KNOWING RECEIPT AND KNOWING ASSISTANCE: WHERE DO WE STAND?

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I. INTRODUCTION

In the last thirty years there has been intense judicial and academic comment over the decision in *Barnes v Addy*,[1] and the issue of when third parties should be held liable as constructive trustees.[2] In *Barnes*, Lord

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1 (1874) 9 Ch App 244.

2 Some of the more well known cases are: *Selangor United Rubber Estates Ltd v Craddock (No 3)* [1968] 1 WLR 1555; *Carl Zeiss Stiftung v Herbert Smith & Co (No 2)* [1969] 2 Ch 276; *Karak Rubber Co Ltd v Burden (No 2)* [1972] 1 WLR 602; *Baden Delvaux and Lecuit v Societe Generale* [1992] 4 All ER 161; *Westpac Banking Corporation v Savin* [1985] 2 NZLR 41; *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373; *Cowan de Groot Properties Ltd v Eagle Trust plc* [1992] 4 All ER 700; *Montagu's Settlement Trusts, Re Duke of Manchester v National Westminster Bank plc* [1992] 4 All ER 308; *Agip (Africa) Ltd v Jackson* [1992] 4 All ER 385. For academic comments see for example: C Harpum, "The Stranger as Constructive Trustee" (1986) 102 *LQR* 114; M Bryan "Cleaning Up After Breaches of Fiduciary Duty - The Liability of Banks and Other Financial Institutions as Constructive Trustees" (1995) 7 *Bond LR* 67; MJ Brindle and RJA Hooley, "Does Constructive Knowledge Make a Constructive Trustee?" 61 *ALJ* 281; PD Finn, "The Liability of Third Parties for Knowing Receipt or Assistance" in D Waters (ed), *Equity Fiduciaries and Trusts* (1993) p 195; YL Tan, "Agent's Liability for Knowing Receipt" [1991] *LMCLQ* 357; RP Austin, "Constructive Trusts" in PD Finn (ed), *Essays in Equity* (1985) p 196; P Birks, "Trusts in the Recovery of Misapplied Assets: Tracing, Trusts and

Selborne formulated a proposition that strangers can be liable as constructive trustees, but that an agent of a trustee is not to be made a constructive trustee *merely by acting as agent* unless the agent: either receives and becomes chargeable with some part of the trust property; or assists with knowledge in a dishonest and fraudulent design on the part of the trustee.[3]

Lord Selborne's dictum has been interpreted as containing two separate limbs, or rules, for the test of liability of strangers to a trust. The first limb is 'knowing receipt': the category of constructive trusteeship due to the defendant having received and become chargeable with trust property. No liability can arise under this limb of the test unless the defendant can be said to have received property. The first limb is also said to encompass 'knowing dealing' with trust property: where property is received by a stranger who did not know of the breach of trust, but the breach becomes apparent before the stranger parts with the property.

The second limb is 'knowing assistance': the category of constructive trusteeship resulting from the defendant having knowingly assisted the trustee in a dishonest and fraudulent design. This category of constructive trusteeship is not based upon the receipt by the defendant of any trust property, and is said to be based on participation in the trustee's fraud. The distinction is particularly relevant to an agent of a trustee: take the position of a solicitor as an example. Trust money may pass through the hands of the solicitor, but the solicitor only deals with the property as a 'channel' and receives no personal benefit from the handling of the property.

Another example of the importance of the distinction applies to banks. A bank may either act as agent or on its own behalf. Where the bank sets off a debt in one account against a credit in another account it is not acting as agent, and receives money on its own account.[4] However, in paying in cheques, the bank is acting as agent, and retains no actual benefit although it receives the money on the client's behalf. The solicitor who receives money as a channel and the bank which pays in a cheque have not 'received' money for the purposes of liability under the first limb of *Barnes*. On the other hand, the bank which sets one account against another has 'received' property, and is within the scope of the first limb. The effect of distinguishing between receipt as an agent, and receipt for one's own benefit means that agents will not be liable for knowing receipt, unless they

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Restitution" in E McKendrick (ed), *Commercial Aspects of Trusts and Fiduciary Obligations*, (1992) p 149; E McKendrick, "Tracing Misdirected Funds" [1991] *LMCLQ* 378; C Harpum "The Basis of Equitable Liability" in P Birks (ed), *Frontiers of Liability* (1994) p 9; P Loughlan, "Liability for Assistance in Breach of Fiduciary Duty" (1989) 9 *OJLS* 260; J Glover, *Commercial Equity Fiduciary Relationships*, Butterworths (1995); AJ Oakley, "Liability of a Stranger as a Constructive Trustee" in M Coper (ed), *Equity: Issues and Trends* (1995) p 62.

3 Note 1 *supra* at 251-2.

4 For example *Westpac v Savin* note 2 *supra*.

act outside the scope of their agency and misappropriate trust money.[5] An agent can clearly be liable for knowing assistance even if no property has been received.

The courts' attempts to apply Lord Selborne's test have created much confusion. Lord Selborne cited no authority for his two-limbed test, thus giving no guidance to later courts attempting to apply his test in a logical and consistent manner. It has even been suggested that Lord Selborne fabricated the second rule, rather than formulating it from existing authority.[6] The absence of reasoning and articulation of policy or authority in *Barnes* has led to inconsistent and muddled reasoning in recent decisions. Until recently, many decisions contained a distinct lack of policy or overall doctrinal reasoning. Those decisions which are based on policy or overall doctrinal considerations are not consistent among themselves. Thus, competing considerations are put forward as the foundation of the stranger's liability for knowing receipt and knowing assistance.

The labels of 'knowing assistance' and 'knowing receipt' are now frequently sought to be applied to defendants in large scale litigation. They are used as a means of finding money in the hands of banks, accountants, and solicitors who dealt with a trustee who now has no funds. The labels of 'knowing assistance' and 'knowing receipt' are, and will continue to be, applied to third parties involved in large scale corporate collapses.[7] It is imperative that this area of the law be overhauled and the confusion removed.

The purpose of this paper is to summarise the current position of English, New Zealand and Australian cases regarding knowing assistance and knowing receipt. It involves some discussion of the changes which have taken place in the law over the last twenty years, as this background is necessary to understand the current law. This is particularly the case in England, as the recent decision of the Privy Council in *Royal Brunei Airlines Sdn Bhd v Tan*[8] makes some fundamental changes to the law regarding knowing assistance.

The analysis demonstrates the lack of direction in the cases to date, and the dearth of articulated policy approach to the area of third party liability.

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5 There is little case law in relation to whether an agent can be liable for 'knowing dealing' with trust property where the agent is acting within the scope of the agency. See Harpum (1986) note 2 *supra*, who adopts the view that the agent can still be liable.

6 Harpum (1994) note 2 *supra*, p 12.

7 As is recognised in the following quote from Lord Nicholls of Birkenhead in *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 3 All ER 97 at 99: "Increasingly plaintiffs have recourse to equity for an effective remedy when the person in default, typically a company, is insolvent. Plaintiffs seek to obtain relief from others who were involved in the transaction, such as directors of the company or its bankers or its legal or other advisers. They seek to fasten fiduciary obligations directly onto the company's officers or agents or advisers, or to have them held personally liable for assisting the company in breaches of trust."

8 *Ibid.*

II. KNOWING RECEIPT

A. England

The Privy Council decision in *Royal Brunei* does not address knowing receipt. Exhaustive discussion of the English position can be found in the two recent decisions of *Cowan de Groot Properties Ltd v Eagle Trust plc*[9] and *Eagle Trust plc v SBC Securities Ltd.*[10] Both decisions were made by single judges.

In each case the judge analysed previous authority in some detail, and set out the conflict within the authorities on the law of knowing receipt. The dispute in the authorities does not relate to the elements of the action. These are established as follows. The plaintiff must prove that:

1. the defendant has received trust money;
2. the defendant knew the moneys paid were trust moneys; and
3. the defendant knew of circumstances which made the payment a misapplication of the trust moneys.

The trust need not be a formal trust, as a breach of fiduciary duty will suffice.

The conflict in the authorities relates to what facts will suffice to prove a claim: in particular, when will a defendant 'know' the necessary facts.

Essentially, the controversy centres around the categorisation of knowledge formulated by Peter Gibson J in *Baden v Societe Generale pour Favoriser le Developpement du Commerce et de l'Industrie en France SA.*[11] In that case, knowledge was broken into five separate mental states as follows: (1) actual knowledge; (2) wilfully shutting one's eyes to the obvious; (3) wilfully and recklessly failing to make such inquiries as an honest and reasonable man would make; (4) knowledge of circumstances which would indicate the facts to an honest and reasonable man; and (5) knowledge of circumstances which would put an honest and reasonable man on inquiry. Categories (1), (2) and (3) were said to encompass forms of actual knowledge, while categories (4) and (5) encompassed constructive knowledge.[12]

Since Peter Gibson J categorised knowledge this way, a major issue for the English courts has been the determination of whether actual or constructive knowledge is necessary for liability for knowing receipt (and for knowing assistance). The debate centres on whether the defendant must be acting with bad faith or 'want of probity' to be liable for knowing receipt. If all five of the *Baden* categories are sufficient for liability, the

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9 Note 2 *supra*

10 [1992] 4 All ER 488.

11 Note 2 *supra*.

12 Categories (4) and (5) are sometimes said to be examples of constructive knowledge, while other times they are said to represent constructive notice. For a thorough discussion on the overlapping use of 'knowledge' and 'notice' in the context of knowing assistance and knowing receipt see: S Gardner, "Knowing Assistance and Knowing Receipt: Taking Stock" (1996) 112 *LQR* 56.

objective nature of the forms of knowledge in (4) and (5) means that a defendant can be liable even if there is no want of probity on the defendant's part. On the other hand, proponents of the view that the defendant must be guilty of 'want of probity' would limit the relevant types of knowledge to (1), (2) and (3).

From a reading of *Eagle Trust* and *Cowan de Groot* it becomes clear that there are three main lines of authority on the question of what knowledge is sufficient for knowing receipt liability.

(i) Constructive and Actual Notice

First, some judges have accepted that all five categories from *Baden,* and therefore both constructive and actual notice, will give rise to liability for knowing receipt. This was the approach taken in the older cases on knowing receipt,[13] and more recently, the line of authority is demonstrated by the decision in *International Sales and Agencies Ltd v Marcus*[14] where Lawson J stated:

> In my judgment, the knowing recipient of trust property for his own purposes will become a constructive trustee of what he receives if either he was in fact aware at the time that his receipt was affected by a breach of trust, or if he deliberately shut his eyes to the real nature of the transfer to him...or if an ordinary reasonable man in his position and with his attributes ought to have known of the relevant breach. This I equate with constructive notice...I am satisfied that in respect of actual recipients of trust property to be used for their own purposes the law does not require proof of knowing participation in a fraudulent transaction or want of probity, in the sense of dishonesty, on the part of the recipient.[15]

Justice Lawson's decision is supported by comments of Millett J in *El Ajou v Dollar Land Holdings plc,* where His Honour was content to assume, without deciding, that "dishonesty or want of probity involving actual knowledge (whether proved or inferred)" was not required. [16] A recipient will not be required to be unduly suspicious and is not to be held liable unless he went ahead without further inquiry in circumstances in which "an honest and reasonable man would have realised that the money was probably trust money and was being misapplied".[17]

The view that recipient liability is based on all five forms of knowledge is particularly attractive to restitution lawyers, who see the actual receipt as

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13 For example: *Nelson v Larholt* [1948] 1 KB 339; *Selangor United Rubber Estates Ltd v Craddock (No 3)* note 2 *supra*; *Karak Rubber Co Ltd v Burden (No 2)* note 2 *supra*; *Belmont Finance Corporation v Williams Furniture (No 2)* [1980] 1 All ER 393; *Rolled Steel Products (Holdings Ltd) v British Steel Corporation* [1986] 1 Ch 246.

14 [1982] 3 All ER 551.

15 *Ibid* at 558. On the facts of the case before him, Lawson J considered the defendant to have had actual knowledge, or to have turned a blind eye to the obvious.

16 [1993] BCC 698 at 718. See also *Johnathan v Tilley* (unreported, English Court of Appeal, Peter Gibson and Otton LJJ, 30 June 1995).

17 *Ibid* at 718. In *Agip* note 2 *supra* at 403, Millett J also commented in obiter that constructive notice is sufficient for liability for receipt.

the basis of the liability, regardless of the level of knowledge held by the defendant.[18] This is the view preferred by Millett J.

(ii) Actual Knowledge and Commercial Transactions

The second view is that, at least in commercial transactions, categories (1), (2) and (3) are necessary, and constructive notice will not suffice for liability. This view is influenced by the courts' traditional reluctance to extend the doctrine of constructive notice into commercial transactions.

In *Eagle Trust*, Vinelott J was dealing with a typical commercial transaction: a payment made in the ordinary course of business to a defendant to discharge a liability owed. Justice Vinelott referred to *Re Montagu's Settlement Trusts*,[19] and the reluctance of Megarry VC to apply the notice doctrine to "cases in which the investigations apt for a purchaser are not normally required".[20] Justice Vinelott decided that the plaintiff must show that the defendant had knowledge within *Baden* categories (1), (2) and (3), or that such knowledge could be inferred in the absence of explanation or evidence. The inference may be made if, in the circumstances, "an honest and reasonable man would have inferred that the moneys received were probably trust moneys and were being misapplied, and would either not have accepted them or would have kept them separate until he had satisfied himself that the payer was entitled to use them".[21]

In *Cowan de Groot*, Knox J approved the statement of principle made in *Eagle Trust*, and considered the fact situation before him to be an equally inappropriate one for the imposition of a test of constructive notice.[22] Consequently, the defendant would only have been liable, in his view, if *Baden* categories (1) to (3) were proved against the defendant.[23] Justice Knox also indicated his general unhappiness with the *Baden* categories, and the distinction between actual and constructive knowledge based on the *Baden* scale. He suggested an underlying principle for commercial transactions: that knowledge will be imputed to the defendant "on the basis of what a reasonable person would have learnt, to a person who is guilty of commercially unacceptable conduct in the particular context involved".[24]

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18 According to restitution lawyers, if liability for knowing receipt is restitutionary, 'knowledge' only becomes relevant as an element of the defence of bona fide purchase for value without notice. Apart from the question of whether the plaintiff or the defendant should prove the 'knowledge' element, questions arise as to the precise meaning of 'notice' in the restitutionary defence, and how it may overlap with the *Baden* categories. These issues will not be discussed in this article.

19 Note 2 *supra.*

20 Note 10 *supra* at 505, citing *Re Montagu* note 2 *supra* at 318-9.

21 *Ibid* at 509. The same test was applied in *Cowan de Groot*, note 2 *supra.*

22 The question on the facts was whether the directors of a defendant company which was purchasing land from the plaintiff company knew of breaches of fiduciary duty committed by the directors of the plaintiff company.

23 He concluded that none of the *Baden* tests were satisfied.

24 Note 2 *supra* at 761.

The conclusion that knowledge of types (1) to (3) is required is determined by the commercial nature of the transaction, rather than being reached through a reasoned discussion on principle. This approach to third party liability does not indicate how knowledge is to be treated in non-commercial cases. However, despite the lack of doctrinal analysis, this view does attempt to reconcile third party liability with broader policy issues of commercial responsibility.

(iii) Actual Knowledge for all Transactions

The third view is that constructive notice is unlikely ever to be enough, regardless of the type of transaction. On this view, the fundamental issue is the conscience of the recipient, and whether the defendant's conscience is "sufficiently affected to justify the imposition of"[25] a constructive trust. Thus, a level of knowledge which is consistent only with carelessness is unlikely to warrant the imposition of a constructive trust. This was the view taken by Megarry VC in *Re Montagu's Settlement Trusts*.[26]

Justice Alliott accepted this view at first instance in *Lipkin Gorman (a firm) v Karpnale Ltd.*[27] His Honour considered that the result of this approach would be that "the recipient will be liable, if with want of probity on his part he had actual or constructive knowledge that the payer was misapplying trust money and that the transfer to him was in breach of trust".[28] In this context, the reference to "constructive knowledge" can mean no more than types (2) and (3) from *Baden*. Most recently, in *Polly Peck International plc* v *Nadir (No 2)*,[29] Scott LJ stated that knowledge of type (3) would be sufficient, but he had doubts as to the sufficiency of type (5) knowledge.[30]

Unlike the second view as to knowledge, the cases which adopt this third view demonstrate an attempt by judges to articulate and apply doctrinal reasoning to the whole issue of third party liability.

The three views on knowledge discussed above are predicated on the use of *Baden* categories to determine states of knowledge. Recent cases demonstrate a judicial disillusionment with the rigid *Baden* categories. In *Re Montagu*, Megarry VC said the *Baden* categories are guides to help the court determine if the defendant's conscience was sufficiently affected that the defendant should be liable.[31] Justice Millett in *Agip (Africa) Ltd v Jackson* stressed that the jury must determine if the defendant had acted

25 *Re Montagu* note 2 *supra* at 323.
26 Note 2 *supra*.
27 [1992] 4 All ER 431.
28 *Ibid* at 349.
29 [1992] 4 All ER 769.
30 See also *Johnathan v Tilley* note 16 *supra*, per Peter Gibson LJ. His Lordship assumed, without deciding, that only knowledge of types (1), (2) or (3) will justify the imposition of constructive trusteeship.
31 Note 2 *supra* at 324.

honestly or dishonestly.[32] In *Cowan de Groot*, Knox J suggested that "commercially unacceptable conduct"[33] may be the touchstone, and Scott LJ in *Polly Peck* stated that the *Baden* categories do not have rigid boundaries, and may merge into each other.[34]

In conclusion, there is a distinct lack of cohesion in the English position. The two strongest lines of authority (views (1) and (3)) are opposed on the fundamental question of whether there must be a want of probity on the defendant's part before liability will be imposed. Further, the position is complicated by the cases which suggest a distinction between commercial and non-commercial contexts, and the rejection of *Baden* categories in favour of more flexible criteria. These criteria, to the extent to which they have been articulated are, variously: dishonesty; commercially unacceptable conduct; and whether the defendant's conscience is sufficiently affected.

A rejection of the strict *Baden* categories is ultimately to be applauded. However, until the courts have framed a test for knowing receipt which articulates the underlying rationale for liability, the rejection of the *Baden* categories results in the law being even more uncertain than before.

B. New Zealand

Until recently, the New Zealand decisions were unanimous in concluding that all five of the categories from *Baden* are sufficient to found liability. However, this consistent approach may be overturned.

The first major knowing receipt case[35] in New Zealand was *Westpac Banking Corporation* v *Savin*.[36] The Court of Appeal found the bank to be liable. Using the *Baden* knowledge scale, Richardson J found that the bank had knowledge of type (2) or (3). His Honour did not express a final view on the sufficiency of constructive knowledge, but could see "no adequate justification"[37] for excluding categories (4) and (5), at least for knowing receipt. Despite the fact that a duty to inquire will have inhibiting effects on commercial transactions, he considered that "there must be cases where there is no justification on the known facts for allowing a commercial man who has received funds paid to him in breach of trust to plead the shelter of the exigencies of commercial life".[38]

Justice McMullin and Sir Clifford Richmond found that the bank had knowledge type (4). Justice McMullin held that the necessary knowledge for knowing receipt liability includes actual knowledge, reason to believe, cognisance that money is being wrongfully used, as well as knowledge of

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32 Note 2 *supra* at 405. In *Cowan de Groot*, note 2 *supra* at 762, Knox J shared the reservations of Millett J regarding the use of *Baden* categories.

33 Note 2 *supra* at 761.

34 Note 29 *supra* at 777.

35 The defendant bank had received a benefit by accepting payments to reduce a client's overdraft.

36 Note 2 *supra*.

37 *Ibid* at 53.

38 *Ibid*.

circumstances that would put an honest, reasonable man on inquiry.[39] Sir Clifford Richmond concluded that actual or constructive knowledge is sufficient for liability for knowing receipt.

Since this decision there have been several single judge decisions in New Zealand. The judges have noted the divergence of opinion in England regarding the appropriate level of knowledge, but have followed their own authority.[40]

Although the New Zealand decisions demonstrate a consistency lacking in the English decisions, the line of authority following *Savin* demonstrates little attempt by the New Zealand courts to address knowing receipt as an issue of principle. In *Savin* the Court of Appeal reached its decision by considering the existing discussion on knowledge in the existing English judgments. The judges did not consider why the law had developed as it had, or whether such an approach was desirable. Instead, the decision was an exercise in interpreting English authority, and determining the preponderant view.

More recently, there are indications that the courts are willing to reconsider the issue, without mechanically applying previous authority. In *Powell v Thompson*, Thomas J accepted a requirement of knowledge, but adverted to the possibility of a defendant being liable even "where the defendant was not aware that he or she was receiving or dealing with the property in a way which was inconsistent with a trust". [41] His Honour would prefer the test to set the level of knowledge "no greater than necessary to permit the Court to examine the circumstances of the case with a view to deciding whether or not the defendant's retention of the trust property is inequitable".[42]

Justice Thomas is to be applauded for his attempt to reformulate knowing receipt principles. His fundamental concern is to prevent the "enrichment of the third party at the expense of the beneficiary", and to ensure a result "which is consonant with good conscience".[43]

The latest position which has been taken in New Zealand is that of Smellie J in *Equiticorp Industries Group Limited v Attorney-General (NZ)*.[44] His Honour accepted an argument that liability for receipt is founded in unjust enrichment.[45] However, he was not prepared to hold that liability should be strict.[46]

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39 *Ibid* at 60.

40 For example see: *Marr & anor v Arabco Traders Ltd and ors* (1987) 1 NZBLC [102,732]; *Powell v Thompson* [1991] NZLR 597.

41 *Ibid* at 608.

42 *Ibid.*

43 *Ibid.*

44 (unreported decision, New Zealand High Court, Smellie J, 12 July 1996).

45 *Ibid* at 230.

46 *Ibid* at 239 His Honour found that the Crown had knowledge of type (2), or at least, type (3) and did not need to make a finding of whether knowledge types (4) and (5) will be sufficient.

In conclusion, prior to the decision in *Powell,* the New Zealand position was consistent but stagnant. Constructive notice was accepted as sufficient for liability without consideration of why this should be so. This approach was challenged in *Powell.* The underlying rationale of the decision in this case is similar to the view adopted in England by Millett J in *Agip.*[47] Justices Millett and Thomas were both looking to unjust enrichment as the underlying principle which should determine liability. However, the principle was applied differently, as Thomas J was more concerned with comparing the equities between the parties.

The view of Thomas J may not ultimately be accepted. In any event, the decision may prompt the New Zealand courts to reconsider their position. This process appears to have started in the *Equiticorp* decision. If constructive notice is considered sufficient, the courts should articulate why this is so, particularly if unjust enrichment is the foundation of liability. If constructive notice is ultimately rejected, this should only be as the result of reasoned analysis, and not merely by application of tests prevailing in another jurisdiction.

C. Australia

The leading Australian case on third party liability for breach of trust is *Consul Development Pty Limited v DPC Estates Pty Limited.*[48] The Australian position is different from both New Zealand and England. The trend in Australia is to accept knowledge of types (1) to (4) from *Baden,* but to reject (5), constructive knowledge due to a negligent failure to inquire. This trend commenced with the decision in *Consul.*[49]

The case was one of knowing assistance rather than knowing receipt. However, the judgments make little or no distinction between knowing assistance and knowing receipt, and the statements of principle made in the case can be applied to knowing receipt. The main majority judgments were given by Gibbs and Stephen JJ.

Justice Gibbs made no distinction between knowing assistance and knowing receipt, treating both categories of constructive trusteeship as "knowing participation in breach of fiduciary duty". This includes where trust property is received, and also where no such property can be said to

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47 Note 2 *supra.*

48 Note 2 *supra.*

49 *Consul* has been applied without discussion of principle in numerous cases. Liability has been imposed in the following cases: *Linter Group Ltd (in liq) v Goldberg* 7 ACSR 580; *In the Marriage of Wagstaff* (1990) 99 FLR 390; *Colour Control Centre Pty Ltd v Ty* [1996] 39 AILR 4316; *Tavistock Pty Ltd v Saulsman* 3 ACSR 502; *Southern Cross Commodities Pty Ltd (in liquidation) v Ewing* (1987) 91 FLR 271. See also *Stephens Travel Service International Pty Ltd (Receivers and Managers appointed) v Qantas Airways Ltd* (1988) 13 NSWLR 331, however, the main issue in this case was whether the bank had received funds, and not the level of knowledge sufficient for liability.

have been received.[50] His Honour did not make a concluded statement on the issue of type (5) constructive knowledge,[51] but stated:

> It may be that it is going too far to say that a stranger will be liable if the circumstances would have put an honest and reasonable man on inquiry, when the stranger's failure to inquire has been innocent and he has not wilfully shut his eyes to the obvious. On the other hand, it does not seem to me to be necessary to prove that a stranger who participated in a breach of trust or fiduciary duty with knowledge of all the circumstances did so actually knowing that what he was doing was improper. It would not be just that a person who had full knowledge of all the facts could escape liability because his own moral obtuseness prevented him from recognizing an impropriety that would have been apparent to an ordinary man.[52]

Justice Stephen (with whom Barwick CJ agreed) considered whether the reference to knowledge in *Barnes* must be taken to include constructive knowledge, and concluded that he was not bound to accept a test of constructive notice based on negligence.[53] He then stated that the position may be different where "a defendant knows of facts which themselves would, to a reasonable man, tell of fraud or breach of trust".[54]

Although this comment was made in the context of discussing knowing assistance, it would seem to apply equally to knowing receipt. His Honour made it clear that he saw no reason why there should be a distinction between the type of knowledge required for knowing assistance and the knowledge required for knowing receipt.[55] As there was no argument on the point, Justice Stephen's comments perhaps indicate a willingness to adopt separate tests for knowing assistance and knowing receipt if the point had been fully argued.

Justice McTiernan dissented on the facts and would have imposed a constructive trust on the defendant. His Honour clearly preferred a wide view of knowledge, and would have applied all five of the *Baden* categories.[56] As with Gibbs J, McTiernan J treated the case under a broad heading of participation in breach of fiduciary duty without clearly differentiating between knowing receipt and knowing assistance.[57]

It is unlikely that knowing assistance and knowing receipt would be run together today. However, until *Consul* is reconsidered by the High Court, the majority view is that the same test for knowledge applies for all forms of liability under *Barnes*.

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50 Note 2 *supra* at 396-7.

51 Justice Gibbs assumed that the decision in *Selangor United Rubber Estates Ltd v Craddock (No 3)* note 2 *supra* was correct. In this decision, Ungoed-Thomas J said that sufficient knowledge for liability was knowledge of circumstances which would put an honest and reasonable man on inquiry. This corresponds to *Baden* knowledge type (5).

52 Note 2 *supra* at 398.

53 *Consul* note 2 *supra* at 412.

54 *Ibid.*

55 *Ibid* at 410.

56 *Ibid* at 386.

57 *Ibid* at 378.

In *US Surgical Corp v Hospital Products,*[58] the NSW Court of Appeal interpreted *Consul* as accepting *Baden* categories (1) to (4) as sufficient for liability. In this case, the Court of Appeal interpreted Justice Gibbs' test of moral obtuseness as being the same as Justice Stephen's test of unreasonable failure to recognise fraud or breach of duty.[59] In any event the Court recognised that it was bound to reject constructive notice by reason of a negligent failure to inquire.[60] In effect, the NSW Court of Appeal interpreted both of the main majority judgments as endorsing constructive knowledge where the defendant knows the facts but does not connect them to a breach of duty.[61]

Two decisions arguably apply a broader test than *Consul*. First, in *Ninety Five Pty Ltd (in liquidation) v Banque Nationale de Paris*[62] the defendant bank was sued for knowing receipt. In deciding the claim, Smith J considered *Consul* and the English authorities.[63] His Honour considered that the result of the English authorities is that liability for knowing receipt depends not on "dishonesty but on notice - which may be constructive notice - that is to say liability can arise where the recipient does not know but ought to know".[64] He considered the cases to be "authority for the proposition that it is not essential...to prove dishonesty or want of probity on the part of the third party who receives trust property for liability to arise under the first limb of Lord Selborne's proposition".[65] On this basis he was prepared to find the bank liable unless it was a bona fide purchaser without notice. He concluded that the bank had sufficient notice. The bank manager had knowledge of sufficient facts to enable the conclusion to be drawn that the bank was receiving funds from a company whose directors were acting in breach of fiduciary duty, although the bank manager did not know the legal consequences of those facts.[66] Ultimately, the conclusion in

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58 [1983] 2 NSWLR 157.

59 *Ibid* at 254. See M Lodge, "*Barnes v Addy*: The Requirements of Knowledge" (1995) 23 *ABLR* 25, who suggests that Stephen J applied a different, and more limited test to that of Gibbs J. AJ Oakley, note 2 *supra*, p 75, considers that the views of Gibbs J and Stephen J are the same, and that they both accept categories (1) to (4).

60 Note 58 *supra* at 256.

61 See also the dissenting judgment of Kirby P in *Equitcorp Finance Ltd v Bank of New Zealand* (1993) 32 NSWLR 50 at 104. Note that he considered an argument that knowledge type (5) was sufficient. In the opinion of His Honour, this was a case where each of the five types of knowledge from *Baden* existed. Thus, there was a situation where the bank was put on inquiry. President Kirby did not disapprove of the argument, and noted that a type (5) level of knowledge existed, but based his decision on the presence of knowledge of types (2) and (3), that is a shutting of eyes to the obvious, or a wilful and reckless failure to make inquiries.

62 [1988] WAR 132.

63 In particular, His Honour considers *Selangor* note 2 *supra*; *Karak* note 2 *supra*; *Baden* note 2 *supra*; *Belmont (No 2)* note 13 *supra*; and *Rolled Steel Products* note 13 *supra*. In the decision of *Belmont (No 2)* actual or constructive knowledge was said to be sufficient. The decision was also quoted with approval by Southwell J in *Linter* note 49 *supra*.

64 Note 62 *supra* at 174.

65 *Ibid* at 176.

66 Type (4) knowledge from *Baden*.

the case is consistent with *Consul* although the reasoning suggests that a broader test was applied.[67]

In *Beach Petroleum NL v Johnson*[68] von Doussa J stated, in obiter, that the "first limb of *Barnes v Addy* may apply to impose a constructive trust where the recipient of trust funds ought to have known that the funds were being misapplied".[69] His Honour did not indicate exactly what he meant by using the phrase "ought to have known" and he could have been referring to knowledge in the type (5) sense from *Baden*.

Recently, *Consul* was discussed in *Lord v Spinelly*[70] and *BTR Engineering (Australia) Ltd v Patterson*.[71] In *Spinelly*, the defendant had received money as a volunteer and would have been liable to a tracing action. However, the money received by the defendant had been spent. Therefore, Commissioner O'Connor had to consider if liability remained, even after dissipation of the property.

He referred to the judgment in *Consul*, and also to the decision of Smith J in *Ninety Five*, and continued as follows:

> It seems to me that it is still an open question, at least in Australia, as to the extent of the knowledge which is required before the recipient of trust property will be held to be a constructive trustee. The obiter dicta of Gibbs and Stephen JJ in *Consul*...[*sic* was] in the context of a case of assistance in a breach of trust. I do not see why the principles should be any different where the defendant actually receives the trust property. Thus I am inclined to doubt the view taken by Smith J in *Ninety Five*...that a person may have knowledge imputed to him, sufficient to render him a constructive trustee, in the absence of any want of probity.[72]

He did not express a concluded opinion because, on the facts, a reasonable person acting honestly would have been suspicious and would have made proper inquiry. Thus, there was sufficient lack of probity to impute knowledge of the breach of trust.[73]

In *BTR*,[74] Justice Giles considered a claim that third parties had knowingly received property. On the issue of knowledge required by the third parties, his Honour was obviously swayed by the decisions in *Re Montagu* and *Lipkin Gorman*. His Honour stated:

> I do not think that the earlier cases establish that constructive notice in the sense developed in equity for the determination of the priority of proprietary

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67 The case was recently applied in *Hinds v Uellendahl* (unreported, Supreme Court of the Northern Territory, Thomas J, 22 September 1995). However, the case is arguably still consistent with *Consul*, as Thomas J held, at 55, that the defendant "turned a literal blind eye", and that "there was a calculated abstention from inquiring".

68 (1993) 115 ALR 411.

69 *Ibid* at 592.

70 (1991) 4 WAR 158.

71 (unreported, Supreme Court of New South Wales, Parker J, 20 June 1991).

72 Note 70 *supra* at 174.

73 See also the decision of Master Adams in *Hancock Foundation v Belle Rosa* (1992) 8 WAR 435 at 439, where it was stated: "there is...no concluded authority on the question of what degree of knowledge is required to constitute constructive notice in a 'knowing receipt' case". The Master was not required to decide the issue.

74 Note 71 *supra*.

> interests is sufficient for the personal liability which can arise under the first limb of *Barnes v Addy*...[75]

He then referred to the decision of the New South Wales Court of Appeal in *Hospital Products*, and stated that he interpreted the reference in that case to "facts which, to a reasonable man would demand inquiry" as being equivalent to "knowledge of facts which would tell of fraud or breach of trust".[76] In other words, he equated it to type (4) knowledge from *Baden*. Interestingly, he read down the decision in *Ninety Five*, stating that it could be read in the same way as the Court of Appeal decision. When the decision in the *Ninety Five* case is read closely, it is difficult to see how this conclusion can be reached.

Justice Giles applied the findings of the NSW Court of Appeal in *Hospital Products* to the case before him. He considered that as type (4) knowledge had been held to be sufficient for knowing assistance, he should accept it for knowing receipt. Further, as constructive notice due to a failure to make inquiries was rejected by the Court of Appeal for knowing assistance, he saw no reason why it should be sufficient for knowing receipt, and concluded that it was open for him to so hold.

In conclusion, the majority of Australian decisions have applied *Consul*, resulting in type (4) knowledge on the *Baden* scale being sufficient for liability. The Australian position is narrower than the prevailing New Zealand position, and does not represent any of the views which have been adopted in England. Unfortunately, the Australian decisions contain virtually no discussion of principle justifying this conclusion. If the Australian view is to be preferred to the views put forward in other jurisdictions it must be justified by reference to underlying principle.

III. KNOWING ASSISTANCE

A. The English Position Prior to the Decision of *Royal Brunei*

The early English cases[77] did not differentiate between claims of knowing assistance and knowing receipt. However, in *Baden* it was recognised that the limbs of Lord Selborne's test involve two different bases for liability. Once the limbs in *Barnes* are treated as separate, knowing assistance must be analysed in its own right. The controversial issues with the test of knowing assistance have been the level of knowledge required before liability will be imposed, and the question whether the defendant must be assisting in a dishonest and fraudulent design.

(i) Knowledge for Knowing Assistance

In *Baden*, Gibson J set out three elements necessary to prove a claim of knowing assistance. The defendant must know that a design having the

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75 *Ibid* at 108.

76 *Ibid.*

77 *Selangor* note 2 *supra*; *Karak* note 2 *supra*.

character of being fraudulent and dishonest was being perpetrated, the defendant must know that his or her act assisted in the implementation of such a design, and the knowledge must be of facts and not mere claims or allegations.[78] In his opinion, any of the five categories of knowledge he set out was sufficient for liability for knowing assistance.[79] However, he said that type (5) knowledge should only be imputed in exceptional circumstances where an agent, such as a bank, is acting honestly on the instructions of its principal.[80]

This was not the accepted view prior to *Royal Brunei*.[81] The view that negligence is sufficient for liability was first questioned in *Belmont Finance Corporation Ltd v Williams Furniture Ltd*.[82] Since then, there has been a strong trend toward only the first three categories being sufficient for knowing assistance liability.[83]

The reason for rejecting negligence as a sufficient basis for liability was articulated by Millett J in *Agip*.[84] His Honour stated that knowing assistance relates to "furtherance of fraud", and in his view it was not sensible to require "dishonesty on the part of the principal while accepting negligence as sufficient for his assistant". On this point he concluded:

> Dishonest furtherance of the dishonest scheme of another is an understandable basis of liability; negligent but honest failure to appreciate that someone else's scheme is dishonest is not.[85]

The position of the appeal judges in *Agip* was less clear.[86] Lord Fox gave the leading judgment and appeared to approve earlier decisions which accepted constructive notice. He referred to all of the *Baden* categories, without indicating if all or some were sufficient for knowing assistance liability.[87] On the facts the defendants were liable, as it was held that the defendants knew that something was being concealed and that honest people in their situation would have satisfied themselves that no fraud was involved. [88] This corresponds with *Baden* categories (2) or (3). The

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78 Note 2 *supra*.

79 This reflects the position from *Selangor* and *Karak*. See note 2 *supra*.

80 Note 2 *supra* at 243.

81 Note 7 *supra*.

82 [1979] 1 All ER 118.

83 In *Lipkin*, the issue of the bank as constructive trustee was not taken to the House of Lords. Only the first three categories were considered sufficient by Alliott J, the judge at first instance. See note 27 *supra*. In the Court of Appeal, [1992] 4 All ER 409, the finding of knowing assistance against the bank was overturned on an issue of pleading. However, May LJ, at 420, said there was "at least strong persuasive authority" that only categories (1) to (3) from *Baden* are relevant. See also *Cowan de Groot* note 2 *supra*, and *Polly Peck* note 28 *supra*.

84 Note 2 *supra*.

85 *Ibid* at 404-5.

86 Note 2 *supra*.

87 *Ibid* at 467. See S Gardner note 12 *supra* at 65 who says it is not "absolutely clear what Fox LJ was driving at in the passage in question" and refers to the judgment [1991] Ch 547 at 553C and 569C-570D, where he says his Lordship indicated that liability depends upon dishonesty.

88 Note 2 *supra* at 469.

judgment leaves open the possibility that less knowledge would, nonetheless, have been sufficient.

In the later case of *Eagle Trust*,[89] Vinelott J interpreted the judgment of Fox LJ in *Agip* to contain an implicit acceptance of the test propounded by Millett J at first instance.[90]

(ii) Need for a Dishonest and Fraudulent Design

In England, prior to *Royal Brunei*, it was not doubted that there must be participation, by the defendant, in a dishonest and fraudulent design of the trustee. It was not questioned in the cases of *Baden*, and *Belmont (No 1)*;[91] where the judges strongly rejected an argument that there was no need for a fraudulent and dishonest design.

The term requires more than just a breach of trust or misfeasance which is not dishonest; and no distinction is drawn between the words "dishonest" and "fraudulent". An accepted meaning of fraudulent conduct is the "taking of a risk to the prejudice of another's rights, which risk is known to be one which there is no right to take".[92]

B. The English Position After the Decision in *Royal Brunei Airlines Sdn Bhd v Tan*[93]

The decision in *Royal Brunei* has fundamentally changed the legal test for knowing assistance. Although it is a decision of the Privy Council from Brunei, it heralds the view which is surely to be taken in England from now on.

In this case, the airline was seeking to recover money from Mr Tan, the principal director and shareholder of an insolvent travel agency, Borneo Leisure Travel Sdn Bhd ("BLT"). BLT had been appointed as a general travel agent for the airlines. The terms of its appointment provided that BLT collected moneys on behalf of the airlines, and was to hold the collected moneys on trust. The moneys received on behalf of the airline were, in fact, paid into BLT's ordinary current account with its bank, and were used for BLT's ordinary purposes. The Court of Appeal of Brunei Darussalam held that there had been no fraud or dishonesty on the part of BLT, and it was conceded that Mr Tan had assisted the company in breaching its duty.

The issue for the Privy Council was whether Mr Tan could be liable for knowing assistance even though the breach by the trustee was not dishonest and fraudulent.

Lord Nicholls of Birkenhead delivered the advice of the Privy Council and held that Mr Tan could be liable, notwithstanding that there was no

89 Note 10 *supra*.
90 *Ibid* at 499.
91 Note 82 *supra*.
92 Note 2 *supra* at 234, per Peter Gibson LJ.
93 Note 7 *supra*.

dishonest and fraudulent design on the part of BLT.[94] In coming to this conclusion, the court said that "there has been a tendency to cite Lord Selborne's formulation as though it were a statute" resulting in an approach "inimical to analysis of the underlying concept".[95]

Lord Nicholls provided the following example of how the knowing assistance test (what he calls accessory liability) had, in his view, been artificially constricted. A trustee wishes to make a payment out of a trust fund, and believes that the payment is within power. The trustee's solicitor is asked to arrange the payment. The solicitor knows that the payment is a breach of trust, knows that the trustee believes the payment to be within power, and dishonestly does not advise the trustee of this. In his Lordship's opinion, accessory liability should be available in this situation. However, under the law as it then stood, the solicitor would not be liable as an accessory, as the trustee was not engaged in a dishonest and fraudulent design in which the solicitor could be assisting. Therefore, it was necessary to "take an overall look at the accessory liability principle".[96]

The principle formulated by Lord Nicholls is one of liability for dishonest conduct. Honesty is an objective standard, but is to be assessed with regard to a particular defendant in light of what was subjectively known by the defendant at the time. The court will also consider the personal attributes of the defendant. Lord Nicholls rejected a formulation of liability based on whether the defendant "'knowingly' assisted, as he considered that "knowingly" is inapt as a criterion when applied to the gradually darkening spectrum where the differences are of degree and not kind".[97]

The overall restatement of the principle is, therefore, that accessory liability arises for the dishonest procuration of assistance in a breach of trust or fiduciary obligation, even where the trustee is not acting dishonestly.

On the face of the decision it appears that knowledge will no longer be relevant for accessory liability. However, it may not be possible for courts to determine the honesty or dishonesty of a defendant's state of mind without determining what the defendant knew. Gardner has stated the issue as follows:

> If a person's behaviour must be defined by a process which includes reference to the motives and attitudes with which he acted, reference must inevitably be made to that person's cognisance (to use a neutral term) of the potential harm in question...It is doubtful, then, that the new law of direct reference to a concept of dishonesty obviates any need for an exegesis upon cognisance.[98]

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94 Note the comment by L Aitken in "Liability for "Knowing Assistance" (1995) 69 *ALJ* 785 at 787 that the Privy Council does not explain how "Tan himself could be relevantly dishonest when the company which he controlled and was his alter ego was 'not guilty of fraud or dishonesty in relation to the amounts it held'".

95 Note 7 *supra* at 103.

96 *Ibid.*

97 *Ibid* at 107.

98 Gardner note 12 *supra* at 67. See also G Watt, "Accessory Liability for Breach of Trust" (1995) 4 *Nottingham LJ* 111 at 116 where it is stated, "descriptions of what is dishonest bear an uncanny

In a recent unreported decision, Rimer J commented in obiter:

> In my view the judgment proceeds on the basis that a claim based on accessory liability can only be brought against someone who knows of the existence of the trust, or at least of the facts giving rise to the trust; and all that the judgment is directed at clarifying is what further is also needed to be shown in order to make the accessory liable. The only further ingredient is dishonesty on the part of the accessory, and that is a sufficient ingredient.[99]

It is the second change to the test of knowing assistance effected by *Royal Brunei* which is the most important. The requirement that the stranger be assisting in a dishonest and fraudulent design has been removed. Under Lord Nicholls' new accessory liability principle there must still be a breach of trust or fiduciary duty, but the trustee need not be acting dishonestly. The only dishonesty required is that of the stranger.

In conclusion, the decision in *Royal Brunei* may or may not result in the issue of knowledge becoming irrelevant for accessory liability for a breach of trust. Ultimately, dishonesty may be assessed using similar tests. The fundamental change to the law has been the removal of the requirement that the trustee be acting pursuant to a dishonest and fraudulent design.

C. New Zealand

In New Zealand the main question with respect to knowing assistance has been the appropriate level of knowledge for liability. The initial trend in New Zealand was toward the pre-*Brunei* English position. However, more recently, it has been suggested that liability can be judged by reference to unconscionability rather than simply by knowledge.

In *Savin* (a knowing receipt case), Sir Clifford Richmond indicated that he was strongly in favour of the approach of the English Court of Appeal in *Belmont Finance Corporation v Williams Furniture (No 2).*[100] In saying this, he was indicating a preference for the view that want of probity is required for liability for knowing assistance.

In *Marr and anor v Arabco Traders Ltd and ors*[101] Tompkins J applied a test of actual knowledge. He considered that this would be constituted by only the first two categories from *Baden* - actual knowledge or a wilful and deliberate shutting of the eyes.[102]

A more flexible approach to knowing assistance has since been applied. In *Powell*, Thomas J held that the basis of liability in knowing assistance is unconscionable conduct.[103] His approach requires flexibility, as all the circumstances of the case must be considered to determine if conduct is

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resemblance to the *Baden* knowledge-types. Counsel in future cases will have the unenviable task of disputing "dishonesty" on the basis of the defendant's conduct, and the state of mind evidenced by that conduct, whilst seeking to place no reliance on, nor drawing aid from, *Baden*-like categories of knowledge".

99 *Brinks Ltd v Abu-Saleh and ors* (unreported, Chancery Division, Rimer J, 10 October 1995) at 38.

100 Note 13 *supra.*

101 Note 40 *supra.*

102 *Ibid* at [102,762].

103 Note 40 *supra.*

unconscionable. The level of knowledge is not the sole determining factor and cannot be rigidly set for all situations. However it is clear that, depending on the circumstances, actual or constructive knowledge may suffice.[104] Justice Thomas gave no indication of particular factors which should be taken into account when considering the facts of a case, and stated that:

> it is ultimately a question of fact and degree, namely, whether in the circumstances of the particular case, the conduct of the defendant can properly be described as unconscionable to the point that he or she should be required to assume the obligations of a constructive trustee and account to the plaintiff.[105]

Further, as part of his flexible approach, Thomas J rejected the requirement that the defendant must have assisted in the dishonest and fraudulent design of the trustee. Again, in his opinion, all of the relevant facts can be put together and considered under the umbrella of unconscionable conduct.

The test of unconscionability was accepted, in principle, by Wylie J in *Equiticorp Industries Group Ltd v Hawkins*.[106] However, Wylie J had a different view of what constitutes unconscionability. In his view, unconscionability equated to want of probity, and did not include "mere carelessness, neglect or oversight, which is not wilful or reckless".[107] The result of Justice Wylie's view is that, prima facie, the first three of the *Baden* categories are relevant. Interestingly, however, Wylie J commented that "in practice it is likely, if not inevitable, that lack of probity will elevate what would otherwise have been a type (4) or (5) knowledge to the level of types (2) or (3)".[108] Unfortunately, His Honour did not indicate what factors would be relevant in this context.

The approach of Wylie J was endorsed in *Marshall Futures Ltd* v *Marshall*.[109] Justice Tipping did not express a concluded view, but found Justice Wylie's approach "more satisfactory and consistent with precedent and the approach of other jurisdictions than that of Thomas J".[110] He rejected carelessness or lack of imagination as sufficient knowledge of a dishonest and fraudulent design.

The final New Zealand decision, prior to *Royal Brunei*, containing any analysis on the principles of knowing assistance is *Nimmo v Westpac Banking Corporation*.[111] In his judgment, Blanchard J referred to two schools of thought on knowing assistance. He recognised that the approach requiring dishonesty or want of probity was "very much the majority

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104 *Ibid* at 615.
105 *Ibid* at 610.
106 [1991] 3 NZLR 700.
107 *Ibid* at 728.
108 *Ibid*.
109 [1992] 1 NZLR 316.
110 *Ibid* at 325.
111 [1993] 3 NZLR 218.

view".[112] The minority view is the unconscionability approach of Thomas J from *Powell*.

Justice Blanchard considered the *Baden* categories unhelpful and unrememberable[113] and approved of the view of Knox J in *Cowan de Groot*: that a test of "commercially unacceptable conduct" may underlie the authorities.[114] Ultimately, he concluded that in the absence of a Court of Appeal decision on point he should apply the test of dishonesty. However, as he had identified a second school of thought he also addressed the question of unconscionability in his judgment.[115]

There has been one case in New Zealand since *Royal Brunei*. In *Cigna Life Insurance New Zealand Ltd v Westpac Securities Ltd*, Greig J held that there was no liability as a constructive trustee. His Honour interpreted the Privy Council case as supporting the "want of probity" test, and did not refer to the authorities on unconscionability.[116]

In conclusion, the stronger line of authority in New Zealand accepts knowledge of types (1) to (3) from *Baden*, although there is some support for the less structured approach of Thomas J in *Powell*. The unconscionability approach, as formulated by Thomas J, is similar to the *Royal Brunei* test of accessory liability. Neither requires the defendant to be assisting in a dishonest and fraudulent design of the trustee, and neither test focuses on the knowledge of the defendant. The difference is between defining the defendant's conduct as unconscionable rather than dishonest. The test of unconscionability, as broadly defined by Thomas J, can apply to a defendant who has been careless. However, given the recent interpretation of *Royal Brunei* in New Zealand, it remains to be seen whether the unconscionability approach will be adopted with more vigour.

D. Australia

In Australia, the generally accepted view is that type (5) knowledge from *Baden* is not sufficient for liability, but knowledge types (1) to (4) will be sufficient. This is wider than the preponderant New Zealand view, and the English view prior to *Royal Brunei*. Where Australian judges have been in doubt as to the proper test, the test has generally been framed narrowly to avoid controversy. Lord Nicholls' reformulation of accessory liability has been considered in Australia, but the test of dishonesty has not yet been applied in preference to the test of knowledge.

It seems that in Australia, mere breach of fiduciary duty will satisfy the requirement of a "dishonest and fraudulent design". Due to this loose formulation of the above requirement, Australian courts may be more ready

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112 *Ibid* at 226.
113 *Ibid* at 228.
114 *Ibid* at 228.
115 *Ibid* at 236.
116 *Cigna Life Insurance New Zealand Ltd v Westpac Securities Ltd* [1996] 1 NZLR 80 at 87-8, per Greig J.

to accept Lord Nicholls' accessory liability formulation than New Zealand courts are likely to be.

(i) The Level of Knowledge Required

The decision of the High Court in *Consul Development*[117] is the leading case on knowing assistance in Australia. The majority judges (Barwick CJ, Gibbs and Stephen JJ) rejected type (5) knowledge from *Baden*. Only McTiernan J would have accepted constructive knowledge due to a failure to make inquiries.

Justice Gibbs was prepared to impose liability on a morally obtuse defendant who did not realise the impropriety of his or her conduct if the impropriety would have been apparent to an ordinary person.[118] Justice Stephen (with whom Barwick CJ agreed) accepted that liability could be imposed where the facts would tell of fraud or breach of trust to a reasonable defendant, and where the defendant consciously refrained from inquiry.[119]

In *US Surgical Corp v Hospital Products* the Court interpreted Justice Gibbs' test of moral obtuseness to be the same as Justice Stephen's test of unreasonable failure to recognise fraud or breach of duty.[120] The result seems to be that *Consul* stands for the proposition that types (1) to (4) of knowledge on the *Baden* scale are sufficient for liability, but type (5) knowledge is not.[121]

Very little discussion on knowing assistance can be found in other Australian cases. The cases which address the issue of knowledge are *BTR Engineering*,[122] *Ninety Five*,[123] *Beach Petroleum*,[124] *ASC v AS Nominees*,[125] and *Turner v TR Nominees*.[126]

In *BTR*, Parker J applied the conclusions of the NSW Court of Appeal *in US Surgical Corp v Hospital Products* saying that:

> a calculated omission to enquire for fear of unearthing fraud or breach of duty, or the unreasonable failure to recognise fraud or breach of duty, may be equivalent to actual knowledge of the breach of duty and of the dishonest and fraudulent design, but innocent (albeit negligent) failure to enquire will not.[127]

Justice Parker was also required to decide if the defendant stranger had assisted the defaulting fiduciary in the dishonest and fraudulent design of

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117 Note 2 *supra*.
118 *Ibid* at 398.
119 *Ibid* at 412.
120 *US Surgical Corp* note 58 *supra* at 254.
121 *Ibid* at 256. This view is supported by the recent decision of the New South Wales Court of Appeal in *Sansom v Wesptac Banking Corporation* [1996] Aust Torts Rep [63,315]. The Court rejected a test of constructive notice. See also the dissenting judgment of Kirby P in *Equiticorp Finance Ltd v Bank of New Zealand* note 61 *supra* at 104.
122 Note 71 *supra*.
123 [1988] WAR 132.
124 Note 68 *supra*.
125 (1995) 133 ALR 1.
126 (1995) Aust Torts Rep 578.
127 Note 71 *supra* at 95.

the fiduciary. The defendant had argued that any design had terminated by the time the defendant did acts which could constitute assistance. In determining the scope of the design of the defaulting fiduciary, Parker J was not prepared to confine the dishonest design to the acts immediately constituting the breach of duty. He stated that, as it is usually essential to the design of the defaulting fiduciary that a benefit be received from the breach of duty, the stranger could be liable for assisting the fiduciary to obtain the benefit without being involved in the initial breach of duty.[128]

In *Ninety Five*, Smith J, in obiter, briefly addressed the issue of knowledge for knowing assistance. His Honour had indicated that, in his view, constructive notice was sufficient for knowing receipt, then commented as follows:

> The position may well be otherwise in circumstances in which the trust property does not pass through the hands of the defendant in relation to the knowing participation category of liability in that for liability to arise under that limb of Lord Selborne's proposition the knowledge, actual or constructive, may need to include actual or constructive awareness of the facts relevant to the breach of duty.[129]

A narrower view was taken by von Doussa J in *Beach Petroleum,* where his Honour held that a particular defendant was not liable, on the ground that the second limb of *Barnes* required actual knowledge.[130]

The rule was also expressed conservatively by Finn J in *ASC* v *AS Nominees Ltd.*[131] His Honour deliberately expressed the rule in a conservative form as this was sufficient for a decision to be made on the facts, and avoided any implication in the "controversies which have beset this limb of *Barnes v Addy*".[132] The rule was expressed to apply against a person who "knowingly or recklessly assists in or procures a breach of trust or of fiduciary duty by a trustee".[133]

The formulation is conservative for two reasons. First, although *Royal Brunei* was cited, the formulation retains reference to knowledge, rather than dishonesty. Secondly, the formulation given by Finn J adopts a narrow view of the knowledge sufficient for liability.

Lord Nicholls' formulation from *Royal Brunei* was also discussed in *Turner v TR Nominees Pty Ltd.* Unlike Finn J, Santow J applied the test of dishonesty from *Royal Brunei.* He held that the conduct of the defendant was dishonest, as it was deliberate, and occurred in circumstances where the defendant should have known that he was dealing with trust money. The conduct was dishonest even though the defendant may have considered himself morally justified in his conduct. Justice Santow also applied the traditional formulation of knowing participation, and found the defendant liable on that formulation also.

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128 *Ibid* at 92.
129 Note 123 *supra.*
130 Note 68 *supra* at 592, citing *Belmont (No 1).*
131 Note 125 *supra.*
132 *Ibid* at 19.
133 *Ibid.*

(ii) The Need for a Dishonest and Fraudulent Design

In *Consul*, both Gibbs and McTiernan JJ framed their tests of liability broadly, using the term "participation in breach of fiduciary duty". This is a wider test than knowing assistance, as it does not specifically require a dishonest and fraudulent breach by the trustee or fiduciary. Justice Gibbs also accepted the early English interpretation of "dishonest and fraudulent" as words which are to be understood using ordinary principles of equity.[134] This is broader than the interpretation given to "dishonest and fraudulent" in modern English decisions prior to *Royal Brunei.*

Justice Stephen did not explicitly consider the meaning of "dishonest and fraudulent". He referred to fraud and dishonesty when discussing the defendant's conduct, but did not indicate whether he was using these words to equate with *morally* reprehensible conduct (including any breach of fiduciary duty) or whether he considered that the defendant was consciously dishonest in acting the way he did.[135]

Since the members of the High Court do not adopt a consistent test (whether the test be "knowing assistance" or "knowing participation"), later Australian authority is also inconsistent. Most recently, the High Court applied the test of "participation in breach of fiduciary obligation".[136] In other decisions the defendant has been found liable for "participation in breach of trust or fiduciary duty";[137] "participation with knowledge in a dishonest and fraudulent design";[138] "knowing assistance in a breach of fiduciary duty";[139] and "knowing assistance in a dishonest and fraudulent design of the trustee".[140]

The Australian position on the need for a dishonest and fraudulent design is not settled. However, as the Privy Council has rejected the need for such a design, Australian courts may now prefer the test of "participation in

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134 From *Selangor* note 2 *supra.*

135 The facts of the case suggest that even using the English test of "dishonest and fraudulent" the defendant Grey would have been held to be acting in furtherance of a dishonest scheme.

136 *Warman v Dwyer* (1995) 182 CLR 544 No discussion of principle was made. Third party liability was not the major issue before the court.

137 *Transport Industries Insurance Co Ltd v Brown* (unreported, Supreme Court of New South Wales, Wood J, 24 July 1987); *Tutte v Exelby* (unreported, Supreme Court of Queensland, Sheperdson J, 31 August 1992); *Douglass Automated Laboratories and Allied Services Pty Ltd v Sonic Technology Australia Ltd* (unreported, Supreme Court of NSW, Giles J, 8 June 1994); *Ravinder Rohini Pty Ltd v Kriziac* 105 ALR 593; *Turner v TR Nominees Pty Ltd* note 126 *supra. Turner* applies the decision in *Royal Brunei* note 7 *supra.*

138 *Avtex Airservices Pty Ltd v Bartsch* (1992) 107 ALR 541.

139 *Biala Pty Ltd v Mallina Holdings Limited* (1993) 13 WAR 11; *Colour Control Centre Pty Ltd v Ty* note 49 *supra*; *Tavistock Pty Ltd v Saulsman* note 49 *supra; Australian Securities Commission v AS Nominees Ltd* note 125 *supra* 1.

140 *Akhil Holdings Ltd v Bank Commerciale SA (in liq)* (unreported, Supreme Court of NSW, Kirby P, Hope and Clarke JJA, 15 November 1988). Note that the decision was later set aside by the High Court on the grounds that the pleadings against the defendant bank had not pleaded fraud: see *Banque Commerciale SA, En Liquidation v Akhil Holdings Ltd* (1990) 169 CLR 279; *Gulf Pacific Pty Ltd v Londish* (unreported, Federal Court, Wilcox J, 15 October 1992); *Re Terrence Murray Lewis* [1995] 2 Qd R 506.

breach of fiduciary duty", as it follows two judges of the High Court, as well as being more consistent with the Privy Council formulation.

In conclusion, as the Australian position is based on one High Court decision handed down in 1975, there is insufficient Australian authority to state a settled Australian position. However it is clear that, to date, the Australian cases use a lower knowledge threshold than New Zealand, or England prior to *Royal Brunei*. Further, two judges in *Consul* adopt a loose view of the "dishonest and fraudulent design" requirement. As a result, the Australian authorities are currently closer to Lord Nicholls' new formulation than were the English authorities prior to *Royal Brunei*.[141]

IV. CONCLUSION

The above discussion has demonstrated the divergent approaches to *Barnes v Addy* that have been taken in three jurisdictions, and how authorities are not consistent within those jurisdictions. In each of the three jurisdictions the approach to the two limbs of third party liability is different. The more recent cases in England demonstrate an attempt by the courts to address third party liability from the basis of underlying principle, rather than as an exercise in interpretation of Lord Selborne's discussion in *Barnes v Addy*.

The English courts have concentrated on the issue of knowledge, but this issue cannot be properly resolved without overall reconsideration of the whole rationale for knowing assistance and knowing receipt. The decision in *Royal Brunei* is, at least, an attempt to introduce a more principled basis to the law on knowing assistance. To date, the New Zealand authorities are remarkably consistent regarding both limbs from *Barnes v Addy*, but do not address the underlying rationale for third party liability. Review of the New Zealand position on both limbs is required. In Australia, the law on knowing assistance and knowing receipt is clearly underdeveloped, and urgently in need of consideration by the High Court.

141 In the decisions of *Sansom v Wesptac Banking Corporation* note 121 *supra*, the New South Wales Court of Appeal applied the test of knowing assistance in a dishonest and fraudulent design. Although the decision was handed down in March 1996, no reference was made in the judgment to the Privy Council decision of *Royal Brunei*.