PART III — ACCESSORY LIABILITY

I *Introduction*

A *Definition*

Accessory liability concerns the remedies available against parties who, although not the fiduciary, are connected in some way to a breach of fiduciary duty — whether by receiving property, participating in the breach itself, or both.

The general rule is as follows: third parties who knowingly participate in the default of a fiduciary may themselves be accountable in equity to the principal (*Barnes v Addy*). The doctrine of accessory liability provides a way for these other defendants to be liable for their role in breaches of fiduciary duties owed by other, in some way related, parties.

B *Rationale*

It may well be puzzling to the naïve scholar why there is much concern for the liability of third parties when, plainly, a breaching fiduciary will herself be subject to all the remedial ferocity with which equity treats its villains. There are essentially three reasons why secondary participants in a breach may become important focal points in a dispute:

1 **Insolvency of the primary defendant**
If the breaching fiduciary cannot satisfy a personal judgment against them, and has no assets against which to secure a primary remedy, there is little point (besides public condemnation) in pursuing that party;

2 **The absconder–fiduciary**
Dealing, as it does, with depraved exhibits of human greed and frailty, the equitable doctrine of breach of duty must be prepared to deal with the breaching fiduciary who absconds to avoid incurring the wrath of his beneficiaries;

3 **Piercing the corporate veil**
If the breaching fiduciary is a company, it might be possible to make an individual director liable as an accessory to the breach, ensuring equitable liability corresponds to the parties' true measure of practical responsibility.

Accessory liability will be of central interest when the primary defendant is insolvent or missing. It provides a means for the plaintiff to join third party defendants with deeper pockets and within the jurisdiction, where it may be necessary, desirable or convenient to do so. Importantly, however, it does not afford an avenue for double recovery by the plaintiff.

It also provides a way to break through the corporate veil, as where the breaching party is a company. The individual director of that company might also be responsible in equity as an accessory to the breach.

C *Categories of Accessory Liability*

The fundamental statement of the law of accessory liability was given by the Court of Chancery in *Barnes v Addy*. The subsequent authorities have, for over a century, made reference to 'the rule in *Barnes v Addy*' or 'liability under the first/second limb of *Barnes v* Addy'. These somewhat quixotic phrases are to be avoided, but will be explained shortly.

***Barnes v Addy* (1874) UK Ch:**

Facts

- Mr Addy is trustee of an estate
- Addy proposes to resign and make a Mr Barnes his replacement trustee
    - In the circumstances, the prudent course is not to appoint a sole trustee
    - In fact, to do so is, technically, in breach of his duties as trustee
- Duffield is Addy's solicitor; he draws up the new trusteeship agreement
- Duffield warns Addy that the replacement is in breach of trust
- Preston is Barnes' solicitor
    - Barnes subsequently sells the trust property
    - This sale is fraudulent and in breach of trust
- Preston approves the sale of the trust property

Issues

- Could Duffield and Preston be made liable as constructive trustees for breaches of trust committed by Barnes and Addy?

Reasoning (Lord Selborne LC)

- '**[251]** Those who create a trust clothe the 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*.'
- '**[251]** … on the other hand, strangers are not to be made constructive trustees merely because they act as the agents of trustees …, transactions, perhaps of which a Court of Equity may disapprove, unless those agents receive … some part of the trust property, or unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees.'
- Knowledge of the trustees' wrongful conduct is required
    - If liability was strict, this would place too high a burden on third parties, who may be liable for conduct about which they knew nothing
    - Knowledge is required
    - Here, Duffield and Preston did not have knowledge so they cannot be liable
- When considering the issue of accessory liability, it should always be remembered that there is
    - 'no better mode of undermining the sound doctrines of equity than to make unreasonable and inequitable applications of them' (at 251)

Decision

- No, neither Duffield nor Preston could not know that anything wrong was intended in the conduct
- Strangers (third parties) are not to be made constructive trustees merely because they act as agents for the trustees, unless:
    - They beneficially received some part of the trust property; or
    - They assist with knowledge in a dishonest and fraudulent design of the trustee

The proposition for which *Barnes v Addy* rightfully stands may be stated succinctly as follows. Agents for breaching fiduciaries will not be accessories, unless:

(i) They beneficially received some part of the trust property ('first limb'); or
(ii) They assist with knowledge in a dishonest and fraudulent design of the trustee ('second limb').

The judgment of Lord Selborne LC clearly established the availability of remedies against those who receive property from, or otherwise assist in, a breach of fiduciary duty.

The bases on which accessories may be held liable can be stated in these terms:

1 **First limb: knowing receipt**
Liability under the first limb requires the third party to have received property in breach of the fiduciary or trustee's equitable obligations; and

2 **Second limb: knowing assistance**
Liability under the second limb requires the third party to have assisted in the breach of trust or fiduciary obligations.

D *The Nature of Accessory Liability*

Equity acts *in personam* to restrain accessories from assisting with or receiving the fruits of a breach of duty. This means that liability as an accessory is personal: it gives rise to personal remedies enforceable only against the assistant or recipient.

To date, accessory liability has only entailed an order to pay equitable compensation to the wronged principal or beneficiary.

The terminology of remedies against accessories can be confusing. Courts and scholars frequently refer to 'constructive trusteeship' and other pseudo-proprietary remedies. This concerning philological lapse was initiated by *Barnes v Addy* itself, which spoke in terms of imposing constructive trusteeship upon accessories.

Perhaps the easiest way to avoid confusion is to note that constructive trusteeship, as described in this context, is something markedly different from the proprietary constructive trust with which courts of equity are now familiar. Rather what is meant is a kind of 'construed' trusteeship. By this I mean that the third party participant is treated as if they were themselves the breaching trustee (or fiduciary). Any remedies that would have been available against the breaching trustee will be available from the 'constructive' trustee — the accessory.

Although accessory liability is limited to personal remedies, it can be even more useful than a proprietary remedy in some circumstances. Specifically, it is of prime importance where the misappropriated property has since been dissipated or lost, since it still makes such a third party personally responsible for repaying the value of the property.

II *First Limb of* Barnes v Addy

A *Receipt of Property in Breach of Trust*

Three requirements must be satisfied to hold a recipient liable in equity:

1 **Breach**
A breach of fiduciary duty must have occurred; it can be dishonest or accidental;

2 **Receipt**
The accessory must actually have received a beneficial interest in some proceed of the breach of fiduciary duty; and

3 **Knowledge**
The defendant must have received the interest with the required mental standard.

The following sections make several preliminary observations about these prerequisites, noting in particular the especial difficulty entailed by specifying the required standard of knowledge.

B *Breach of Duty*

A breach of fiduciary duty arises at the time at which the relevant unauthorised profit is made, or the time the conflict comes into being.

For details of when a fiduciary duty is owed, and what constitutes its breach, see above Part II.

C *Beneficial Receipt*

The proceeds of a breach of fiduciary duty are as diverse as the human whims that motivate their acquisition. They can be money, land, shares or any other type of property, be it personalty or realty.

Someone 'receives' property when they acquire a beneficial interest in it. That is, to have received property, an accessory must obtain it for their own benefit, rather than as agent for another. Agents, such as banks or brokers, do not generally hold beneficial interests in the money they receive, so they cannot be liable as accessories for so receiving it.

Thus, a bank that 'receives' the proceeds of a breach of trust by way of payment into a bank account does not receive a beneficial interest. It cannot therefore be liable as an accessory, without more. However, there are exceptions to this proposition. In particular, when a bank draws upon a deposit for its own personal interest — as by closing an overdrawn account once the overdraft has been reduced by the deposit of trust moneys — the bank will hold those moneys beneficially, and can be said to have received the proceeds of a breach of duty: see *Stephens Travel Service International Pty Ltd v Qantas Airways Ltd* ('*Stephens v Qantas*').

Having established beneficial receipt, the relevant question is then simply whether the bank received those proceeds with the required mental state.

***Stephens Travel Service International Pty Ltd v Qantas Airways Ltd* (1988) NSW CA:**

Facts

- A trust arrangement exists between travel agents and Qantas Airways ('Qantas'), the terms of which require travel agents to hold the proceeds of ticket sales on trust for Qantas until transferred
- Agents bound by the terms of the agreement are obliged to deposit their proceeds of sale into a special trust bank account ('the ticket trust')
- Stephens is a travel agent bound by the agreement
- When Stephens receives money from its customers for tickets, it ordinarily deposits them into a special trust bank account to which Qantas has access
- However, on certain occasions, it pays the money directly into its own general business overdraft account, held with Australia and New Zealand Banking Corporation Ltd ('ANZ')
    - ANZ had known Stephens for many years, it having conducted its banking there for quite some time
    - ANZ also knew about the standard Qantas ticket arrangements, and knew that Stephens was a Qantas agent
    - Indeed, ANZ was itself a Qantas agent, and it was 'fully familiar' with the ticket trust system of payment
- Stephens is in financial trouble and has a large overdraft
- One day, upon receipt of an especially large deposit into the ANZ account, ANZ decides to close the account, bankrupting Stephens
    - Essentially, ANZ closes the account and usurps the money in it by reducing the amount of the overdraft
- Stephens has clearly committed a breach of trust (breach of fiduciary duty)
- ANZ claims entitlement to the money (some $800 000) and refuses to transfer it to Qantas under the terms of the trust agreement (which doesn't bind ANZ)
- Qantas contests ANZ's entitlement to the money, arguing that ANZ had notice of the ticket trust, that Stephens used the ticket money in breach of trust, and that ANZ must therefore account to Qantas for that money

Issue

- Did ANZ beneficially receive the money in breach of fiduciary duty?
- If so, can ANZ be made liable to account to Qantas for the money paid by Stephens into its account with ANZ?

Reasoning

- ANZ had actual knowledge of the breach of trust because its officials were constantly reviewing the bank account's deposits
    - ANZ was fully aware of the standard form terms between Qantas and tis agents
    - ANZ also knew that Stephens' payments into the ANZ account comprised payments for tickets not yet accounted for
    - '**[359]** In these circumstances ANZ must be held to have had notice both of the existence of a trust … and that the use of those moneys by Stephens to reduce its debt to ANZ would be a breach of trust'
    - Stephens had for many years been depositing and withdrawing funds in the manner required by the ticket trust agreement
    - The bank 'obviously knew' that its overdraft to Stephens would be increased when the money was transferred to the ticket trust account
    - Consequently, '**[359]** ANZ had actual notice of the facts which establish that Stephens received the relevant moneys as trustee, that the moneys belonged beneficially to Qantas and that Stephens was bound to account to Qantas for them, that it was a breach of trust on the part of Stephens to use the moneys in

repayment of its debt to ANZ and that a part of the moneys paid into the account after 1 May 1984 were trust moneys belonging beneficially to Qantas'

- In these circumstances, 'facts were "brought home to [ANZ] which shew that to [its] knowledge the money is being applied in a manner which is inconsistent with the trust"' (citing *Consul Development Pty Ltd v DPC Estates Pry Ltd*)
  - The fact that ANZ may not have known the legal consequences of the breach of trust does not mean that it did not know there was a breach of trust
  - It is sufficient that ANZ had notice of the facts which would have the legal consequence of being a breach of trust

- Further, it does not matter that ANZ did not know which part of the $800 000 were trust moneys, and which were not
  - 'It can be appreciated that in practice this situation could give rise to problems for a bank'
  - '**[360]** If however a bank has notice that a customer wishes to pay trust moneys into an overdrawn account in breach of trust, it is quite able, even though it does not know precisely which of the moneys are trust moneys, to require the customer to pay the trust moneys into a separate account and not into the overdrawn account'

- However, there is a qualification to the principle of knowing receipt; it originates in *Gray v Johnson* (1868)
  - If a bank simply obeys 'the order of his customer', it receives no personal interest
  - The banker simply transfers certain sums of money as specified by the customer
  - No balance is struck upon the account; it is simply operated 'in the ordinary way'
  - If the payment of money is a payment for the benefit of the bankers, designed and intended to be the means of payment to the bankers of the debt that might be due to them on the new account', then the bank will be liable as receiver
  - However, if the payment of money is simply in the ordinary course of the account's operation, it will not have been beneficially received by the bank, and will not, therefore, render them liable to account as a receiver
  - Whether this is so is a question of fact

- Here, ANZ was attempting to retain 'what can only be described as the benefit of the moneys which had been paid into the account in the preceding fortnight, some of those moneys belonging to Qantas …'
  - Up until that time, it fell within the *Gray v Johnson* exception, since it honoured the cheques of Stephens drawn on the overdrawn account, even where they increased the overdraft
  - Only in mid-May 1984, when the $800 000 payment was received, did ANZ strike upon the account, closing it up and denying access to the overdraft
  - At that point, the trust money paid by Stephens into the account was 'appropriated to the payment of the balance due in respect of the overdrawn account to ANZ'
  - At that point, it was therefore held beneficially by ANZ
  - Therefore, 'we shold want no more to compel restitution from the bankers, and the case would fall within the ambit of well-settled and firmly-fixed authorities'

Decision

- Yes, the bank beneficially received the money
- Therefore, it will be liable under the receipt limb of *Barnes v Addy*
- ANZ is liable to account to Qantas for moneys received from the sale of airline tickets between 16 May 1984 and 7 June 1984, except to the extent it has already done so

Stephens v Qantas broadly accords with what is noted in *Scott on Trusts* (2nd ed, 1956) vol III, s 324.2:

> *If the bank has actual knowledge that the trustee is misappropriating the trust money in making the deposit, it is liable for participation in the breach of trust. So also if the circumstances are such that the bank ought to know that the trustee is misappropriating trust money in making the deposit in his personal account, the bank is liable. …*
>
> *A different situation arises where the bank has a personal interest in the transaction, as where it seeks to apply the funds deposited with it to an indebtedness of the depositor to it. It is clear that the bank will not be permitted to profit through a misapplication by the depositor of trust funds if the bank has notice of the breach of trust. Where the bank seeks to apply the funds deposited to an indebtedness of the depositor individually to it, it is chargeable with notice that this would involve a breach of trust, although it would not be chargeable with such notice where it had no personal interest in the transaction but was acting merely as a depository.*

These two scenarios correspond broadly to the assistance and receipt limbs of *Barnes v Addy*, respectively. (Although subsequently modified by 'the argument at your Lordships' bar' in *Gray v Johnston*, much remains good law. What is suggested is that a higher standard of knowledge will be required where the bank does not derive a personal (beneficial) interest in the moneys deposited, the matter being one of liability as accessory rather than as recipient.)

More importantly, for present purposes, the bank 'has a personal interest in the transaction' — that is, it has beneficially received the proceeds of the breach of duty. This means that it can be liable as a recipient, rather than as an accessory.

D *Knowledge*

Knowledge refers to the degree to which the third party recipient was aware of the breach of fiduciary duty and the circumstances surrounding it. The law in this area is unclear about precisely what is sufficient to constitute knowledge.

1 *Historical approaches*

There is considerable debate about the standard of knowledge that the secondary party is required to possess of the breaching fiduciary's dishonest or fraudulent design.

Several thousand pages of scholarly and judicial debate about this matter may essentially be reduced to the question: 'what must be the state of mind of the receiver? Must there be actual knowledge of some dishonest or fraudulent design, or will constructive knowledge suffice?' These are simple questions, but admit of no easy answers.

It is perhaps little surprise, then, that judicial treatments of the knowledge requirement are murky, voluminous and lacking in unifying principle. There is no binding High Court of Australia decision on point. Unfortunately, the remaining authorities are most confused.

***Baden Delvaux and Leçuit v Société Générale pour Favoriser le Développement du Commerce et de l'Industrie en France SA* (1983) UK:**

Reasoning (Gibson J)

- With regard to the necessary mental state of a recipient, there are several possibilities:

  (1) Actual knowledge;
  (2) Wilful shutting one's eye to the obvious;
  (3) Wilfully and recklessly failing to make such inquiries as an honest and reasonable person would make;
  (4) Knowledge of circumstances which would indicate the facts to an honest and reasonable person; and
  (5) Knowledge of circumstances which would put an honest and reasonable person on inquiry.

- These five standards of knowledge may further be classified as follows:
  - Categories (1), (2) and (3) encompass forms of actual knowledge
  - Categories (4) and (5) encompass constructive knowledge

The *Baden* taxonomy of knowledge is structured in order of consciousness, ranging from actual, subjective awareness of the breach of fiduciary duty, through to objective suspicion. To these categories of knowledge might well be added:

(6) Complete ignorance.

This latter category serves only to complete the mental taxonomy. It may relevantly be described as encompassing 'no knowledge' for the purposes of recipient liability.

Note that categories (4) and (5) are probably narrower than their 'notice' counterpart in property law. Concepts of notice in property law encompass constructive knowledge even where there are no suspicious circumstances, and permit notice to be imputed from an agent or employee.

Actual knowledge will clearly lead to liability. Suspicion, failures to make enquiries, wilful blindness, and 'naïve though unreasonable blindness' raise far more difficult issues. Whether these latter categories of knowledge will be sufficient to found accessory liability is a subject of continuing controversy.

2 *Subsequent treatments of the* Baden *taxonomy*

Judges like the *Baden* taxonomy since it provides a relatively complete classification of the mental element and clear analytical structure by which to assess it. However, the distinctions between each category can be exceedingly difficult, often impossible, to draw in practice. This fundamental shortcoming should be borne in mind when considering subsequent judicial treatments of the taxonomy.

For example, in *Bank of Credit and Commerce International (Overseas) Ltd v Akindele*, the categories of knowledge were completely rejected by Nourse LJ in favour of a test premised on unconscionability. The test, stated succinctly is:

> *A recipient of property will be liable under the first limb of Barnes v Addy when, having received the property, his or her knowledge is such as to make it unconscionable for him or her to retain its benefit.*

***Bank of Credit and Commerce International (Overseas) Ltd v Akindele* (2000) UK CA:**

Reasoning (Nourse LJ)

- The real debate is whether actual knowledge must be present or whether constructive knowledge will be sufficient
  - '**[231]** Expressed in its simplest terms, the question is whether the recipient must have actual knowledge (or the equivalent) that the assets received are traceable to a breach of trust[,] or whether constructive knowledge is enough.'
  - 'In the Commonwealth, … the preponderance of authority has been in favour of the view that constructive knowledge is enough.'

- The *Baden* categories are unhelpful and should be rejected
  - 'What then, in the context of knowing receipt, is the purpose to be served by a categorisation of knowledge? It can only be to enable to the court [sic] to determine whether … the recipient can "conscientiously retain [the] funds against the company' or … '[whether the recipient's] conscience is sufficiently affected for it to be right to bind him by the obligations of a constructive trustee."'
  - '**[225]** But if that is the purpose, there is no need for categorisation. All that is necessary is that the recipient's state of knowledge should be such as to make it unconscionable for him to retain the benefit of the receipt. For these reasons I have come to the view that, just as there is now a single test of dishonesty for knowing assistance, so ought there be a single test of knowledge for knowing receipt. **The recipient's knowledge must be such as to make it unconscionable of him to retain the benefit of the receipt.**' (emphasis added)

- Strict liability is inappropriate and commercially unworkable
  - 'I beg leave to doubt whether strict liability coupled with a change of position defence would be preferable to fault-based liability in many commercial transactions, for example where, as here, the receipt is of a company's funds which have been misapplied by its directors. … it would appear to be commercially unworkable … that, simply on proof of an internal misapplication of the company's funds, the burden would shift to the recipient to defend the receipt either by a change of position or perhaps in some other way.'
  - Strict liability is an incorrect allocation of risk onto a third party who has transacted with the company in this situation
  - The notion that liability is based on unconscionability is inherently incompatible with strict liability, since a recipient may not be liable on an unconscientiousness test notwithstanding that they have no change of position defence
  - By rejecting both knowledge and strict liability as determinants, liability is influenced by circumstance rather than classification

3 *Australian approaches*

In general, the knowledge requirements adopted by Australian courts may be grouped into three categories. The basis for liability in the case of each is indicated below, along with the corresponding categories in the *Baden* taxonomy (in parentheses):

(a) **Consciousness approach**
Liability is only imposed where the recipient has some form of actual knowledge (categories 1, 2 or 3); there must be a guilty mind or some awareness of

wrongdoing by the recipient: see, eg, *Robins v Incentive Dynamics*;

(b) **Property approach**
Liability is imposed on the basis of actual or constructive (including imputed) notice (categories 1, 2, 3 and 4): see, eg, *ratio decidendi* in *Koorootang Nominees*);

(c) **Restitutionary approach**
Knowledge is irrelevant and the existing tests are unworkable. Any recipient of the proceeds of fiduciary wrongdoing should be strictly liable to return the money to the beneficiary, regardless of whether they knew or even ought to have known of the breach. Liability is strict (imposed regardless of knowledge), subject to equitable defences available on the basis of the property approach: see, eg, *obiter dicta* in *Koorootang Nominees*. This is sometimes referred to as the unjust enrichment approach: see, eg, *Say-Dee Pty Ltd v Farah Construction*.

Further *rationes* may be found in the judgments of English, Canadian and New Zealand courts. Although the restitutionary approach is gradually being accepted, its growth has been paralleled by the rise of a fourth basis of liability: *the unconscionability approach* (see, eg,).

The following sub-sections examine the rationales of cases purporting to apply one of these three approaches.

4 *Restitutionary and property approaches*

In *Koorootang Nominees*, Hansen J expresses a strong preference for the restitutionary approach to recipient liability. Where a third party has beneficially received property at the expense of the principal, in circumstances making it unjust for that benefit to be retained, the third party bears *prima facie* liability regardless of the mental state with which they became a recipient. It is only in relation to the equitable defences that notice becomes relevant.

However, because *Koorootang Nominees* was conducted by the parties on the basis that some mental element is necessary, the case does not provide direct support for the restitutionary approach, instead adopting a broad 'property law' view of knowledge.

Koorootang Nominees Pty Ltd v Australia and New Zealand Banking Group Ltd (1997) Vic SC:

Facts

- Koorootang Nominees Pty Ltd ('Koorootang') is a trustee of the Koorootang trust, a family estate
- One of the company's directors, Jock Jefferies, also happens to operate a business which is in dire financial straights
- Jeffries' financial difficulties stem from the fact that he owes certain moneys to the Australia and New Zealand Banking Group Ltd ('the Bank'), which is seeking further security for outstanding loans
- Jeffries decides to use several of the Koorootang trust assets to provide security for his own personal loans
    - To do so, Jeffries forges the security documents and gives them to the Bank
    - He also lies to the Bank, telling it that he was trustee of a non-active trust
    - The Bank's solicitors prepared the securities accordingly
    - However, during preparation, one of the Koorootang family solicitors told a

solicitor of the Bank that Jeffries was actually a trustee of the family estates
    - The bank's solicitor relayed this information to the bank, and the bank was aware that this contradicted Jeffries' earlier statements that he held no assets on trust
- This is a clear breach of fiduciary duty by Jeffries — a misappropriation of trust assets by a director of the trustee company
- Nevertheless, the Bank processes the security documents and a new mortgage is registered over the trust property
- Jeffries later purports to authorise the Bank to sell shares own by the Koorootang trust, which he directs be paid into his personal business account to reduce their indebtedness to the bank
    - The Bank does so
- The trust seeks to set aside the securities and recover its provided assets
- The Bank concedes that, despite being the registered mortgagee, it will be bound by an exception in s 42 of the *Transfer of Land Act 1958* (Vic) to indefeasibility for an *in personam* claim founded in *Barnes v Addy*, but contests liability on that basis

Issue
- Can the bank be made liable as a third party accessory to Jeffries' breach of duty?

Reasoning (Hansen J)
- There are three competing approaches to the principles underpinning recipient liability
    - ***Property approach***: based on equity's concern for the protection of equitable estate sand interests in property
        - Third parties will be liable when they have 'notice' of the beneficiary's interest
    - ***Conscience approach***: third party liability is premised upon equity's concern for the avoidance of unconscionable conduct
        - Third parties will be liable whenever they have such knowledge as to make it unconscionable for them to retain beneficiary property
        - This encompasses a wider spectrum of mental states than the property approach: at least (1)–(3), and possibly (4) in some instances
    - ***Restitutionary approach***: third parties' liability is based on the avoidance of unjust enrichment

- The restitutionary approach should be adopted
    - '**[100]** There is considerable persuasion in the third view of recipient-liability.'
    - '**[105]** I favour the view that the liability of a recipient of trust property is restitution-based.'
    - Under this approach, the recipient's knowledge is not relevant to determining liability as an accessory
    - Instead, the beneficiary is *prima facie* entitled to restitution if the transaction was vitiated by some 'unjust' factor (eg, beneficiary's ignorance of the trustee's misapplication of trust property)
    - At that point, attention then turns to the recipient's defences
    - All that need be shown is:
        - Enrichment of the defendant (here, the receipt of trust property as security for Jeffries' debt);
        - At the expense of the plaintiff (here, Koorootang, which lost unencumbered title in the trust property); which is
        - Unjust because of some recognised factor
    - The unjust factor will normally be the plaintiff's ignorance of the transfer of his or her asset to the defendant
    - Here, that factor is Koorootang's ignorance of the transfer of assets to the bank
    - One those elements are established, the onus falls upon the defendant to

establish a defence such as change of position

- If the restitutionary approach is accepted, there is a strong argument that the liability of a recipient should be strict; however, this point is not decided
    - A strict liability approach would mean that any third party who receives property is *prima facie* liable as constructive trustee, subject to certain defences, including:
        - Where the third party is a *bona fide* purchaser for value without notice of the beneficiary's prior equitable interest
        - Good faith change of position
    - The strict liability approach is now favoured, to some extent
    - However, Koorootang conducted its case on the basis that some degree of knowledge is necessary
    - '**[105]** Therefore, in light of the way the case was conducted by the plaintiff, I leave for another day a determination of the issue whether liability under the first limb of *Barnes v Addy* is strict.'

- Under a restitutionary approach, the knowledge of the third party defendant is not initially relevant: it is only relevant to defences, going towards '*bona fide*' and 'without notice' in relation to the purchaser for value defence, and 'good faith' in the change of position defence

- This basis also draws a distinction between mental requirements for liability under limb one (strict liability) and limb two (clearly not strict) of *Barnes v Addy*
    - '**[105]** I am persuaded both as a matter of principle and of precedent that a distinction does and should exist between the criterion for accessory liability and that of recipient liability. In my opinion, given the nature of those two claims … there are strong grounds supporting the existence of a rational and principled distinction between the two limbs of *Barnes v Addy*.'
    - 'In my view, that distinction is represented by the proposition that it is not necessary to establish that the defendant acted dishonestly or with a want of probity in order to establish his liability as a recipient of misapplied trust property.'
    - 'In my judgment, recipient liability may be established when the defendant had constructive knowledge at the time he received the relevant property that (a) it was trust property and (b) it was being misapplied. I take "constructive knowledge" in this context to mean knowledge falling within any of the first three categories of knowledge defined by Peter Gibson J in *Baden*.'
    - 'I think too that knowledge falling within the fourth category may likewise constitute the requisite constructive knowledge, for the difference between the categories are [sic] matters of degree in which there may be blurring at the edges.'
    - 'I do not think that knowledge in category five is sufficient, on the assumption that cases in that category are properly to be characterised as ones where the defendant is guilty only of mere carelessness. Of course, if recipient liability truly is strict, then this characterisation of knowledge would be irrelevant to the establishment of *prima facie* liability.'

- From this discussion, the requirements may be summarised thusly — what is required is:
    - Enrichment of the defendant (ie, beneficial receipt of property)
    - At plaintiff's expense (ie, property belonging in equity to the plaintiff)
    - Which is unjust (ie, misdirection of funds without the plaintiff's knowledge)
    - Liability is strict because in this scenario the requirements will always be met regardless of the defendant's mental state

  - However, the defendant can plead a number of defences, which do depend on knowledge
  - In the context of the defences, notice includes:
    - Actual notice, encompassing:
      - Wilful blindness;
      - Contrived ignorance; or
      - Deliberate abstinence from enquiry; and
    - Constructive notice
      - Notice of facts that would have been discovered had the party taken proper measures to discover them
      - Especially if certain facts are known which put the party on enquiry, and the party fails to make the enquiry or to make reasonable steps to verify the situation
      - However, does not include mere carelessness

- In short, the first limb of *Barnes v Addy* does not need dishonesty or want of probity
  - When pleading a defence, notice seems to encompass (1)–(4) on the *Baden* scale (though mere carelessness, category (5), is not enough)
  - This is based on traditional knowledge principles, but is a kind of extended conscience approach (normally (1)–(3), but this includes (4))

- Application to the facts
  - The Bank knew (had actual knowledge) that the mortgaged property was trust property
  - At the time the mortgage was executed, the Bank was wilfully blind to the fact that the property was being misapplied by Jeffries
  - At the very least, the bank had constructive knowledge of the breach of trust by reason of its 'wilful and reckless failure to make the inquiries about that matter which an honest and reasonable banker would have made in the circumstances'
  - A reasonable banker in the position of the Bank here would have furthered enquired about the status of the properties after having been told by its solicitor that Jeffries was a trustee of an active trust, especially when this information revealed earlier statements by Jeffries as lies, and when the Bank knew that he was in debt
  - At the minimum, the Bank should have asked Jeffries to explain the conflicting information
  - If Jeffries had simply said that Koorootang used to hold the assets on trust, but not any more, the Bank should have demanded proof
  - It did none of this
  - Instead, knowing as it must have that Jeffries had been lying to it, the Bank could not honestly explain the basis on which property was held, and proceeded with registration of the mortgage recklessly failing to make those inquiries, that were reasonable in the circumstances
  - The bank was not simply 'honestly confused'
  - It acted with want of probity

<u>Decision</u>

- The Bank is liable as accessory because:
  - It had actual knowledge that Jeffries' property was actually trust property; and
  - By wilfully and recklessly failing to make inquiries about the property, it had 'at least constructive knowledge' that the property was being misapplied
  - The Bank actually acted dishonestly and can therefore not rely on the mortgage securities in its favour
- The Bank's actual or constructive knowledge is sufficient for Koorootang to establish an

in personam claim under *Barnes v Addy*, so as to impeach its indefeasibility of title
- What must be shown is actual or constructive knowledge that
  - the property was trust property; and
  - it was being misapplied
- Constructive knowledge means 'wilfully shutting one's eyes to the obvious; wilfully and recklessly failing to make such inquiries as an honest and reasonable person would make and knowledge of the circumstances which would indicate the facts to an honest and reasonable person'
- However, constructive knowledge does not include 'knowledge of the circumstances which would put a reasonable person on inquiry'
- This knowledge must be possessed at the time of receipt

It is at least arguable, in relation to the bank cases, that a recipient bank should not be liable as an accessory unless it has category one (actual) knowledge. The rationale for such an approach is pragmatic: banks receive property all the time, so to impose strict obligations to verify the source of the money, make reasonable inquiries, and follow up suspicions would add significantly to transaction costs and hinder the workings of commerce. However, this does not appear to have been the approach adopted in *Koorootang Nominees*, which imposes the same burden on banks as other recipients.

Nevertheless, where the bank has not usurped the money for its own benefit, the exigencies of commerce rule may apply, as noted above in relation to the issue of receipt (*Stephens v Qantas*). If the bank has not beneficially received the funds, but instead acted as its mere conduit, it will be exempted from third party liability unless it has actual knowledge of the misapplication. By contrast, once it is accepted that property has been received by the bank for its own benefit, this rule will not apply and banks will not, as a result of *Koorootang Nominees* and *Stephens v Qantas*, receive any special treatment.

5 *Consciousness approach*

In *Robins v Incentive Dynamics Pty Ltd (in liq)*, Mason P considers that it is unnecessary to decide the issue of knowledge. On the facts, the recipient has actual knowledge of the breach, since the breaching fiduciaries are themselves directors of the recipient.

Although dealing with an unusual situation, *Robins* highlights how useful the doctrine of accessory liability can be in enabling wronged corporate principals to recover property lost in a breach of its directors' duties from another party when the primary fiduciaries are insolvent.

***Robins v Incentive Dynamics Pty Ltd (in liq)* (2003) NSW CA:**

Facts
- Incentive Dynamics Pty Ltd ('I Co'), is controlled by the Robins, who subsequently become bankrupt
- The Robins are also majority shareholders in Coldwick ('C Co')
- The Robins gift some of I Co's money to C Co, which uses the money to purchase two parcels of real estate; one in South Melbourne, the other in Crows Nest
- No interest is paid to I Co and no attempt is made to recover the money
- Essentially, the Robins are shifting funds from one company they control to the other
- However, as directors of I Co, the Robins still owe fiduciary obligations to it as a separate entity, and can't give its money away

    - The Robins are therefore in breach of their fiduciary obligations
- However, the Robins are bankrupt and therefore unsuitable as defendants

Issue
- Can C Co be made liable as constructive trustee for being a recipient of property in breach of duty?

Reasoning (Mason P)
- '**[297]** The recipient cause of action may generate a personal obligation to make restitution with interest of moneys received. In a proper case the unjustified receipt can also be made the springboard for a proprietary claim such as a (remedial constructive) charge or trust'
- '**[298]** The principles relating to the "knowing receipt" of trust property limb of the rule in *Barnes v Addy* are in considerable flux … [however, t]his appeal is not the proper vehicle to plunge into these murky waters.'
- This is because knowledge is here clearly established
    - Regardless of whether notice, actual or constructive knowledge, or neither is required, C Co here had actual knowledge of the breach through its officers
    - The Robins engaged in transactions that were 'from start to finish an improper diversion of [I Co's moneys] in favour of a body which, through its directors was complicit in and privy to the impropriety'
    - Thus, where officers of a recipient company have actual knowledge of the circumstances in which money is paid, the company itself will be deemed to have actual knowledge of those circumstances, and such company can be liable as a recipient
- In these circumstances, it would be unconscionable for C Co (and its shareholders) to retain any benefit from the improper receipts

Decision
- Because Coldwick had actual knowledge of the breach of fiduciary duty by the directors of Incentive Dynamics, it is liable as an accessory for receipt of the property from them
- Further, it being unconscionable to retain the benefit of this property, Coldwick holds the property on constructive trust for Incentive Dynamics

6 *The trend towards strict liability*

Say-Dee Pty Ltd v Farrah Constructions Pty Ltd ('*Say-Dee v Farrah*') is an example of the emerging standard of strict accessory liability. Supported by the academic writing of scholars such as Peter Birks and Michael Bryan, and mirroring the upward trend of the second limb of *Barnes v Addy* liability, the case law appears to be moving further towards the acceptance of such a standard.

In *Say-Dee v Farrah*, the Court of Appeal of the Supreme Court of New South Wales expressly adopts a restitution-based approach, taking the preference expressed in cases like *Koorootang Nominees* and *Lipkin* one step further. Although not binding on Victoria, *Say-Dee* is an interesting indication of current trends. It is currently on appeal to the High Court.

Say-Dee Pty Ltd v Farah Constructions Pty Ltd (2005) NSW CA:

Facts
- Say-Dee Pty Ltd ('Say-Dee') is a company owned and operated by Ms Dalida and Ms

Sadie, neither of whom has any prior experience in property development
- Farrah Constructions Pty Ltd ('Farah') is a company controlled by Mr Farah, an experienced real estate developer
    - Note: confusingly, Farah's surname is 'Elias', the same surname as Dalida and Sadie; they are, however, unrelated
    - [First names are here adopted to avoid confusion]
- Say-Dee and Farah enter into a joint venture agreement to develop certain land at 11 Deane Street, Burwood
    - Under the arrangement, Say-Dee provides finance while Farah is responsible for the development application, construction and sale of the units
    - Profits will be divided equally upon completion of the project
- Having lodged the development application, Farah becomes aware that the council will refuse to grant approval for the project unless the group acquires the adjoining properties, since the single property is too thin for the proposed development
- Consequently, Farah coopts his wife and two daughters into purchasing the neighbouring properties, numbers 13 and 15 Deane Street
    - Their names are on title, but they are essentially agents for Farah
- Say-Dee now discovers Farah's purchase of those properties, and commences proceedings seeking their recovery from Farah's agents
- Say-Dee argues, and it is conceded, that Farah owed fiduciary duties to Say-Day; the issues is those of scope, remedies and accessory liability
    - Say-Dee argues that in failing to disclose the opinion of the Council, and by subsequently exploiting that information to acquire numbers 13 and 15, Farah was in breach of his fiduciary duties

Issue
- What is the scope of Farah's fiduciary duties?
- Can Say-Dee obtain an *in personam* remedy against Farah's agents such as to impeach their otherwise indefeasible title and so obtain ownership of the adjacent properties?

Reasoning
- Trial judge (Palmer J):
    - On the facts, it was more probable than not that Farah had actually disclosed to Dalida and Sadie his proposed acquisition of numbers 13 and 15
    - Further, inviting Say-Dee's assistance in any further (even adjacent) development was beyond the scope of his duties as fiduciary
    - Consequently, Farah was under no fiduciary duty to disclose to Say-Dee the opportunity to acquire the neighbouring properties, nor was it prohibited from acquiring those properties for itself

- Court of Appeal (Tobias JA; Mason P and Giles JA agreeing):
    - As a matter of fact, Farah did not disclose to the acquisition to Dalida and Sadie, nor did he invite their participation
    - Even if he did, this would still have been a breach of fiduciary duty: there was no fully informed consent to the acquisition and the reasons for it (to maximise the development potential of number 11)
    - When Farah used the Council information without the principals' fully informed consent, he breached his fiduciary duty
        - There was a conflict: between his interest as purchaser of 13 and 15 and his fellow joint-venturers, since his acquisition of those properties was antithetical to the purpose of the joint venture
        - There was a profit: Farah misused information obtained in his capacity as fiduciary to reap a personal gain
    - Further, the subject matter of the joint venture was 'the redevelopment of No 11

with a view to maximising profit'
    - Thus, Farah's fiduciary obligations did extend to disclosing 'fully and accurately to Say-Dee all matters pertinent to any such redevelopment'
    - This included the Council's rejection of the application, and the need to acquire the neighbouring properties: [177], [197]

- The fact that Say-Dee would probably have been unable to purchase the property for itself is irrelevant: *Brickenden*; *Boardman v Phipps*
    - It is irrelevant that Say-Dee may have declined to purchase the extra properties even if they were informed about the properties
    - (Despite the fact that they probably could not have afforded them)
    - This is similar to *Boardman v Phipps*: the capability of the principal to benefit from the breach is irrelevant

- More importantly, for present purposes, the agents of Mr Farah — his wife and two daughters — are recipients within the first limb of *Barnes v Addy*

- Required mental element:
    - Personal dishonesty is unnecessary: even on the accepted view of things, actual or constructive knowledge will suffice
        - This includes imputed knowledge
    - Here, the knowledge of Farah, acting as agent, is imputed onto his wife and daughters
        - Farah had actual knowledge of the breach of trust (or, the facts constituting that breach), since he himself committed it
        - Farah acted as agent for the recipients in purchasing property in their names
        - Therefore, Farah's knowledge can be imputed to the recipients
    - However, regardless of the outcome in relation to knowledge, the unjust enrichment approach should determine liability
        - '**[229]** The principles which deeply underlie equity suggest that a restitution-based remedy must have some basis in the position in conscience of the person against whom it is awarded so that **it must be shown that a recipient did not** receive the **payment for value or** had notice of another person's equitable interest in the money; or at the very leas, it should be open to him to show that he did give value and had no notice.' (emphasis in original)
        - '**[230]** … where the recipient is *not* a purchaser for value the first limb in *Barnes v Addy* may be satisfied without the necessity to establish actual or constructive knowledge.'
        - '**[232]** But in the absence of any High Court authority to the contrary, I see no reason why the proverbial bullet should not be bitten by this Court in favour of the Birks/Hansen approach. In my opinion there is support for the adoption of the restitutionary approach in *Lipkin* … and in the exposition on the subject by Hansen J in *Koorootang*'
    - A person can be a recipient within the first limb of *Barnes v Addy* even without actual, constructive or imputed knowledge of a breach of fiduciary duty

- Defences are not satisfied:
    - Farah's wife and daughters received title without paying anything; consequently, they cannot argue that they are *bona fide* purchasers
    - Good faith change of position
        - If the defendant has changed its position on the basis of receiving the property, in good faith, it will be protected

- Eg, taking out a loan and purchasing a house on the basis of a good faith assumption that money would be received (if the property was lost, indebtedness would be retained, and the party would be exceedingly disadvantaged)
- However, that cannot be made out on the facts of this case

Decision

- Yes, the wife and daughters are liable and their interest in numbers 13 and 15 will be held on constructive trust for the joint venture
- Thus, personal liability is imposed, supported by a proprietary remedy
- The third parties are treated as if they themselves were the breaching fiduciaries
- An allowance for Mr Fariah's entrepreneurial skill will be made, but it will not be liberal (cf *Boardman v Phipps*): [249]

The line of authorities beginning with *Lipkin*, Say-*Dee* and *Koorootang* may be summarised as follows:

> *Recipient liability is restitution-based; accessory liability is not.*

Exam note: be prepared to argue about the different results reached by different approaches.

If there is clear actual knowledge, mention that the precise standard is unimportant. There would in such a case be no need to resolve the authorities. However, if there is only partial knowledge or suspicion, it is very important to consider and apply the different authorities, including strict liability.

Note any differences in the result and predict which would (or ought to) be applied.

E *Summary of Authorities*

The following table summarises the standards of knowledge that have been required of defendants in recipient cases during recent years in Australia and the United Kingdom:

Decision	Case type	Required knowledge	Knowledge on facts	Result
Barnes v Addy	Solicitor acting as agent for breaching client	Actual or constructive	None	Not liable
BCCI	–	Irrelevant; unconscionability is determinative	–	–
Stephens	Bank benefiting from deposit in breach	Actual or constructive, including suspicion	Constructive	Liable
Koorootang	Bank receiving security in breach	None; strict liability, subject to defences	Actual	Liable
Incentive Dynamics	Company receiving transfer from breaching party	–	Actual	Liable
Say-Dee	Family receiving in breach of joint-venture	None; strict liability, subject to defences	Imputed	Liable

F *Theoretical Analysis*

This section addresses the issue of what, if any, is the preferable criterion upon which to hinge the liability of recipients of property in breach of duty.

1 *Traditional approaches: fault-based liability*

Bare receipt will not, without more, give rise to personal liability. Some personal fault is necessary. Equity treats guilty recipients as burdened with personal duties of trusteeship, by which recompense must be made to the beneficiary.

Actual or constructive notice: at least (1) to (4) on *Baden* scale, currently recognised
Stephens
Koorootang (but note dicta)
Robins v Incentive Dynamics

Unfortunate terminology: constructive trustee (proprietary vs personal), notice (property vs equity): apt to confuse, liable to import the common law into equity, respectively.

Degree of fault conceptually unclear and difficult to analyse in practice: 'bedevilled by an obsessive refinement'. At a practical level, often difficult to adduce evidence capable of establishing mental state with the required specificity — a problem hardly isolated to personal liability in equity.

Megarry V-C criticised the 'cold calculus of constructive and imputed notice': *Re Montagu's Settlement Trust*.

2 *Lord Nicholls' view: strict liability*

Lord Nicholls has argued that fault-based approaches should be eschewed in favour of blanket liability upon recipients — knowingly or not — of trust property. Under this approach, volunteers would receive property at their peril. Restitutionary in nature: restoring an unjust gain, subject to defences.

His Lordship's justification for such an expansive view of recipient liability is that justice requires 'at least in some circumstances' the return of money notwithstanding that its recipient is blameless.

With great respect, the caveat 'in some circumstances' ought bear further prominence. Injustice in a minority of cases is no reason to impose a rigid and inflexible rule that may lead to substantial injustice in the majority. Equity is, after all, a flexible jurisdiction focused on justice *civilis et naturalis* — in individual cases.

All this approach does is to defer assessment of culpability to the conceptual structure of unjust enrichment: namely, can the facts be construed (or manipulated) so as to bring them within a recognised blueprint for restitutionary relief? Restitution will be granted when retention of the property is in 'all the circumstances inequitable': *Lipkin Gorman* (Lord Goff). However, this simply restates the underlying question — whether retention of the trust property would be *unconscionable*. The fact that it brings the law of knowing receipt into closer alignment with that of unjust enrichment — with its common law origins in an action for money had an received — is not sufficient reason for its adoption.

Certainly, no reason is provided for why strict liability is better equipped to deal with these difficulties than the more nuanced and morally proportional position of unconscionability. I fear

that, in his Lordship's attempt to craft broad rules of general application, Lord Nicholls overlooks the very basis of equitable relief.

Difficult to articulate a rule of sufficient breadth and certainty to cover the many circumstances in which third parties will receive property in breach of trust or fiduciary duty.

Rather than make the attempt, appears to argue for the simplest and least nuanced rule possible: strict liability. Although clear and certain, it represents, respectfully, a simplistic, clumsy response to a complex and nuanced problem. One need only look to the unworkability of the change of position defence — a would-be safeguard against injustice — to see that this is so.

Change of position insufficiently broad to protect recipients from injustice. Subject to its own arbitrariness and conceptual difficulties. Eg, consider two wrongful distributions: one to a party who, knowing that she is not so entitled, immediately purchases property subject to a mortgage; the other, an innocent though conservative party who does nothing with the money. Why should the former recipient — who has inequitably relied upon her own dishonesty — be protected from liability, but the honest party be made to disgorge the gain? Prescient are the comments of the HCA in *Warman*, which, though made in another context, remind us that certain equitable remedies should not be transformed into vehicles for the unjust enrichment of the plaintiff.

The problem is this: given that the recipient's attitudes toward receipt are irrelevant, why look to their conduct at all? If, at its widest, change of position involves assessing the comparative fault of recipients, surely it simply restates the question once again, and arguably marks a return to fault-based liability. If, on the other hand, it offers a mechanical set of arbitrary rules by which to deprive an innocent recipient of property, then it might rightfully be questioned whether this marks a return to the days in which one's 'equity' was measured by the Chancellor's foot.

3 *Thomas' view: unconscientious receipt*

Thomas suggests that the true question is whether retention of property by its recipient would be unconscionable. Recipient liability becomes predicated upon circumstance rather than classification or rigid application of a rule. A form of fault-based liability: a more explicitly normative evaluation.

More flexible, circumstantial. Provides sufficient conceptual framework while exposing more directly judicial value judgments. Context-sensitive: different standards depending on whether the recipient is a bank, director, *de facto* spouse or inexperienced investor. Makes deterrents against wrongful conduct tailored and proportional to the likelihood and effect of a breach of duty. Of course, much depends on the precise meaning to be accorded to the term.

What, then, is the content of unconscionability? Courts have a ready platform, viz, unconscionable dealing, estoppel — and, yes, restitution — upon which to build. Thomas suggests it should be understood in economic terms: where the recipient could have taken effective precautions to prevent the breach but didn't. Although one possible answer, Thomas' approach seems unconvincing for its tendency to distort *human* values in equitable fraud by the cold hand of economic morality, producing results incongruent with community values and employing analysis insensitive to social issues.

Regardless of the content that is to be given unconscionability, it remains a better candidate than either of the knowledge or strict liability approaches.

The analogy with restitution becomes especially tenuous if one accepts Lionel Smith's rejection of any equitable title-based personal claim founded in unjust enrichment. On this view, the only remaining view of knowing receipt is that it is an independent equitable wrong — something Lord Nicholls himself admits — not an equitable mirror of the common law.

The content of 'inequitable' retention under a restitutionary approach has essentially been limited to ignorance of the transaction. This is a narrow view of knowing receipt, one more suggestive of artificial categorisation for purposes of unjust enrichment than of any principled analysis. By contrast, the 'unconscionability' conception advanced by Smith and Thomas calls for broader and more detailed analysis processes and outcomes of a transaction, and is therefore to be preferred.

Nourse LJ noted in *BCCI v Akindele* that strict liability represents an incorrect allocation of risk onto third parties transacting with breaching fiduciaries. I agree. By contrast, a test with unconscionability as its touchtone would place the onus on the plaintiff to show that retention is unconscionable. Some might argue that this is excessively harsh upon wronged beneficiaries, but I suggest that it is more commercially sensible than the alternatives, and that the evidentiary burden posed by unconscionability may not be as insurmountable as a knowledge-based criterion.

4 *Opinion of the author*

In my opinion, all three approaches are unworkable and should be rejected in favour of a broad unconscionability approach. That is … . It is only by predicating accessory liability upon a general normative standard of unconscionability that courts of equity will have sufficient flexibility to make liability reflect the moral blameworthiness of a recipient.

Instead, what courts have hitherto done is muddy the *Barnes v Addy* principle by fixating on broad requirements of general application. But if universal rules are the purview of the common law, surely flexibility and conscience are hallmarks of equity. Given the course of the law's development in this area, it is somewhat ironic, and of significant prescience, for Lord Seldon LC to have noted in *Barnes v Addy* that 'there is …'.

Perhaps unjust enrichment has a role to play in giving content to the concept of unconscionability. Ie, unconscientious to retain when a third party is unjustly enriched at the expense of the principal. But concepts of unconscionability are necessarily broader than 'unjust' retention. Recipient liability goes beyond even the breadth of unjust enrichment, subject however to counter-arguments broader than the narrow and relatively inflexible defences of BF and COP.

Consequently, I offer unconscionability as the paragon of recipient liability. Whether this is understood as a gloss on restitutionary principles or an entirely new, more flexible way of looking at third party transactions is largely a matter of terminology. However, whatever view is adopted, it is important to recognise the inherent flexibility … required to adapt equitable doctrines to changing commercial and social environments.

Possible objection: construction of broad concepts too widely shaped by personal values, therefore commercially uncertain and liable to marginalise historically disadvantaged groups. Two counter-arguments: such influence inevitable; broad concepts in equity bring underlying assumptions into the spotlight better than a rigid conceptual framework, which tends to conceal and justify rather than expose and clarify (see *Louthe v Diprose*).

5 *Conclusion*

No single approach is wholly satisfactory. As Lord Nicholls has remarked, each will produce an unattractive result in some situations. The focus must therefore be on adopting an approach that is (i) reasonably certain; yet (ii) flexible enough so as to admit of nuanced application. It is submitted that unconscionability provides the most workable standard for assessing the liability of recipients.

As a concept of increasingly certain content and broad consistency with equitable aims, it seems best able to balance the legitimate expectations of third parties against the rights of wronged beneficiaries to recompense.

One need only look to the shortcomings observed of knowledge-based criteria in adapting to the multifarious circumstances in which property is received to realise that a blanket rule would pose even greater difficulties. However, an unconscionability criterion

III *Second Limb of* Barnes v Addy

A *Knowing Assistance in Breach of Duty*

The second limb of *Barnes v Addy* is described as 'knowing assistance'. It arises when someone other than the fiduciary or their principal facilitates the breach to occur, doing so with some level of mental culpability.

It may be observed immediately that a different knowledge element is required to the first limb. In general, a higher (more culpable) mental standard is required, because the third party is only indirectly involved with the breach — an ancillary offender — and has not actually received its proceeds. A higher standard protects innocent third parties who happen to have been involved in the breach — for example, banks and other intermediaries — by requiring some complicity in the primary wrongful conduct.

However, like the situation faced under the first limb, the knowledge requirement again proves difficult to articulate and apply. Three approaches have emerged from the case law; with these are dealt below.

1 Actual or constructive knowledge

Accessory liability will attach even though no trust property reaches the secondary party's hands; nor is it necessary that the defaulting fiduciary be a trustee (*Consul Development Pty Ltd v DPC Estates Pty Ltd*). What is required is actual or constructive knowledge of a breach by the primary party. It is not sufficient that the facts were such as to put a reasonable person on enquiry. However, it is not necessary that there be subjective awareness of the breach itself.

Consul Development Pty Ltd v DPC Estates Pty Ltd (1975) HCA:

Facts
- Walton is a director of DPC Estates Pty Ltd ('DPC'), a company engaged in property development
- Grey is an employee of DPC
- Walton also operates a law firm, in which is employed Clowes, an articled clerk
- Grey discloses confidential information to Clowes about the existence of certain real estate suitable for development by DPC
- However, Grey tells Clowes that DPC is not interested in the properties because it cannot afford them
- Clowes and Grey therefore agree to acquire the property themselves for their own advantageous development and share profits thereby accrued
- Clowes, through Consul Development Pty Ltd ('Consul'), purchases the property
- Walton discovers the purchase and claims that Clowes' company, Consul, holds the property on constructive trust for DPC

Issue
- Grey is clearly in breach of the fiduciary duties he owes to DPC; however, can Clowes be personally liable for having knowingly assisted in the breach of duty?

Reasoning
- McTiernan J (dissenting):
  - Clowes' company should be liable, even if this means relaxing the standard of

the mental element to category five
    - 'In my opinion the arm of equity is not to be foreshortened to make it incapable of dealing with underhand transactions entered into by persons in a fiduciary capacity with the encouragement of those who stand to gain from such conduct.'
    - 'It is, I think, sufficient to warrant equitable relief against a third person that he has undermined the loyalty of an agent with a fiduciary obligation'
    - This appears to be a very stringent standard: undermining a fiduciary obligation is seen as a freestanding equitable wrong, akin to the tort of interference with the performance of a contract

- Gibbs CJ:
    - The question here is whether the *Barnes v Addy* principle applies to impose liability on strangers who knowingly participate in a breach of fiduciary duty'
    - The doctrines of accessory liability serve two purposes
        - Maintaining the high standard of fiduciary conduct owed by fiduciaries by deterring other persons from assisting in their breach
        - Upholding equitable principles by preventing a third party from retaining a benefit obtained from assistance in a breach of fiduciary duty
    - It is consistent with these objectives to whole a person 'who knowingly participates in a breach of fiduciary duty' liable to account to the principal for any benefit thereby obtained
    - However, it would be going too far to impose liability on a fully objective basis
        - Even if the circumstances would have put a reasonable person on inquiry, this will not attract secondary liability as an assister
        - That is, mere carelessness is insufficient
    - Nevertheless, if liability were imposed only if the party is consciously aware of actual wrongdoing, this would be too strict
        - If the secondary party's assistance is anything but innocent — if, for example, she wilfully shut her eyes to the obvious — then liability will attach
        - A person will not escape liability just because of 'his own moral obtuseness'
        - That is, actual knowledge is unnecessary; constructive knowledge is sufficient
    - This approach provides *possible* support for a test encompassing *Baden* categories one through four
    - However, on the facts, Clowes did not know that what Grey was doing involved a breach, so had no knowledge at all
        - On the facts Clowes believed to exist, Walton did not want to buy the property
        - This meant that, as far as Clowes was concerned, there was no possibility of a conflict between interest and duty: the property was 'removed from the ambit of his duties'
        - This is so notwithstanding that he 'might have been lacking in candour, and perhaps in moral sensibility, in acting behind Walton's back'
        - In these circumstances, a reasonable person would not suspect that Grey was acting in breach of his fiduciary duty in purchasing the properties
        - Certainly, Clowes did not knowingly participate in Grey's breach
        - No honest and reasonable man would have thought it necessary to enquire further
        - Therefore no secondary liability attaches to Clowes

- Stephen J (Barwick CJ agreeing):
    - Excludes category (5) knowledge, but possibly includes category (4)

- 'If D knows of facts which to a reasonable man would tell of a breach' this is sufficient for liability (category four)
- 'Consul will only be liable … if recourse may be had to the doctrine of constructive notice and if, by that means, Clowes, and through him Consul, may nevertheless be treated as if they had that knowledge of Grey's breach of fiduciary duty which they in fact lacked'

- However, to go further would be to disregard equity's concern for the defendant's state of knowledge (category five insufficient)
- Here, Clowes believed that the solicitor's firm was not in the market for the properties (through the independent evidence and Grey's statements)
- Obviously this is no excuse for Grey's own breach, for which Grey will definitely be liable
- However, it does mean that Clowes didn't consciously know of the breach (this is somewhat questionable given his knowledge of the law as an articled clerk)
- It also means that he could not be expected to have known, and will therefore not be liable as an assister
  - 'In my view the law, as it now stands, did not require Clowes to make any further inquiries once he believed that the Walton Group was not in the market for the properties'
  - '[A] reasonable, honest man would not, in my view, have had knowledge of circumstances [suggesting a] breach of fiduciary duty by Grey'

Decision

- Actual or constructive knowledge is necessary for third party liability as an assister
- Here, Clowes is not liable as a third party because he did not have actual or constructive knowledge of Grey's breach

It is unclear why *Consul* was not argued on the basis of the first limb of *Barnes v Addy*, which imposes lower standards of mental culpability. On the face of it, the case certainly seems apt to be dealt with by the knowing receipt limb, Clowes' company having actually acquired the properties and retained them beneficially.

The Court seems to be reasoning that the property the subject of the breach was actually the confidential information (that the properties existed and were suitable for profitable development). The subsequent use of that information by Clowes to purchase those properties was secondary conduct that assisted in the breach, rather than a retention of its proceeds. However, as Sarmas notes, and I agree, this is arguably a far too narrow view of first limb liability.

2 *Dishonesty test*

Royal Brunei Airlines Sdn Bhd v Tan **(1995) Privy Council:**

Facts

- Royal Brunei Airlines ('the Airline') appoints BLT Co as agent for the sale of its tickets
- Tan is the managing director and principal shareholder of BLT Co
- Under the agreement, BLT is to hold the money from ticket sales on trust for the Airline until an account is made to the plaintiff (superficially similar to the arrangement employed in *Stephens v Qantas*)
  - The money should therefore have been held in a trust account independently from BLT's own day-to-day chequing account

    - In fact, BLT pays the money into its ordinary account and, in breach of trust, uses the money for other purposes
- Eventually, BLT becomes insolvent and fails to account for its sales to the airline
- The Airline brings proceedings against Tan for assisting in BLT's breach of duty
    - It does so to pierce the corporate veil and obtain a personal remedy from a solvent party
- It is beyond dispute that the defendant participated in the breach and had actual knowledge
- Court of Appeal of Brunei:
    - Tan is not liable because it was not established that BLT was not guilty of fraud or dishonesty itself; ie, he did not intend to defraud the Airline
    - Applying *Barnes v Addy*, the requirement of 'assisting in a dishonest or fraudulent design' is not met, so second limb liability cannot be invoked

Issue

- What mental state required of the secondary party to a breach?
- Is Tan liable for having assisted in BLT Co's breach of fiduciary duty?

Reasoning

- There are several possibilities when considering the required mental standard
    - No liability
    - Strict liability
    - Fault-based liability
    - Unconscionability
    - Dishonesty
    - Negligence

- No liability must clearly be rejected: at 386–7
    - If a third party deliberately interferes in a trust relationship by assisting the trustee to deprive the beneficiary, the beneficiary should be able to recover from the third party as well as the trustee
    - The availability of a remedy against the third party serves dual purposes
        - Making good the beneficiary's loss if the trustee is insolvent
        - Imposing liability to deter others from behaving in a similar fashion

- Strict liability can also be rejected out of hand: at 387
    - The law has never gone so far as to impose liability upon third parties who have no knowledge, or any reason to suspect, that a breach of trust has been committed
    - This is because accessory (assister) liability is concerned with the liability of a person who has not himself received any property
    - 'His liability is not property-based. His only sin is that he interfered with the due performance … of the fiduciary obligations'
        - Because such obligations are personal (like contractual obligations), the remedy should also be *in personam*
    - Ordinary commerce would become impossible if third parties could be liable for '*unknowingly* interfering' (emphasis in original) in the due performance of personal obligations
    - Beneficiaries are not entitled to expect that third parties will bear the risk of default by the fiduciary, even where they receive no property and had no way of knowing that they were dealing with trustees

- Fault-based liability: at 387–9
    - It is obvious that some accessory liability exists; identifying the 'touchstone of

liability' is the real issue
    - There has been considerable disagreement about the precise level of fault required
    - In general, however, three approaches emerge:
        - Dishonesty (actual or constructive knowledge)
        - Negligence (carelessness)
        - Unconscionability

- 'By common accord dishonesty fulfils [the role of touchstone]'
    - Acting dishonestly means 'not acting as an honest person would in the circumstances'
    - 'This is an objective standard. At first sight this may seem surprising. Honesty has a connotation of subjectivity, as distinct from the objectivity of negligence.'
    - Carelessness is not honesty
    - Thus, dishonesty is either:
        - Conscious impropriety (subjective, actual knowledge); or
        - Nevertheless behaving unlike an honest person would (objective, constructive knowledge)
    - The reason why constructive knowledge is important is that individuals cannot be left 'free to set their own standards of honesty in particular circumstances. The standard of what constitutes honest conduct is not subjective. Honesty is not an optional scale, with higher or lower values according to the moral standards of each individual.'
    - Thus, even if the accessory does not believe his conduct is dishonest, it can be if it falls short of how an honest person would behave in the circumstances
    - Normally, there will be 'little difficulty' in identifying how an honest person would behave; thus
        - Honest people do not intentionally deceive others to their detriment
        - Honest people do not knowingly take others' property
        - Honest people do not participate in a transaction if they know it involves a breach of duty, absent exceptional circumstances
        - Honest people do not deliberately close their eyes and ears, or deliberately avoid asking questions, lest they learn something they would rather not know, and then proceed regardless
    - Although some complications arise in the area of risk-taking, honesty remains an objective standard
    - Third parties are 'expected to attain the standard which would be observed by an honest person placed in those circumstances. It is impossible to be more specific.': at 390
        - [This is arguably troublesome: how is this standard any better defined than unconscionability?]
    - The honesty of the third party is to be judged objectively:
        - 'Based on the standards of an honest person placed in the same circumstances as the third party'
        - 'Acting dishonestly or with a lack of probity means not acting as an honest person would act in the circumstances, and can usually be equated with conscious impropriety (as distinct from inadvertent or negligent conduct)'
        - 'A reckless disregard of the rights of others might also amount to dishonesty'
        - 'The third party's conduct must be assessed on the basis of their actual knowledge at the time, and not on what a reasonable person would have known or appreciated'
        - Regard can be had for the party's subjective characteristics, including experience and intelligence

        - Thus, in *DPC*, the articled clerk would be assessed at the level of knowledge of a practitioner of his training and experience: ie, on the basis of what he actually knew (probably not dishonest since no knowledge that it would constitute a breach)

- Mere negligence is insufficient
    - Dishonesty is 'an essential ingredient'
    - The fact that a third party may in some cases owe a duty of care to the beneficiaries is not indicative of secondary liability generally: at 392
    - 'As a general proposition … beneficiaries cannot reasonably exepct that all the world dealing with their trustees should owe them a duty to take care lest the trustees are behaving dishonestly.'

- Unconscionable conduct should be avoided as a touchstone of liability
    - '**[392]** Mention, finally, must be made of the suggestion that the test for liability is that of unconscionable conduct. Unconscionable is a word of immediate appeal to an equity lawyer. Equity is rooted historically in the concept of the Lord Chancellor, as the keeper of the Royal Conscience, concerning himself with conduct which was contrary to good conscience. It must be recognised, however, that unconscionable is not a word in everyday use by non-lawyers. If it is to be used in this context, and if it is to be the touchstone for liability as an accessory, it is essential to be clear on what, *in this context*, unconscionable *means*. If unconscionable means no more than dishonesty, then dishonesty is the preferable label. If unconscionable means something different, it must be said that it is not clear what that something different is. Either way, therefore, the term is better avoided in this context.'

- State of mind of the breaching fiduciary
    - Provided there has been a breach, the state of mind of the initial breaching fiduciary is irrelevant
    - Thus, it can be an honest, technical breach
    - What is relevant is the state of mind of the third party

- Application
    - BLT committed a breach of trust by using the money instead of simply deducting its commission and holding the money pursuant to the terms of the agreement
    - Tan has admitted knowing assistance in that breach of trust — that he caused BLT to apply the money in a way he knew was not authorised by the trust
    - This is dishonest: Tan assisted a breach by using trust money for his own business purposes when he knew that the company was not authorised, by the terms of the trust, to do this
    - 'It is possible that in certain circumstances [the reasonableness of intermingling moneys in a single overdrawn bank account] might sustain an argument that, although there was a failure to pay, there was no breach of trust.'
    - Here, however, there was such a breach, Tan knew of this and assisted it to take place
    - Tan is therefore liable as an accessory

<u>Decision</u>

- The appeal is allowed
- Tan is liable as accessory and must account for the lost ticket sales to the Airline

Dishonesty is a deceptively broad concept. Upon closer examination, it appears suspiciously vacuous — at least to the same extent as unconscionability. Indeed, their Lordships note that '[i]t is impossible to be more specific' than some objective normative standard. Their Lordship's trenchant criticism of unconscionability as a possible touchstone of liability therefore rings hollow with the echoes of doubt. Unconscionability both encompasses and goes beyond dishonesty, but provides a more flexible basis upon which to unify liability under the first and second limbs. The only real criticism advanced of the concept is that it 'is not a word in everyday use by non-lawyers'. However, if linguistic accessibility is to be the touchstone of doctrinal legitimacy, I would respectively submit that courts of equity have more — namely, *de son torts*, subrogations, marshallers, *cestuis que trust* — about which to be worried than the benign normative standard of 'unconscionability'!

This aside, it is unclear whether a dishonesty approach will be adopted in Australia. However, *Brunei* seems to be a sign of things to come. See *Twinsectra*, which discussed *Brunei* and a majority of which Court adopted its approach: 'a combined subjective–objective test'. This test, succinctly stated, is whether the third party knows that what was being done was dishonest by the standards of ordinary people. Lord Millett dissented on this point: his Lordship stated that the test should be fully objective.

Since *Brunei*, English courts have come to find that a 'dishonesty' standard poses its own difficulties. See, for example, *Twinsectra v Yardley*, which concerned a loan financing a property development.

Twinsectra Ltd v Yardley (2002) HL:

Facts

- Yardley, a solicitor, acts for Leach, a builder, in the purchase of land
- Leach finances the purchase by way of loan, for which the lender, Twinsectra Ltd ('Twinsectra') requires payment to be secured by Yardley's personal undertaking, which Yardley is unwilling to provide
- Consequently, Leach approaches a second solicitor, from the firm Sims & Roper
- Sims & Roper represents itself as acting for Yardley; it purports to provide the following undertaking:
    - (1) The loan moneys wil be retained by us [Sims & Roper] until such time as they are applied in the acquisition of property on behalf of our client
    - (2) The loan moneys will be utilised solely for the acquisition of property on behalf of our client and for no other purposes
    - (3) We will repay to you the said sum of £1 000 000 together with interest
- Sims & Roper seeks assurances from Leach that the money will be used in the acquisition of property, but Yardley does not provide these undertakings, being unaware of them
- Sims & Roper releases the money to Yardley as instructed by Leach
- Yardley holds the money for the client and pays it out on the client's instructions, after taking steps to ensure that it is only applied to the acquisition of property
- However, it eventuates that Leach uses the money for other purposes
- Sims & Roper goes bankrupt; the loan is not repaid to Twinsectra

Issue

- Can Yardley be liable as an accessory for assisting in a breach of duty by Leach?

Reasoning

- Lords Hoffman and Hutton: *Brunei* is restated
    - A dishonesty test is both subjective and objective

- This builds upon observations made by Lord Nicholls in *Brunei* to the effect that a person ought not be able to escape liability purely because they believed what they were doing was right
- The new test of dishonesty:
  - The defendant's conduct must be dishonest by the standards of a reasonable and honest person ('the objective component'); and
  - The defendant must himself have realised that by objective standards his conduct was dishonest ('the subjective component')
- This may be viewed as a further complication to the *Brunei* test of accessory liability as assister

Courts since *Twinsectra* have applied a hybrid objective–subjective standard to determine accessory liability. However, it is unlikely to be approved by the High Court of Australia for its intermingling of subjective and objective standards and associated conceptual complexity.

Barlow Clowes v Eurotrust provides an archetypal example of fraudulent fiduciary conduct. The case illustrates, it is submitted, a far more workable approach to dishonesty, and one more likely to be adopted by an Australian court.

Barlow Clowes v Eurotrust (2005) Privy Council:

Facts

- Barlow Clowes, the fiduciary, takes investor money from small private investors by advertising that it would be invested in low-risk government securities
- In fact, Clowes and its directors decide to use the money for their own private purposes
- They buy a brewery, private yachts and various other assets for their personal enjoyment
- Barlow Clowes passes the investors' money through Eurotrust, a private, off-shore 'tax haven' in the Isle of Man
- The deception is discovered, actions are commenced and the Barlow Clowes directors are found liable for breach of fiduciary duty
- The directors are jailed in the event
- Investors now seek to recover money from Eurotrust as an accessory to the breach
- Mr Henswood, a director of Eurotrust, gives evidence that he suspected the money was being misapplied, but thought that his obligation as director was 'simply to obey client instructions'

Issue

- Are Mr Henswood's actions dishonest within the meaning of *Twinsectra* and *Brunei*?

Reasoning

- Trial judge: dishonest, because Henswood's conduct does not confirm with the objective standards of honest and reasonable financial advisers
  - Henswood has a 'warped personal morality' and no business ethics
  - An honest and reasonable adviser would not have contented himself with following client instructions, but would have sought further information

- Privy Council (Lords Nicholls and Hoffman)
  - Distinguish *Twinsectra v Yardley*: dishonesty is an objective standard
  - A person will be dishonest if they fail to conform to the standards of a reasonable and honest person in their business

Decision
- Dishonesty is established

Barlow Clowes seems the most likely approach to be followed in Australia. Indeed, Gummow J, speaking extra-curially, has recently hinted strongly at rejecting *Twinsectra* in favour of *Barlow Clowes*.

IV *Other Forms of Secondary Liability*

A *Wrongful Recipients of Property under Wills*

An executor of a will is also a fiduciary with respect to beneficiaries under the will. In normal circumstances, any beneficiary wronged by an error of the executor will have a remedy against the fiduciary for breach of duty. Such a beneficiary also has personal and proprietary remedies against the wrongful recipients. The proprietary remedy is tracing, considered below in Part IV. Here we are concerned with the personal action available against the wrongful recipient as accessory to the breach of duty.

A person to whom a deceased's estate has been erroneously distributed is personally liable to repay those rightfully entitled to the deceased's property (*Re Diplock's Estate*; *Ministry of Health v Simpson*). This is so regardless of the mental state of the recipient: liability is strict.

The rule applying to wrongful recipients of property under wills ('the *Diplock* principle') is another form of accessory liability. However, unlike the liability of assisters (and, possibly, recipients), legatees are strictly liable. They will be obliged to return any property to which they are not entitled but which they have nevertheless received under a will.

The issue normally arises when an executor makes disbursements from a deceased estate to the wrong parties or in the wrong amounts. Such disbursements will normally be challenged by other beneficiaries, or the next of kin. Alternatively, a next of kin may challenge the disposition or the will itself — whether as unduly executed, in breach of the rule against perpetuities, or for want of one of the three certainties — in which case, if successful, any disbursements made will be invalid and the recipients liable to effect its return.

The action is similar to a 'knowing receipt' claim, and potentially within the first limb of *Barnes v Addy*. However, cases dating back to *Re Diplock* have suggested that a special rule should apply in this circumstance. *Re Diplock* has been described as 'a gothic horror of a case' (Bryan). It spans several years of pitiable conflict, involving multiple parties, actions and seemingly interminable appellate litigation. Although not quite a *Bleak House*, it comes close.

Re Diplock (1948) UK CA:

Facts

- Kaleb Diplock, a British millionaire, directs his executors to apply his residuary estate (whatever is left after disbursements) 'for such charitable and benevolent objects as my executors shall select'
    - This amounts to some £260 000 pounds
- The executors, acting in accordance with these wishes, distribute the money to 139 charities
- Three of the next of kin challenge the validity of the residuary gift
    - The next of kin succeed
    - The residuary clause is invalid because, although property may be left for charitable purposes, it cannot be left for 'benevolent' purposes (which are not necessarily charitable)
    - The use of the word 'benevolent' invalidated the clause — trusts may be granted in favour of a charitable object but not a benevolent object
    - The payments to the 139 charities were therefore wrongly paid
    - Diplock's next of kin are therefore entitled, under the default intestate provisions, to the residuary

- Consequently, distribution of the proceeds amounted to a breach of the executors' fiduciary obligations
    - However, the next of kin can only recover about £15 000 from the executors
- The next of kin therefore sue all 139 charities
    - Some of the money had been paid to a hospital, which had even used the proceeds to develop a new children's ward, named in Mr Diplock's honour
- The charities are clearly innocent recipients; however, the next of kin argue that they should be liable under *Barnes v Addy*

Issues

- Can the money be traced into their hands?
    - This issue is considered below
- Alternatively, are any other remedies available to the legatees against the charities as wrongful recipients?

Reasoning

- Both personal and proprietary remedies are potentially available against the wrongful recipients
    - Personal: receipt of trust property
    - Proprietary: tracing

- A personal claim is available in equity against the wrongly paid beneficiary of a will (reference is made to 17th century case law)
    - *Ignorantia juris no excusat* (ignorance of the law is no excuse)

- However, the charities argue that knowledge a necessary ingredient in the cause of action, of which the defendants here had none
    - This argument is rejected
    - The conscience of the third party beneficiaries is bound by the simple fact that they received something to which they were not entitled
    - This is an unjust enrichment approach

- A claim against the wrongful legatees is therefore open to the unpaid beneficiary (the plaintiff)
    - However, it will be subject to certain equitable defences
    - Here, though, the claim is not defeated because the third parties are innocent volunteers
    - This reflects a strict liability approach

- There is one qualification on the ability of the plaintiff to claim against the wrongful beneficiaries
    - In order to claim against the third parties, the plaintiff must first have exhausted its claims against the breaching fiduciary (ie, the executor of the will)

Decision

- The claims are upheld

One of the 139 wrongfully-paid charities is a hospital controlled and administered by the Ministry of Health. Once it received the money from Diplock's executors, it commenced construction of a new wing named in his honour. The money was applied to the specific purpose of erecting the new building, purchasing equipment and altering existing buildings. The Ministry of Health, upon learning of the decision in the Court below, is outraged, and intervenes in the proceedings, bringing an appeal to the House of Lords.

Ministry of Health v Simpson (1951) HL:

Issues

- Is the appellant hospital under a personal liability to refund to Diplock's estate the money wrongfully received?

Reasoning (Lord Simonds)

- 'My Lords, I think that the reasoning and conclusion of the Court of Appeal are unimpeachable'

- Citing *Harrison v Kirk* (1904) per Lord Davey:
  - 'But the Court of Chancery, in order to do justice and to avoid the evil of allowing one man to retain what is really and legally applicable to the payment of another man, devised a remedy by which, where the estate had been distributed either out of court or in court without regard to the rights of a creditor, it has allowed the creditor to recover back what has been paid to the beneficiaries or the next of kin who derive title from the deceased testator or intestate'
  - The cited passage's importance 'is manifold', for it 'explains the basis of the jurisdiction, the evil to be avoided and its remedy'

- The argument that the Court of Chancery acts upon conscience and will only make a decree if the defendant charities have acted in an unconscientious manner is rejected (at 276)
  - The argument that the defendant charities ought not in conscience be ordered to refund their property received in good faith is also rejected
  - The only limiting requirement is that the plaintiff must first exhaust any remedy available against the executors
  - The fact that a third party has acted in good faith is also irrelevant
  - 'The Court of Chancery, it was said, acted upon the conscience, and, unless the defendant had behaved in an unconscientious manner, would make no decree against him. The appellant or those through whom he claimed, having received a legacy in good faith and having spent it without knowledge of any flaw in their title, ought not in conscience to be ordered to refund. My Lords, I find little help in such generalities. Upon the propriety of a legatee refusing to repay to the true owner the money that he has wrongly received I do not think it is necessary to express any judgment. It is a matter on which opinions may well differ.
  - 'The broad fact remains that the Court of Chancery, in order to mitigate the rigour of the common law or to supply its deficiencies, established the rule of equity which I have described and this rule did not excuse the wrongly paid legatee from repayment because he had spent what he had been wrongly paid.'
  - 'No doubt the plaintiff might by his conduct and particularly by *laches* have raised some equity against himself; but if he had not done so, he was entitled to be repaid.'
  - 'In the present case the respondents have done nothing to bar them in equity from asserting their rights.'

Decision

- The next of kin has both a personal action (accessory liability) and a proprietary action (tracing) against the charities, including the hospital

Crucially, liability under a *Re Diplock* action is strict. This means that recovery of the wrongfully distributed assets is not dependent on proof of knowledge that the will was invalid or that the recipients were not otherwise entitled. That is, the rightful recipient has a strict liability action against any wrongful recipients. Supporters of a strict liability approach use this action to argue for an expansion of strict liability to other circumstances, such as receipt.

A different outcome would have been reached were *Re Diplock* to be decided today. First, the will would probably not have been invalid (cf *Chichester Diocesan Fund v Simpson* (1944)). Second, the defence of change of position would be available to the hospital and other beneficiaries. Those beneficiaries would need to establish some commitment (as by entering into contracts, loaning the money, using it for building or otherwise dispersing it). However, the recipients — as volunteers — could not raise good faith purchase as a defence.

Although *Re Diplock* concerned third party liability under a wrongly distributed estate, there remains an unanswered question in whether this strict liability approach may extend beyond the administration of deceased estates. There is nothing to suggest that this approach will be extended. It has not been expressly adopted in Victoria, but in Queensland and Western Australia has been incorporated into statute (see those states' respective *Trustee Act*s). The requirement that a plaintiff first exhaust their remedies against the executor is not present in Western Australia.

In many respects, the traditional *Barnes v Addy* approach operates less harshly on third parties, who have available several defences, including change of position and *bona fide* purchaser for value without notice. However, *Re Diplock* illustrates the frequently harsh operation of a strict liability approach to third party liability without such defences. The House of Lords is right to call into question the propriety of insisting upon repayment.

V *Hypotheticals*

A *Hypothetical 1*

1 *Breach*

There has been a breach of duty by Cheapo Travel Company (CTC), which owed fiduciary duties to Qansett Airlines ('Q') as its agent or alternatively as express trustee (a presumed category of fiduciary relationship). Clause 10 of the agreement is probably sufficient to create an express trust in Q's favour. There were two breaches. First, CTC appropriated, through its managing director, money held on trust for Q, thereby profiting from the relationship and conflicting with its duties to Q (to hold the money, rather than use it to ease its cash-flow problems). Second, Bruno withdrew some of these funds for Maria.

2 *Equitable entitlements of Q*

Q has several equitable entitlements:

- **As against CTC for breach of fiduciary duty**
  Rights against CTC for breach of fiduciary duty, potentially giving rise to a personal or proprietary remedy over the assets it continues to hold in breach of trust;

- **As against Eezycash ('E') for assistance in breach of duty** (second limb)
  Personal rights against E for its knowing participation in the breach by permitting the funds to be transferred;

- **As against Bruno ('B') for assistance in breach of duty** (second limb)
  Personal rights against E for his dishonest breach of duty in appropriating the funds;

- **As against Maria ('M') for receipt of property in breach of duty** (first limb)
  Personal rights against M for her receipt of the $20 000.

Only an action against CTC for breach of fiduciary duty will be capable of creating proprietary remedies. Because CTC is in liquidation and has other unsecured creditors, Q should pursue the proprietary remedy as its primary claim.

However, E is also likely to be solvent, so a personal remedy against E may be sufficient to cover Q's loss. Further, if B and M are solvent, Q could recover a portion of the loss from them.

3 *E*

(a) Receipt

- E received Q's trust/agency money from the Qansett Account ('the Account'), thereby reducing its overdraft

(i) No actual knowledge

- Exigencies of commerce rule does not apply where the bank receives a beneficial interest in the property

  - Here, assuming that the operating account held with E, E benefits from the receipt of the funds
  - But: unlike *Stephens*, E didn't close the account just after the receipt
  - Consequently, the money was still available to be drawn on overdraft
  - E didn't necessarily usurp the trust money
- E probably did not have actual knowledge of the breach of trust, unless its officials were constantly reviewing the bank account's deposits, like ANZ in *Stephens*
  - Was E aware of the arrangement between Q and its agents?
- No evidence of actual notice; constructive notice sufficient?
  - Not on the consciousness approach
  - Yes on the property or strict liability approaches

(ii) Defences

- BFPFVWN: receiving the payment is a receipt of property for value, without notice of the equitable interest of Q
  - Constructive notice? Depends on further facts
- If E held off closing the account on the basis that the overdraft was annulled, there might also be a good faith change of position defence available

(b) Assistance

- E assisted in the breach by passively transferring the money into CTC's account from Q's account
- Exigencies of commerce rule: where E does not have a E will only be liable if they had actual knowledge of the breach
- Here, not actual knowledge
- Even if they did have a beneficial interest, they still would not have the required level knowledge (unless they knew of clause 10, and a pattern of trading at the end of each month, etc, as in *Stephens*)

4 *B*

(a) Assistance

- B assisted CTC in receiving Q's trust property, and M in receiving same
- B clearly had actual knowledge of the breach of trust (*Consul* test satisfied)
  - He knew of the terms of the express trust/agency agreement
  - Therefore he must have known that shifting the money would amount to a breach of trust
  - [Exam note: do not refer to *Baden* categories of knowledge purely by their numbers]
- In knowing what he did, to act as he did was clearly dishonest (*Brunei* test satisfied)
  - Indeed, B instigated the breach of trust
  - Knowing that it was a breach of trust, an honest person would not allow it to happen
- B is liable to pay the entirety of the amount transferred in breach of trust

(b) Receipt

- Nothing to suggest actual receipt of the overall trust/principal money

- However, it may be possible to argue that he has beneficially received $20 000 of the money, since he made a gift to M
- The fact that he was able to make a gift of the money suggests that he had a beneficial interest to give
- Note uncertainty about level of mental element required
- Because B has actual knowledge, it does not matter what the required standard is: all would be satisfied
- Remedy would be to repay the $20 000, assuming that the first limb failed (on the other hand, his receipt is what enabled the transfer of the whole to occur, so a court might be prepared to order repayment of the whole, or that since he was the breaching fiduciary he should be liable for the entire breach — the extent of liability will depend on the type of breach and the amount received)
    - This is a frequent fact pattern: a third party may receive only a portion of the total amount in whose misappropriation he or she participated
    - Interaction between the two limbs is unclear

5 *M*

(a) Receipt

- M received $20 000, but did not otherwise assist

(b) Knowledge

(i) Strict liability

- Clearly no actual or constructive notice of the breach, unless special facts
- Only a strict liability approach will give rise to liability: see *Say-Dee*
- BFPFVWN: no, a volunteer (recipient of a gift)
- GFCOP: renovations to the house on the basis of receiving the property
- Tracing issue: renovations (see below)

(ii) Application of *Re Diplock*

- If *Re Diplock* is extended beyond receipt of wrongfully administered beneficial interests under a will, strict liability will apply
- GFCOP not a defence (though the harshness of this approach may well be relaxed)
- However, Q must first sue CTC as breaching fiduciary

B *Hypothetical 2*

1 *Breach*

Lawyer–client relationship: clearly fiduciary (presumed).

Wrongful appropriation of the trust funds for an extraneous purpose (repayment of personal debt) clearly in breach: Adrian (‘A’) profits, conflicts with duty to pay on to Rita (‘R’).

2 *Entitlements*

R has the following actions open to her:

- Wright, Hassle and Mess (as a partnership)
  - Breach of fiduciary duty
  - (More solvent, primary target)
- Adrian ('A')
  - May owe simultaneous fiduciary duties
  - Assistance (second limb)
  - Common law: conversion
  - Probably insolvent ('heavily in debt')
- Plutocrat Bank ('PB')
  - Assistance (second limb)
- Brett ('B')
  - Receipt (first limb)
  - Possibly assistance
- Lisa ('L')
  - Receipt (first limb), but only if strict liability
  - Has complete defence
- Monika ('M')
  - Receipt (first limb), but complete defence

3 *R v WH&M: breach of fiduciary duty*

Since R has lost money, WH&M will be liable to pay equitable compensation (a personal remedy): *Youyang v Minter Ellison*.

4 *R v A: breach of fiduciary duty*

- Clear breach of fiduciary duty, but insolvent

5 *R v PB: receipt, assistance*

- Receipt
  - Need to have beneficially received: here, no beneficial receipt (*Stephens v Qantas*)
- Assistance
  - No knowledge, actual or constructive

6 *R v B: receipt, assistance*

- B has beneficially received the money
- Knowledge
  - No actual knowledge in a strict sense
    - Michael Bryan: does have actual knowledge
    - *Koorootang Nominees v ANZ*
    - Reckless failure to make enquiries
      - Didn't believe A's explanation: raised eyebrows
      - Had previously encouraged breach: conversation

        - Wilful shutting of the eyes
        - Can amount collectively to actual knowledge: probably satisfied here
    - Probably constructive knowledge
        - B knows facts that would indicate, to a reasonable person, breach of fiduciary duty (Hansen J in *Koorootang*)
    - Strict liability
        - Definitely liable (*Say-Dee*), but probably not good law
- Defences
    - Change of position: paying ex-wife?
        - Not a change of position: no detriment to him
        - No good faith: *mala fides*

- Note all three tests of knowledge
    - However, do not linger on whether there is actually actual or constructive knowledge (ie, the precise application doesn't matter since there aren't enough facts)
    - Must show awareness of all tests and *some* application to the facts

- Assistance
    - Less advantageous, since knowledge test more stringent for assistance (especially if receipt carries strict liability)
    - Dishonesty looks like the current test; is difficult to prove
    - Certainly, no need to establish assistance if receipt already established
    - Possible tests:
        - Does he know of facts which would cause a reasonable person to know of the breach or put them on enquiry as to same?
        - Alternatively, is the conduct dishonest? (*Tam*)
            - Here, there is clear dishonesty

7 *R v L: receipt*

- Receipt
    - Knowledge
        - Actual? No
            - Actual knowledge facts that would indicate breach to a reasonable person
            - Unreasonable to expect suspicion just because money received?
            - Depends on circumstances: previous patterns of payments
        - Constructive?
        - Strict liability?
            - *Say-Dee*: if applied, will be liable

    - Defences
        - Change of position:
            - Depositing the $20 000
                - In good faith
                - No detriment
                - In general, using the money to buy a chattel is not a detrimental change of position, since it can always be sold off: *Say-Dee*
                - See *Lipkin Gorman v Karpnale* (1991) HL (solicitor addicted to gambling, gambled away client money, client sues casino, recoverable money must be reduced by the

amount that the casino paid out on the basis of a winning bet, since this is a good faith change of position)
    - See *David Securities v Commonwealth Bank* (HCA, approving *Lipkin*)
- Buying the apartment
    - In good faith
    - No detriment, since apartment is useful
    - Just converting money into a useful form
    - No change of position
- Good faith purchaser
    - Not a volunteer: gave up legal rights
    - Consideration: giving up contractual right to claim ('full settlement')
    - Must have no notice R's claim
        - Here, no actual notice
    - No need for detriment, so advantageous here
    - Complete defence to any equitable claim

- L can also claim contributions from B and WH&M
    - Prima facie: equal liability
    - But since WH&M more at fault, court may adjust accordingly

8 *R v M*

- Receipt
    - No: GFPFVWN (assuming no notice)
    - In effect, 'purchasing money' using her apartment as consideration