory liability principle acting dishonestly, or with a lack of probity, which is synonymous, means simply not acting as an honest person would in the circumstances. This is an objective standard".[139] Following a review of some of the problem areas, he made this observation: "To enquire, in [cases where there is real doubt], whether a person dishonestly assisted in what is later held to be a breach of trust is to ask a meaningful question, which is capable of being given a meaningful answer. This is not always so if the question is posed in terms of 'knowingly' assisted. Framing the question in the latter form all too often leads one into tortuous convolutions about the 'sort' of knowledge required, when the truth is that 'knowingly' is inapt as a criterion when applied to the gradually darkening spectrum where the differences are of degree and not kind".[140] Then, in answer to the crucial question of "whether an honest third party who receives no trust property should be liable if he procures or assists in a breach of trust of which he would have become aware had be exercised reasonable diligence",[141] he concluded that "dishonesty is an essential ingredient here. There may be cases where, in the light of the particular facts, a third party will owe a duty of care to the beneficiaries. As a general proposition, however, beneficiaries cannot reasonably expect that all the world dealing with their trustees should owe them a duty to take care lest the trustees are behaving dishonestly".[142]

The conclusion of the Privy Council as to the law, set out in a paragraph headed "The accessory liability principle" deserves to be reproduced in full. "Drawing the threads together, their Lordships' overall conclusion is that dishonesty is a necessary ingredient of accessory liability. It is also a sufficient ingredient. A liability in equity to make good resulting loss attaches to a person who dishonestly procures or assists in a breach of trust or fiduciary obligation. It is not necessary that, in addition, the trustee or fiduciary was acting dishonestly, although this will usually be so where the third party who is assisting him is acting dishonestly. 'Knowingly' is better avoided as a defining

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135 [1979] Ch 250, *infra*, text to footnote 39.

136 Transcript, p 5.

137 *Infra*, text to footnotes 55-80.

138 Including that of the author of this paper in Parker and Mellows, *The Modern Law of Trusts* (6th ed), p 253.

139 Transcript, p 10.

140 Transcript, p 12.

141 Transcript, p 13.

142 Transcript, pp 13-14.

ingredient of the principle, and in the context of this principle the *Baden* scale of knowledge is best forgotten".[143]

This decision, although technically constituting the law only of Brunei Darussalam, is for obvious reasons in practice enormously significant both for New Zealand and for England. The Privy Council seems to have completely rejected the requirement for the existence of a dishonest and fraudulent design on the part of the trustee of the trust and has thus imposed an even stricter rule than that laid down by the High Court of Australia (this may well make the decision significant in the latter jurisdiction also). This conclusion, which greatly increases the possibility of the imposition of liability on third parties who have assisted in a disposition of trust property in breach of trust, unquestionably forms part of the *ratio decidendi* of the Board. Because of the concession already referred to, it is technically possible to argue that the remaining observations of the Board as to the standard of conduct required for the imposition of what will now presumably have to be known as "accessory liability" rather than "liability for 'knowing assistance'" are no more than dicta. However, in the light of the fact that the Board itself made no distinction of this kind, in practice these observations are likely to be equally influential. The five categories of knowledge identified by Peter Gibson J in *Baden v Société Générale*[144] have clearly been rejected in favour of the principle that liability should be imposed on third parties who have dishonestly, but not negligently, assisted in a disposition of trust property in breach of trust. Although this principle is quite distinct in approach, the result of its application is in practice unlikely to be significantly different from that of the existing law in New Zealand and in England, although certainly different from that of the existing law of Australia. Most interesting of all, perhaps, is the fact that the adoption of an approach even stricter than that of Australian law in relation to the conduct of the trustee has not brought with it the adoption of the stricter Australian law relating to the conduct of the third party assister. This is likely to mean that, in the event that the courts of New Zealand and of England do adopt the new principles laid down by the Privy Council, the position of bankers in these jurisdictions is still likely to be preferable to the position of bankers in Australia.

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143 Transcript, p 14.

144 (1983) [1993] 1 WLR 503n, 575-576, discussed *infra*, text to footnote 55.