CRAIG R SHRIVE

A BANK'S LIABILITY FOR PARTICIPATION IN A BREACH OF TRUST OR FIDUCIARY DUTY

LLB(HONS) RESEARCH PAPER
BANKING LAW AND BODIES CORPORATE (LAWS 523)

LAW FACULTY
VICTORIA UNIVERSITY OF WELLINGTON

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I INTRODUCTION 4

II BANKING PRINCIPLES 5

III STRANGERS AS CONSTRUCTIVE TRUSTEES 6

IV BANKS AS STRANGERS 8

A The Bank as Recipient 8

B The Bank as Assistor 11

V THE 'KNOWLEDGE' REQUIRED TO FIX LIABILITY 12

A The Categories of 'Knowledge' 12

1 The development of knowledge 12

2 Dishonesty 14

3 Constructive notice 15

B A Bank's Knowledge 20

C Knowledge of a Breach of Trust or Fiduciary Duty 21

D Accessory Liability 24

1 The dishonesty requirement 24

2 The conduct of the trustee 26

3 The appropriateness of dishonesty 27

E Liability for Knowing Receipt 29

1 The 'mixed' account and constructive notice 29

2 A benefit designed or stipulated for 31

3 Funds received in the ordinary course of business 33

VI THE FUTURE OF RECEIPT BASED CLAIMS 37

A The Rationale For Liability 37

1 Unconscionability 37

2 Unjust enrichment 39

B The Beginnings of Strict Liability? 41

1 The foundation for strict liability 41

2 Defence of change of position 43

3 Bona fide purchaser for value 44

4 The fate of knowledge 45

C The Implications for Banking Practice 46

VII CONCLUSION 48

BIBLIOGRAPHY 50

ABSTRACT

This paper examines the extent to which equity requires a bank to account for its participation in a breach of trust or fiduciary duty. The application of the *Barnes* v *Addy* 'knowing assistance' and 'knowing receipt' categories of liability to the banking situation is discussed, with the current uncertainties, particularly in knowing receipt, highlighted. The paper also addresses the notion that *Barnes* v *Addy* jurisprudence may soon be obsolete, following the decision of the House of Lords in *Lipkin Gorman* v *Karpnale*, and the Privy Council's advice in *Royal Brunei Airlines* v *Tan*. Accordingly, some thoughts on the future development of accessory and receipt based liability, and the possible implications for banks, are provided. Throughout, the position is taken that although banks should be encouraged to take steps to eliminate fraudulent transactions, the efficiency of banking business should not be unduly sacrificed by equity's efforts to protect the interests of individual beneficiaries.

WORD LENGTH

The text of this paper (excluding contents page, footnotes, bibliography and annexures) comprises approximately 14 500 words.

I INTRODUCTION

The financial disaster of the late 1980's has served to highlight issues which concern the distribution of losses upon the collapse of corporate entities and individual dealers. Where financial ruin has occurred, the catalysts for losses vary:[1]

> Fraud, theft and incompetence, the abdication of professional responsibility and regulatory failure, misplaced trust and self-interested complacency are all elements in the explanations investors, depositors, financiers and creditors are now receiving of the causes of their plight.

Where fraud or managerial impropriety has occurred, individuals will have been deprived of legitimate interests. The innocent victim is entitled to a remedy. Unfortunately, the primary wrongdoer is often not worth pursuing for economic reasons. Consequently, "the courts are increasingly concerned with attempts by the victims of fraud to trace their money and recover it, not from the fraudsters or their confederates, who have usually disappeared, but from those through whose hands it has passed."[2]
Inevitably, where funds have been misdirected, banks and other intermediaries will be implicated in the losses which have been suffered. Often, it will be through their hands that money has passed, or even remained. When combined with the 'deep pockets' of a bank, an attractive defendant is created. Hence, banks find themselves subject to victims' attempts to include them in the wrongdoing of another.

This paper addresses situations where the victim of fraud or mismanagement is a beneficiary under a trust or fiduciary relationship. In other words, those situations where the principles of equity must be invoked to aid those deprived of financial interests. Equity must define when third parties (such as a bank) have become implicated in primary wrongdoing to such a degree that they should be liable to account to the victim.

[1] P D Finn "The Liability of Third Parties for Knowing Receipt or Assistance" in D W M Waters (ed) *Equity, Fiduciaries and Trusts 1993* (Corswell, Ontario, 1993) 195.
[2] P J Millett "Tracing the Proceeds of Fraud" (1991) 107 LQR 71, 71.

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There are a variety of competing issues at stake:[3]

> How far is the law to go in creating a new class of insurers against corporate mismanagement and managerial impropriety?... Are liability rules to be skewed towards deep pockets?... And, perhaps most fundamentally, is the law to embrace rules on risk assumption and risk allocation which depart from what should reasonably be attributed to the various parties and actors who come together in business associations and dealings?

The nature of banking business necessarily influences the risks which should be imposed upon banks by the courts. There is a difficult balance to be struck. On one side, a bank's reluctance to inquire into customer affairs contributes to the ease and speed with which a fraud can be perpetrated.[4] On the other, the sheer magnitude of banking transactions dictate against any inquiry. An efficient system is required if banks are to process the vast numbers of daily transactions which are placed before it. Computerisation is essential to this task. Consequently, the opportunities for a bank to make inquiries into the integrity of a particular transaction are limited.

At present, equity's response to this conundrum is found within the rules on strangers as constructive trustees. These rules provide the basis for determining a bank's liability to account to those who have been illegitimately deprived of equitable interests. Before introducing these rules, it is desirable to provide a brief overview of basic banking law principles.

II BANKING PRINCIPLES

The fundamental legal principle which underlies banking practice was enunciated by Lord Cottenham LC in *Foley* v *Hill*:[5]

> Money, when paid into a bank, ceases altogether to be the money of the customer; it is then the money of the banker, who is bound to return an equivalent by paying a similar sum to that deposited with him when he is asked for it. ...The money placed in the custody of a banker is to all intents and purposes the money of the banker, to do with it as he pleases.

[3] Above n 1, 195.
[4] Above n 2, 71.
[5] (1848) [1843] All ER Rep 16, 19.

Hence, a bank is not trustee for the money it holds to the credit of its customer. The bank is a mere debtor, and is free to use the money as its own, subject only to the customer's right to repayment.[6]

The same principle applies when the depositor is a trustee. The bank does not become a trustee itself, but remains a simple debtor. The trustee is a creditor, who may claim the debt on behalf of the beneficiaries.[7] Again, the bank is free to use the money deposited to pursue its own interests.

Consequently, a bank is generally not obliged to inquire into the source of customer funds, or "to pay heed to the claims of third parties seeking to reach it in his hands as being by right theirs."[8] Furthermore, the bank has no responsibility to supervise or check the managerial activities of its customers.

Being rules of general application, they are inevitably subject to exceptions. The special circumstances of a relationship with its customer may require that specific obligations be placed upon the bank. In particular, a bank may be held liable to account as constructive trustee.

III STRANGERS AS CONSTRUCTIVE TRUSTEES

The modern foundation for the law on strangers as constructive trustees is Lord Selborne's often cited statement in *Barnes* v *Addy*:[9]

> [S]trangers are not to be made constructive trustees merely because they act as agents of trustees in transactions within their legal powers, transactions, perhaps of which a Court of Equity may disapprove, unless [they] receive and become chargeable with some part of the trust property, or unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees.

The vast body of case law and academic literature which has emanated from this proposition creates problems for those who try to discern consistency in this area. Professor Rickett aptly describes the situation:[10]

[6] M Megrah and F Ryder *Paget's Law of Banking* (9 ed, Butterworths, London, 1982) 83.
[7] W F Fratcher *Scott on Trusts* (4 ed, Little Brown & Co, Boston, 1987) § 527.
[8] Above n 6, 83.
[9] (1874) 9 Ch App 244, 251.
[10] C E F Rickett "Strangers as Constructive Trustees in New Zealand" (1991) 11 OJLS 598, 600.

> There has been an extraordinary amount of confusion in the cases, compounded by any number of different refinements by academic commentators, concerning both the basic philosophy and the detailed rules of law relating to strangers as constructive trustees.

Indeed, the "voluminous and highly technical literature" and international case law can be described as "Babel-like".[11] Much of the inconsistency is due to past inclinations to apply Lord Selborne's statement literally.[12] Furthermore, it has been suggested that the judiciary has failed to take account of the wide range of circumstances in which a participant in a breach of trust has been held liable in the past. Instead, the focus has been on the *Barnes* v *Addy* categories, which resulted in principles from conceptually distinct categories being assimilated into Lord Selborne's classes of liability.[13] However, the impressive amount of discussion over recent years on strangers as constructive trustees has lead to the acceptance that "the words of Lord Selborne LC merely express a principle which was to be applicable in the case before the Court."[14] Indeed, the validity of the *Barnes* v *Addy* jurisprudence is being questioned, with increased demands for its abandonment.[15] As will become clear by the end of this paper, the law is on the verge of achieving this.

Despite the criticisms of the *Barnes* v *Addy* jurisprudence, the two broad categories of liability from Lord Selborne's judgement are still in frequent use.[16] 'Knowing assistance' or 'accessory liability' concentrates on the conduct of the defendant, and his or her facilitation of the breach of trust. Here, the trustee terminology is misleading. A bank is not liable due to a breach of any constructive trustee obligations - there is simply a personal liability to account for the loss caused by the wrongful act.
The rationale for 'knowing receipt or dealing' liability is debatable. One view suggests the unconscionable conduct of the defendant remains in issue. Alternatively, liability

[11] Above n 1, 196.
[12] See Lord Nicholls in *Royal Brunei Airlines Sdn Bhd* v *Tan* [1995] 3 WLR 64, 70: "there has been a tendency to cite and interpret and apply Lord Selborne's formulation in *Barnes* v *Addy* as though it were a statute."
[13] C Harpum "The Basis of Equitable Liability" in P Birks (ed) *The Frontiers of Liability* (Oxford University Press, Oxford, 1994) 9.
[14] Per Greig J in *Cigna Life Insurance New Zealand Ltd* v *Westpac Securities Ltd* [1996] 1 NZLR 80, 85.
[15] See generally above n 1; above n 13.
[16] This is the case in New Zealand, England and Australia. As Finn notes in above n 1, 198: Canada and the United States do not draw such a sharp distinction between assistance and receipt. Professor Finn would prefer to see a general participatory liability scheme, with the same rules applying to assistance and receipt: above n 1, 212. See C Harpum above n 13 for a more refined discussion of the various categories of equitable liability which have been recognized in equity.

could be restitution based, concerned with negating the recipient's unjust enrichment. If the former view is accepted as correct, knowing assistance and knowing receipt are simply different heads of liability. If the latter view is adopted, knowing assistance and knowing receipt are two entirely distinct categories of liability. This debate will be returned to later.

Whichever rationale for knowing receipt is accepted, the constructive trust terminology remains deceptive. The defendant does not claim title to or rights over specific property. The claim is for value received, and if successful, results in the imposition of a personal obligation to repay.[17]

IV BANKS AS STRANGERS

> There is a peculiar overlap between the two limbs of *Barnes* v *Addy* for banks and other intermediaries, since it may be a matter of controversy as to when such an intermediary has received a sufficiently lasting or permanent benefit from the property of others (which it handles in the ordinary course of business) that it can be said to fall within the first limb rather than the second limb.[18]

There are two extremes of participation in a breach of trust. At one end of the scale, the defendant receives the funds and retains them. At the other extreme, the defendant is a party to the breach, but does not come into possession of funds, and receives no benefit.[19] In practice, a bank tends to fall between these two extremes, as it almost always becomes implicated in fraud by dealing with funds in its possession.

A The Bank as Recipient

Due to the nature and diversity of services offered by banks, the risk of constructive trustee liability can arise in a variety of circumstances. Usually, the bank is implicated because the trust property has appeared in its hands. However, this does not imply that liability is receipt-based, as banks frequently act in the course of agency. Lord Selborne

[17] One commentator labels this as "proprietary recovery of value". See J Glover "Equity, Restitution and the Proprietary Recovery of Value" (1991) 14 UNSW Law Jnl 247, 247: " Proprietary recovery of value refers to a certain measure of recovery of non-specific interests in property, usually money. It does not refer to the recovery of any property in specie and is not the enforcement of title to, or rights over, any particular thing or monetary denomination."

[18] G Weaver and C Craigie *The Law Relating to Banker and Customer in Australia* (Law Book Co, Sydney, 1990) 3149 at para 7.540.

[19] See above n 14, 86; *Nimmo* v *Westpac Banking Corporation* [1993] 3 NZLR 219, 224.

was fully aware of the need to protect agents, but nevertheless recognized that an agent could "receive and become chargeable" with trust property. The difficulty lies in defining when an agent becomes chargeable with property received.

Sir Clifford Richmond proposed the following threshold in *Westpac Banking Corporation* v *Savin*:[20]

> So it can be argued that an agent who receives trust funds from the trustee will be within the [knowing receipt] category only if he is setting up a title of his own to the funds which he has received and is not acting as a mere depository or,... merely a channel through which money is passed to other persons.

Other cases have employed different terminology to describe the same effect. In *Nimmo* v *Westpac Banking Corporation*, where a transfer of moneys overseas followed by the issue of bank cheques and travellers cheques was in question, it was thought the bank "was in no better position as a result of the transaction."[21] Transaction fees were not a material consideration.

In *Cigna Life Insurance New Zealand Ltd* v *Westpac Securities Ltd*, Greig J noted that a trading bank uses customer money as part of its stock-in-trade to make a profit. Nevertheless, in the constructive trustee situation "it is right to treat a trading bank defendant as merely a depository or channel through which the moneys are transferred."[22] It must be shown that the bank retains the money as creditor, or in some other way for its own use or benefit.

Accordingly, the paying or collecting bank will not usually be within the knowing receipt category. The prevalent situation where a bank 'sets up a title of its own' to funds is when it receives monies into an overdrawn account, and thereby retains them as creditor.[23]

[20] [1985] 2 NZLR 41, 69.

[21] Above n 19, 224.

[22] Above n 14, 87.

[23] See Richardson J in *Westpac Banking Corporation* v *Savin* above 20, 52: "in accepting the cheque and crediting it against the customer's private overdraft it is advancing its personal interest in the transaction." He uses wording to similar effect in *Westpac Banking Corporation* v *Ancell* (1993) 4 NZBLC 103,269, 103,270.

Although the initial receipt of funds may be insufficient to establish receipt based liability, the bank's later dealing with those funds could be. If a bank receives a benefit from dealing in a manner inconsistent with the trust, "liability is clearly receipt based".[24] A plain example is where a bank purports to set-off an account in debit against an account in credit which contains trust funds.

In *Agip (Africa) Ltd* v *Jackson*,[25] Millett J indicated that inconsistent dealing is distinct from 'knowing receipt'. The distinguishing factor is that the "stranger receives trust property in circumstances in which he is not in consequence of that receipt a constructive trustee."[26] Furthermore, liability is not necessarily linked to any wrongdoing by the trustee, as the bank may act through its own volution.[27]

Lankshear v *ANZ Banking Group (New Zealand) Ltd*[28] is thought to provide an example of 'inconsistent dealing'. The bank's customer had formed a partnership with the plaintiff. The bank knew the plaintiff had advanced funds to the partnership for a specific purpose. The application of those funds to reduce the customer's overdraft with the bank was inconsistent with the specific purpose it was provided for. Accordingly, there was a breach of fiduciary duty.

Wallace J decided that the bank received the money knowing it was subject to a trust, and then dealt with it in a manner inconsistent with the trust.[29] However, it is questionable whether the inconsistent dealing analysis provides a proper basis for liability in this case.[30] The bank was not acting as an agent. It pressured its customer to apply the funds to the overdrawn account, and was asserting a title of its own to the funds. The 'inconsistent dealing' category applies where the funds are initially received in a ministerial capacity - where the bank is acting as agent for the fiduciary.[31] It is difficult to see why this was not treated as a simple knowing receipt case.

Whether a distinction between the knowing receipt and the inconsistent dealing categories is necessary can be queried. As soon as a benefit is retained through dealing, it would seem a defendant is in the same position as one who retained a benefit from the outset.

[24] C E F Rickett "When is a Bank Liable for Receipt in Equity?" [1995] NZLJ 78, 79.

[25] [1990] Ch 265, 291.

[26] Above n 13, 20.

[27] Above n 1, 209.

[28] [1993] 1 NZLR 481.

[29] C Harpum uses ***Lankshear*** to illustrate that 'inconsistent dealing includes: "A banker who receives money for a client knowing that he is under a fiduciary obligation to apply it for a specific purpose and then applies it in discharge of his overdraft.": above n 13, 20.

[30] See C E F Rickett "Banks as 'Stranger' Constructive Trustees: Two High Court Decisions [1992] NZLJ 366, 367.

[31] Above n 13, 20.

Furthermore, the authorities suggest the knowledge required for liability as an inconsistent dealer is the same as a knowing recipient.[32] However, if the bank has dealt inconsistently of its own accord, an analogy with common law conversion indicates liability could be strict.[33]

Essentially, receipt based claims encompass those situations where a bank's debt is reduced through the misapplication of trust moneys. In *Westpac Banking Corporation* v *Savin*, Sir Clifford Richmond thought it indisputable that "a banker who receives trust funds in reduction of the private overdrawn account of the trustee is in the same position as any other creditor... ."[34] When the bank receives money as creditor, it is explicit in Sir Clifford's judgement that its status as banker is irrelevant. The bank will be treated in the same way as any other commercial entity which receives funds in breach of trust. The apparent generality of this proposition will be considered in more detail later.

B The Bank as Assistor

A 'knowing assistance' claim will usually ensue when a bank, in honouring its customer's instructions, has facilitated a breach of trust. The simplest case is where a bank honours a customer cheque which is drawn on trust funds for an improper purpose. In modern times international transfers accomplished by electronic means are more likely to be in issue. The facts of *Nimmo* v *Westpac Banking Corporation*[35] provide a pertinent example. The bank's customer was a fraudster who embezzled monies from Mr Nimmo. He did this by placing Mr Nimmo's money into a trust account at the bank. This enabled a foreign currency exchange, which was credited to a different account upon completion. The customer then proceeded with a scheme whereby the money was transferred to an overseas account, upon which a cheque was drawn to facilitate the collection of bank cheques and travellers cheques. In following the customer's instructions, the bank found itself subject to a 'knowing assistance' claim by Mr Nimmo.

[32] Above n 13, 20.
[33] Above n 1, 209.
[34] Above n 20, 69.
[35] Above n 19.

V THE 'KNOWLEDGE' REQUIRED TO FIX LIABILITY

Given that a bank has become implicated in primary wrongdoing by the trustee or fiduciary, it remains to determined when secondary liability will attach to the bank. Since equity acts on the conscience, the bank's state of mind provides the touchstone for liability. However, equity is also sensitive to the various pressures which exist in the banking environment. The result is a body of case law which has endeavoured to determine an appropriate level of knowledge which is sufficient to fix liability.

A The Categories of 'Knowledge'

1 The development of knowledge

In *Westpac Banking Corporation* v *Savin*,[36] the Court of Appeal adopted the famous dicta of Peter Gibson J in *Baden, Delvaux and Lecuit* v *Societe General pour Favoriser le Developpement du Commerce et de l'Industrie en France SA*,[37] where knowledge was cast into five categories:

(1)actual knowledge

(2) knowledge which is obtainable but for shutting one's eyes to the obvious

(3) knowledge obtainable but for 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

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

The *Baden* classification has been treated with hostility by academics. Arguably, it contributes to the application of law which is "often technical to the point of the artificial and the arcane".[38] However, the *Baden* scale has often provided the bedrock for judicial decision making in this area of the law.[39] In *Westpac Banking Corporation* v *Savin*,

[36] Above n 20.

[37] [1983] BCLC 325.

[38] Above n 1, 196.

[39] Professor Rickett comments that the "categorisation seems to have become an almost quasi-legislative fixture in New Zealand cases on this subject": above n 30, 367.

Richardson J began the discussion of knowledge by extracting relevant principles from the case law, with terms such as "cognizant" and "reason to believe" being emphasized.[40] In hindsight, the reliance on *Baden* without further explanation contributed to the subsequent lack of principled analysis of the underlying basis of stranger liability.[41]

Peter Gibson J posited that all five categories were relevant to receipt and assistance liability, but only rarely would category (5) type knowledge be imputed to agents such as a banks who follow customer instructions.[42] The New Zealand cases have tended to draw a line between the first three and last two categories, depending on the type of liability in issue.[43] The rationale is that the first three categories are indicative of dishonesty,[44] while the final two amount to carelessness only.

By comparison, in the High Court of Australia it was thought that a failure to infer could be equated with actual knowledge, but a careless but innocent failure to inquire could not.[45] It was considered unjust to allow a defendant to escape liability due to his or her obtuseness.

In *Agip (Africa) Ltd* v *Jackson*,[46] Millett J maintained that a negligent failure to infer is not equivalent to actual knowledge, as no dishonesty is involved. However, he proceeded to impute dishonesty by inference, due to a lack of evidence relating to the defendant's actual state of mind.[47] In *Eagle Trust Plc* v *SBC Securities Ltd* Vinelott J viewed the matter in the following way:[48]

> If the circumstances are such that an honest and reasonable man would have appreciated that he was assisting in a dishonest breach of trust, the court may infer from the defendant's silence that he either appreciated the fact or that he wilfully shut his eyes to the obvious or wilfully and recklessly failed to make inquiries for fear of what he might learn.

[40] Above n 20, 51. The relevant authority was *Thomson* v *Clydesdale Bank Ltd* [1893] AC 282.

[41] See above n 30, 366.

[42] See the discussion in *Westpac Banking Corporation* v *Savin* above n 20, 53.

[43] See for example *Equiticorp Industries Group Ltd* v *Hawkins* [1991] 3 NZLR 700; *Springfield Acres Ltd (in liq)* v *Abacus (Hong Kong) Ltd* [1994] 3 NZLR 502.

[44] See above n 25, 293:"[s]uch conduct is dishonest, and those who are guilty of it cannot complain if, for the purposes of civil liability, they are treated as if they had actual knowledge".

[45] *Consul Development Pty Ltd* v *DPC Estates Pty Ltd* (1975) 132 CLR 373, 398 per Gibbs J; 412 per Stephen J.

[46] Above n 25, 293.

[47] Above n 25, 294.

[48] [1993] 1 WLR 484, 494. The statements were made in the context of a knowing assistance case.

Millett J would allow a defendant to rebut the inference of knowledge by showing 'foolishness', so that wrongdoing was not comprehended. Vinelott J leaves open the question whether a defendant can show ignorance of wrongdoing due to "inexperience or because he was unusually or unreasonably trusting, or for some other reason".[49] However, in the case of a commercial entity, and in particular a bank, "it will not be a happy experience... to seek to rebut an inference of knowledge by pleading that it was too foolish to perceive the reasonably perceptible."[50] Unfortunately for banks, this may well be what is required, for if a reasonable banker would have appreciated a breach of trust, "the court, in the absence of explanation, might find a want of probity on the part of the professional... ."[51]

Following the Privy Council's advice that knowledge "is inapt as a criterion",[52] and that the "*Baden* scale of knowledge is best forgotten",[53] it seems the appropriate distinction is between a bank which has acted dishonestly, and one which carelessly fails to inquire into a suspicious transaction.

2 *Dishonesty*

The definition of dishonesty was consolidated by the Privy Council in *Royal Brunei Airlines Sdn Bhd* v *Tan*.[54] Their Lordships were clear that dishonesty "means simply not acting as an honest person would in the circumstances.[55] This is clearly objective, and says that every person will be imputed with the same moral standards as the reasonable person. An individual "will not escape a finding of dishonesty simply because he sees nothing wrong in such behaviour."[56]

However, dishonesty describes conduct "assessed in the light of what a person actually knew at the time, as distinct from what a reasonable person would have known or appreciated."[57] Furthermore, it is proper to "have regard to personal attributes of the

[49] Above n 48, 484.
[50] S Gardner "Knowing Assistance and Knowing Receipt: Taking Stock" (1996) 112 LQR 56, 60.
[51] L Aitkin "The Solicitor as Constructive Trustee" (1993) 67 ALJ 4, 8.
[52] Above n 12, 75.
[53] Above n 12, 76.
[54] Above n 12. Noted in C Harpum "Accessory Liability for Procuring or Assisting a Breach of Trust" (1995) 111 LQR 545.
[55] Above n 12, 73.
[56] Above n 12, 73.
[57] Above n 12, 73.

[defendant], such as his experience and intelligence, and the reason why he acted as he did."[58] The overall test of dishonesty is succinctly described as follows:[59]

> [D]oes the honest person regard it as honest to behave as the defendant did - that behaviour being defined by reference not merely to the external effects of the defendant's actions, but also to the motives and attitudes with which the defendant performed those actions?

In most cases, the answer will be clear. However, situations will arise where there is genuine doubt as to the legitimacy of a proposed transaction. This is the bank's dilemma personified, as usually it will not know for certain whether a transaction is legitimate or not. Lord Nicholls observed that is was impossible to be more specific than to say that an "individual is expected to attain the standard which would be observed by an honest person placed in those circumstances."[60]

Does this mean that on some occasions an honest banker is entitled to ignore a risk of fraud? As has been discussed earlier, a bank faces daunting commercial pressure, which may encourage it to surpass inquiry where the risk of impropriety is small. In such a case, a court might be persuaded that the bank has maintained an honest standard. Lord Nicholls suggests that:[61]

> An honest person would have regard to the circumstances known to him, including the nature and importance of the proposed transaction, the nature and importance of his role, the ordinary course of business, the degree of doubt, the practicability of the trustee or the third party proceeding otherwise and the seriousness of the adverse consequences to the beneficiaries.

Invariably, questions of fact and degree will be involved, and it will be difficult to designate an appropriate threshold.

3 Constructive notice

Put simply, the dishonesty doctrine asserts that a bank has actual knowledge of the breach of trust if it acts dishonestly. Constructive notice on the other hand refers to the standards of the reasonable person.

[58] Above n 12, 74.
[59] Above n 50, 66.
[60] Above n 12, 74.
[61] Above n 12, 74.

There is a natural reluctance to resort to constructive notice, as it has traditionally been excluded from the commercial arena. Constructive notice is usually associated with land conveyancing:[62]

> In dealing with estates in land title is everything, and can be leisurely investigated; in commercial transactions possession is everything, and there is no time to investigate title; and if we were to extend the doctrine of constructive notice to commercial transactions we should be doing infinite mischief and paralysing the trade of the country.

This view has not been challenged. Notice will always have its own meaning in the land conveyancing context.[63] However, this does not bar notice being given a different meaning in different contexts. One possible interpretation is to confine constructive notice in the commercial arena to facts which were actually discovered.[64] The alternative, and perhaps more logical approach is to include matters which the reasonable person would have discovered, and to allow latitude for the notion that a reasonable person is less meticulous in the commercial environment. Such is the approach propounded by Millet J in *Macmillan Inc* v *Bishopsgate Investment Trust Plc*:[65]

> In order to establish constructive notice it is necessary to prove that the facts known to the defendant made it imperative for him to seek an explanation, because in the absence of an explanation it was obvious that the transaction was probably improper.

The generality of this statement belies the inherent difficulties in establishing when a bank's failure to make inquiry into the legitimacy of a transaction is unreasonable. In *Nimmo* v *Westpac Banking Corporation*, Blanchard J identified two ways in which this issue could be approached.[66]

Firstly, the bank's internal instructions with respect to a certain type of transaction could be deficient. In *Nimmo*, expert evidence suggested that the bank's instructions to staff fell

[62] *Manchester Trust* v *Furness* [1895] 2 QB 539, 545.

[63] A person has notice of a fact if a reasonable person would have discovered it, "and the reasonable person has been treated as highly perceptive, businesslike to the point of suspicious, and prepared to go to very considerable lengths in his search for the truth": above n 50, 60.

[64] Above n 48, 494. For an example where a bank was found to have 'actual' notice, see *Stephens Travel Service* v *Qantas* (1988) 13 NSWLR 331. As noted above (see text at n 48), if the reasonable person in possession of those facts would have appreciated that a breach of trust was being committed, the judge may infer that the defendant did also.

[65] [1995] 1 WLR 978, 1000. See also *El Ajou* v *Dollar Land Holdings Plc* [1993] 3 All ER 717, 739.

[66] Above n 19, 228. It should be noted that Blanchard J had already decided that negligence was not enough to fix liability in the knowing assistance category. The findings of negligence merely illustrated that dishonesty was not present.

short of reasonable banking standards, which contributed to a finding that the failure to make inquiry was negligent. Similarly, in *Dairy Containers Ltd* v *NZI Bank Ltd*,[67] "the essence" of the defendant bank's negligence was the failure to enforce a satisfactory system to deal with the type of transaction in question.[68] In both cases, the plain risk of fraudulent action in that type of transaction predicated the need for an effective procedure.

Alternatively, it can be argued that if an employee fails to follow a bank's internal direction to inquire, a finding of negligence should follow. However, it must be realized that a "bank's failure to follow its internal instructions is not conclusive evidence of negligence."[69] Such regulations do provide a useful guide, and may amount to persuasive evidence pointing to negligence.

The second way in which a failure to inquire could be found unreasonable is by examining the specific circumstances surrounding the transaction. This is when the application of constructive notice is most controversial.

The law has perpetually struggled in its attempts to draw a line between the countervailing policy considerations. In *Gray* v *Johnston*, Lord Cairns recognized that:[70]

> On the one hand, it would be a most serious matter if bankers were to be allowed, on light and trifling grounds - on grounds of mere suspicion or curiosity - to refuse to honour a cheque drawn by their customer.... On the other hand, it would equally of serious moment if bankers were to be allowed to shelter themselves under that title, and to say that they were at liberty to become parties or privies to a breach of trust.

The consequences of a bank's special contractual duties with respect to customer instructions were summarized and accepted as correct by Alliott J in *Lipkin Gorman* v *Karpnale*:[71]

[67] [1994] MCLR 465. There, ANZ Bank had pleaded s 5(1) of the Cheques Act 1960 as a defence to a claim for conversion of cheques. The bank was required to show that it acted without negligence when collecting payment of the cheques.

[68] Above n 67, 565.

[69] Above n 67, 566.

[70] (1868) LR 3 HL 1, 11.

[71] [1987] 1 WLR 987.

- A banker is entitled to treat a customer's mandate at face value
- The bank is not obliged to question a transaction which is in accordance with the mandate, unless a reasonable banker would have grounds for inquiry
- If no reasonable grounds appear, the banker must pay
- Suspicion and unease on the part of the bank is not enough to deny payment
- The bank is not an amateur detective.

The bank's contractual obligations owed to its customer are not the sole concern, as "the law should not impose too burdensome an obligation on bankers, which hampers the effective transacting of banking business unnecessarily."[72] When combined, such considerations dictate against a duty of inquiry which obliges a bank to be overly meticulous or suspicious in dealing with its customer's instructions. The practical position is summarized as follows:[73]

> The decision to honour or dishonour a customer's cheques is usually regarded as the classic commercial situation where there is a need for legal principle which recognizes the time pressure involved, and the orthodox contractual duty is to pay promptly unless there is a real or serious possibility that [another party] might be thereby defrauded.

Even where the bank receives funds as creditor, authority suggests there is no stringent duty to inquire. The applicable legal principle was enunciated by Lord Herschell LC in *Thomson* v *Clydesdale Bank Ltd*:[74]

> It cannot, I think, be questioned that under ordinary circumstances a person, be he banker or other, who takes money from his debtor in discharge of a debt is not bound to inquire into the manner in which the person so paying the debt acquired the money with which he pays it.

Accordingly, it would seem that a reasonable banker would only find inquiry necessary if there was a real likelihood of fraud. Therefore, courts should be cautious in assessing the circumstances in which a reasonable acquirer of funds should be put on inquiry.[75] The facts must be sufficient to arouse more than a mere suspicion of impropriety. For

[72] Per Steyn J in *Barclays Bank plc* v *Quincecare Ltd* (1988) [1992] 4 All ER 363, 376.
[73] Above n 18, 3153 at para 7.550.
[74] Above n 40, 282.
[75] P G Watts "Restitution" [1995] NZ Law Rev 395, 403.

example, in *Westpac Banking Corporation* v *Nimmo*, a withdrawal from a trust account in the equivalent of cash, which was at the disposal of a single director, was sufficient to put the bank on inquiry.[76]

Perhaps the best approach to the problem was recognized by Knox J:[77]

> In my judgement it may well be that the underlying broad principle which runs through the authorities regarding commercial transactions is that the court will impute knowledge, 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.

This statement seems to capture the spirit of equity's role in the commercial environment. Equity regulates standards of conduct in commercial relationships and dealings by acting on the conscience of the parties involved.[78] Of course, this does not mean equity will interfere simply because a particular outcome seems unfair to one party. The facts must present a manifestly unjust situation. Sometimes, a bank's conduct may be such that constructive notice is enough to fix liability for participation in a breach of trust, while other situations require dishonesty before good conscience requires the bank to account for its actions. An holistic approach to the problem could be advocated. No single and inflexible test for the level of knowledge required would be appropriate to establish liability. The role the bank played, and the particular circumstances of the case would dictate the knowledge required to fix liability.[79]

However, modern case law favours the *Barnes* v *Addy* distinction, which necessitates a somewhat rigid approach to the level of knowledge required, which in turn depends on the category of liability being used. This will be returned to below, but first it is necessary to deal with some remaining knowledge issues.

[76] Above n 19, 235.

[77] *Cowan de Groot Properties Ltd* v *Eagle Trust plc* [1992] 4 All ER 700, 761. This statement was cited with approval by Lord Nicholls in *Royal Brunei Airlines* above n 12, 74; and by Blanchard J in *Nimmo* v *Westpac Banking Corporation* above n 19, 228.

[78] See Sir Robin Cooke *Equity in Commercial Relationships* (New Zealand Law Society Conference, Wellington, 1993) 2.

[79] See Finn p 215.

B A Bank's Knowledge

Since a bank is an artificial person, it is necessary to identify individuals whose knowledge can be attributed to it. Traditionally, the knowledge of the bank manager has been the knowledge of the bank. Accordingly, the bank manager's diary has been a fertile source of inculpatory evidence. However, with the advance of modern technology, and the sheer bulk of daily transactions, it is increasingly likely that the branch manager has no cognizance of the facts giving rise to liability in any given situation.

Thus, the knowledge of other staff becomes crucial to the interests of the bank. The issue is to identify which employees' knowledge can properly be attributed to the corporate structure as a whole. The position has been summarized by the Privy Council as follows:[80]

> [G]iven that [the substantive rule] was intended to apply to a company, how was it intended to apply? Whose act (or knowledge, or state of mind) was *for this purpose* intended to count as the act etc of the company? One finds the answer to this question by applying the usual canons of interpretation, taking into account the language of the rule (if it is a statute) and its content and policy.

This represents a departure from the old "directing mind and will" rule, which by definition suggested only senior employees' knowledge would count as the knowledge of the company.

The attribution of an employee's knowledge to the company will depend upon the circumstances, with the crucial element being the nature of the functions performed by the employee. Whether or not an individual has authority to perform the particular transaction is a key factor.[81] Ultimately, if an employee has responsibility for the matter with which the particular rule is concerned, his or her knowledge should be attributed to the bank.[82]

[80] *Meridian Global Funds Management Asia Ltd* v *New Zealand Securities Commission* [1995] 3 WLR 413, 419.

[81] *R* v *Rozeik* (1996) BCLC 380.

[82] See R Grantham and B Robertson "Corporate Knowledge - Two Views on *Meridian*" (1996) 2 NZBLQ 63, 65.

Hence, the rogue bank teller who violates the bank's internal instructions and facilitates fraud could have his or her knowledge attributed to the bank.[83] It will be incumbent on the bank to regulate the conduct of all its employees.

A related issue is aggregating the knowledge of different staff members.[84] Due to the electronic sophistication and disjointed nature of bank transactions, a number of employees may participate in a single transaction, each holding a different piece of knowledge. Thus, the facts known to a single employee may not be enough to arouse suspicion, but an aggregation of the various pieces would.[85]
It would be unduly harsh to lay blame on a bank because of a failure to piece together th clues known by various staff members. One solution is to require a single employee to possess the requisite knowledge before it is attributed to the bank.[86] Alternatively, the knowledge of those working in a single department could be aggregated. Such approaches are supported by Blanchard J's comment in *Westpac Banking Corporation* v *Nimmo*:[87]

> It is simply asking too much of a banker to expect it to monitor the numerous transactions of its many customers through its separate departments with the precision which would have been needed to pick up what was occurring at that time.

C *Knowledge of a Breach of Trust or Fiduciary Duty*

For equity to intervene, the funds in question must be subject to a trust. Equity is concerned with protecting the beneficiary against the wrongdoing of his or her trustee, and those who deal with the trustee. In addition, the beneficiary under a fiduciary relationship has been assimilated with the trust beneficiary for the purposes of constructive trustee liability.[88] Indeed, in the commercial arena, the misconduct

[83] See *Re Supply of Ready Mixed Concrete* (1995) 1 AC 456, where the knowledge of an employee who acted against express instructions was attributed to the company. As previously discussed, where an employee fails to follow the bank's internal instructions, then this may be indicative of negligence.
[84] For an example outside the banking context, see *Equiticorp Industries Group Ltd* v *Attorney General* Unreported, 12 July 1996, High Court, Auckland Registry, CP 2455/89. There, the knowledge of Crown servants was aggregated to form the whole.
[85] See above n 7, § 324.4.
[86] See above n 7, § 324.5.
[87] Above n 19, 232.
[88] See *Westpac Banking Corporation* v *Savin* above n 20. There, the Court of Appeal was content to assume that the rules relating to strangers as constructive trustees were equally applicable to breaches of fiduciary duties.

underlying the cause of action is more likely to be a breach of fiduciary duty than breach of trust.

The simplest example is where an agent misdirects the principal's funds.[89] Similarly, a partner may use partnership property for an improper purpose.[90] However, perhaps the most important and far-reaching situation is where an employee misdirects company funds.[91]

The Court of Appeal has exhibited a strong desire for the maintenance of general fiduciary relationship rules. In *Westpac Banking Corporation* v *Savin*, Richardson J reiterated that when property is entrusted to an agent, the beneficial ownership remains with the original owner. When the property is sold, the money received immediately becomes the property of the principal. However, this general rule can be varied by the terms of the agency. It must be determined from the agreement and dealings considered against the surrounding circumstances whether the parties intended to displace the general rule.[92] Even if an implied agreement which allows the fiduciary to act outside the normal rules is found to exist, the fiduciary must still refrain from receiving benefit beyond normal professional fees.[93] Accordingly, although a fiduciary may be entitled to apply funds to an overdrawn account in the ordinary course of business, "it does not follow that the authorisation extends to situations where the [fiduciary] is in a precarious financial state and the payment is in partial discharge of his personal indebtedness to the bank."[94] In *Westpac Banking Corporation* v *Ancell*[95] the fiduciary relationship between a sharebroker and his clients was in issue. It was argued that the normal rules enunciated in *Savin* were displaced in the circumstances of the case. The bank argued that the sharebroker's business was carried out on a debtor/creditor basis with clients,[96] and he was therefore entitled to pay the funds into the overdrawn account.

[89] See *Westpac Banking Corporation* v *Savin* above n 20, where the agent was a boat dealer selling on behalf of the principal. *Westpac Banking Corporation* v *Ancell* above n 23, where a sharebroker misdirected client funds.

[90] See *Lankshear* v *ANZ Banking Group (New Zealand) Ltd* above n 28.

[91] See *Agip (Africa) Ltd* v *Jackson* above n 25. In *Springfield Acres Ltd (in liq)* v *Abacus (Hong Kong) Ltd* above n 43, it was the directors which breached fiduciary duties owed to the company.

[92] Above n 20, 49.

[93] Above n 20, 50; above n 23, 103,264.

[94] Above n 23, 103,264.

[95] Above n 23.

[96] There were three limbs to this argument. Firstly, the actual dealings between broker and client were argued to have taken place on a debtor/creditor basis. Secondly, there was an implied term in the contracts based on the general custom that sharebrokers operate on a debtor/creditor basis. Thirdly, there was implied authority from the customers to pay funds into the overdrawn account.

The Court of Appeal held that the general rules remained intact, due mainly to the clients understanding that money received by the sharebroker was held in some form of trust fo their benefit. They did not believe that they were mere unsecured creditors, and could not be subject to industry custom if they were unaware of it.

The decision represents a strong adherence to the maintenance of fiduciary rules.[97] They will not be set aside unless the bank can show the beneficiary fully understood that monies were not to be held in trust. In practice, this may mean express agreement is needed.

Another feature of the *Ancell* decision is Richardson J's comment that there was no authority to pay client funds into "the bank account which was overdrawn *or could be overdrawn*."[98] Read literally, this statement suggests a breach of fiduciary duty could occur even when funds are deposited into an account in credit. If the account later went into overdraft, and circumstances changed such that the money was not repaid to the beneficiaries, then the bank could face liability as an accessory.

Liability as constructive trustee will only attach when the bank has the requisite knowledge of a breach of trust or fiduciary duty. The mere fact that the bank knows its customer habitually receives money on account of others is not enough.[99] The required knowledge may be relatively easy to establish when the plaintiff is a beneficiary under a 'core' fiduciary relationship. However, knowledge of a breach "is not so easy to establis in cases arising from the increasingly unclear edges of the expanding law of fiduciaries."[100] If the "crucial question... is whether at the material time the person sough to be made accountable knew of the material facts giving rise to the subsistence of the fiduciary duty and its breach",[101] and dishonesty is not required to fix liability, a bank ma find itself liable even where it reasonably believed no trust existed.

However, a defendant should have knowledge of something more than a "doubtful equity". If the existence of a trust or fiduciary duty involves difficult questions of fact and law, then it is difficult to *ex post facto* impute notice of the trust to the bank.[102]

[97] Professor Rickett questions whether it was indeed correct to find a breach of fiduciary duty in this case See above n 30, 371.

[98] Above n 23, 103,270.

[99] Above n 40.

[100] Above n 30, 371.

[101] Per Cooke P (as he was then) in *Gathergood* v *Blundell & Brown Ltd* [1992] 3 NZLR 643, 646.

[102] *Carl Zeiss Stiftung* v *Herbert Smith & Co (No 2)* [1969] 2 Ch 276, 293 per Danckwerts LJ.

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D *Accessory Liability*

1 *The dishonesty requirement*

In *Royal Brunei Airlines Sdn Bhd* v *Tan,*[103] the Privy Council injected long overdue certainty into the principles of 'accessory liability' (the term used by their Lordships). Lord Nicholls explained the rationale for imposing liability in accessory situations:[104]

> The rationale is not far to seek. Beneficiaries are entitled to expect that those who become trustees will fulfil their obligations. They are entitled to expect, and this is only a short step further, that those who become trustees will be permitted to fulfil their obligations without deliberate intervention from third parties. They are entitled to expect that third parties will refrain from intentionally intruding in the trustee-beneficiary relationship and thereby hindering a beneficiary from receiving his entitlement in accordance with the terms of the trust instrument.

It follows from this rationale that strict liability is not appropriate for accessory liability. Fault is required as the defendant's "only sin is that he interfered with the due performance by the trustee of the fiduciary obligations undertaken by the trustee."[105] Accordingly, the focus is purely on the behaviour of the assistor.[106] Questions of priority in property are irrelevant, as the "accessory is a person who either never received the property at all, or who received it in circumstances where his receipt was irrelevant."[107] Liability cannot be strict, as beneficiaries "could not reasonably expect that third parties should deal with trustees at their peril."[108]

Next, the degree of 'fault' required to fix liability was discussed. After considering the authorities and academic commentaries, Lord Nicholls stated that dishonesty is a necessary requirement for liability.[109] There is nothing new in this approach. The majority of New Zealand cases stipulate that dishonesty is the threshold for accessory

[103] Above n 12.
[104] Above n 12, 71.
[105] Above n 12, 71.
[106] Above n 24, 78.
[107] Above n 2, 83.
[108] Above n 12, 71.
[109] Above n 12, 76.

liability.[110] Although English authority initially allowed negligence to fix liability,[111] modern authority is clear in its demand for dishonesty.[112] The novelty in their Lordships' approach was the abandonment of knowledge as an indicator of dishonesty. The New Zealand decisions have tended to equate dishonesty with the first three *Baden* categories. Their Lordships suggested the *Baden* scale of knowledge should be forgotten.[113] Despite this, it would appear the *Baden* scale is not yet extinct. Indeed, Lord Nicholls confessed that actual knowledge, wilful blindness[114] and reckless disregard of other peoples' possible rights[115] all point to dishonesty. Dishonesty will always be measured by what the defendant actually knew, which provides an irresistible temptation for the retention of some type of knowledge scale.

Accordingly, it may be questioned whether the Privy Council has provided a new way forward, or whether courts will ultimately rely on the old principles of knowledge established in previous case law.

Greig J's decision in *Cigna Life Insurance New Zealand Ltd* v *Westpac Securities Ltd*[116] highlights the difficulties which now face New Zealand judges. His Honour fully accepted that following *Royal Brunei*, the relevant test was one of dishonesty. He frame his decision on this aspect in the following way:[117]

> In this case, as I have noted, the plaintiff grounds the claim upon the last three of the *Baden* categories of knowledge.[118] There is no suggestion and no scintilla of evidence of any impropriety or lack of probity or dishonesty whatsoever on the part of the defendant or any of its servants or agents. It is quite plain that none of them knew or wilfully shut their eyes to any circumstance which might have made obvious the fraud which the thief was perpetrating.

[110] See above n 43, 728; above n 19, 228. Compare with the approach in *Powell* v *Thompson* [1991] 1 NZLR 597, where a much more flexible test was allowed.

[111] *Selangor United Rubber Estates* v *Craddock (No 3)* [1968] 2 All ER 1073; *Karak Rubber Co Ltd* v *Burden* [1972] 1 All ER 1210; *Baden* above n 37.

[112] *In Re Montagu's Settlement Trusts* [1987] Ch 264, 285; *Agip (Africa) Ltd* v *Jackson* above n 25, 293 *Eagle Trust Plc* v *SBC Securities Ltd* above n 48, 495; *Polly Peck International Plc* v *Nadir (No 2)* [199 4 All ER 769, 777 (CA).

[113] Above n 12, 76.

[114] Above n 12, 73.

[115] Above n 12, 74.

[116] Above n 14.

[117] Above n 14, 88.

[118] The plaintiff was also claiming in 'knowing receipt', which perhaps explains the reference to the *Baden* categories, despite the Privy Council's assertion that *Baden* should be forgotten in the accessory liability cases. As will be discussed below, *Baden* still has a part to play in New Zealand cases dealing with knowing receipt.

Hence the *Baden* scale remained relevant to the determination of dishonesty. This was a clear-cut case, as there was nothing to raise suspicion in the mind of the reasonable person in the defendant's position. Accordingly, Greig J was not required to analyse the intricacies of the *Royal Brunei* test for dishonesty.

Similarly, in *Equiticorp Industries Group Ltd* v *Attorney General*,[119] Smellie J found that the Crown wilfully shut its eyes to the obvious, or at least wilfully and recklessly failed to inquire. In deference to *Royal Brunei*, it was suggested that when viewed objectively, this amounted to dishonesty.

2 The conduct of the trustee

Prior to *Royal Brunei*, a literal reading of Lord Selborne's statement required the stranger to assist in a dishonest or fraudulent design.[120] It is not clear why it has been thought necessary to give "almost biblical reverence"[121] to this requirement.[122] The conduct of the accessory is all important. If he or she is dishonest, it should be irrelevant whether or not the principal was unscrupulous also. Furthermore, the trustee's liability is strict, so any secondary liability should not be premised on the state of mind of the principal.[123]

As Mr Harpum points out,[124] the authorities had created a separate category of 'inconsistent dealing'. An 'inconsistent dealer' is someone who receives the property in a ministerial capacity, while a 'knowing assistor' never possesses the property. In the 'inconsistent dealing' cases, it is irrelevant whether the trustee acted fraudulently or not.[125]

[119] Above n 84.

[120] New Zealand cases have been inconsistent in dealing with this aspect. In *Equiticorp Industries Group Ltd* v *Hawkins* above n 43, a dishonest trustee was required. In *Gathergood* v *Blundell & Brown Ltd* above n 101, Cooke P did not require proof of dishonesty from the trustee. In *Springfield Acres* above n 43, the inconsistency did not need to be dealt with, as the trustee acted fraudulently.

[121] Above n 1, 205.

[122] As C Harpum points out in above n 13, 11-12: the cases prior to *Barnes* v *Addy* did not insist on the dishonest and fraudulent design requirement - see for example *Fyler* v *Fyler* (1841) 3 Beav 550. Furthermore, *Barnes* v *Addy* was an unreserved judgement given without discussion of the earlier authorities. It was not until *Belmont Finance Corporation Ltd* v *Williams Furniture Ltd* [1979] Ch 250 that the 'dishonest and fraudulent design' requirement was established post *Barnes* v *Addy*.

[123] Above n 13, 10. As Professor Finn points out in above n 1, 206: the more stringent the knowledge requirement of the third party, the less obvious the reason for differentiating between types of conduct of the primary wrongdoer.

[124] See above n 13, 16. Mr Harpum suggests the relevant authorities are *Lee* v *Sankey* (1873) LR 15 Eq 204 and *Soar* v *Ashwell* [1893] 2 Ch 390.

[125] See above n 25, 292.

However, the knowledge required by the defendant was equivalent to the 'knowing assistance' category.[126]

Following *Royal Brunei*, both categories can be grouped under a generic accessory liability principle, due to the Privy Council's advice that to impose liability as an accessory, "[i]t is not necessary that, in addition, the trustee or fiduciary was acting dishonestly".[127]

3 The appropriateness of dishonesty

Even though the requirement for dishonesty in accessory liability is now settled, it is worthwhile examining the arguments which suggest the dishonesty standard is too lenient. Banks present themselves as efficiently managed, prudent institutions. They must be, to maintain customer confidence. Arguably, upon failure to meet the advertised standards, banks should be prepared to suffer the consequences. Indeed, it could be viewed as wholly appropriate to impose a high standard on banks, and hence cast them into a policing role, as they are in a unique position to prevent fraudulent conduct.[128]

A standard lower than dishonesty would not be over burdensome for banks, as the "law here is genuinely sensitive to the usual course of honest business in any context in question, and genuinely postulates context-sensitive fault."[129] Fears of uncertainty in the application of the law are unfounded, as the criteria are sufficiently clear to negate the influence of individual variances in the judiciary.[130] Furthermore, bank procedures are not set in stone, and constantly change to reflect and accommodate the various demands placed upon them.[131]

The concerns expressed are legitimate. Fraud, and breach of fiduciary duty is becoming more commonplace. The natural tendency is to place greater responsibility on those who are in the best positions to protect innocent victims.

[126] Above n 13, 17.

[127] Above n 12, 76. Hence, any argument as to whether the bank is properly thought of as a 'knowing assistor' or 'inconsistent dealer' becomes redundant.

[128] See above n 50, 80 for a more detailed discussion.

[129] G Elias *Explaining Constructive Trusts* (Oxford University Press, Oxford, 1990) 81. Elias further suggests that in cases where banks have been found liable due to carelessness, fault was genuinely present.

[130] P Loughlan "Liability for Assistance in a Breach of Fiduciary Duty" (1989) 9 OJLS 260, 269.

[131] Above n 50, 80.

Consider again the facts of *Nimmo* v *Westpac Banking Corporation.*[132] There, the loss caused by the bank following its customer' instructions would have been prevented if the appropriate inquiry was made. However, such inquiry was not required by the bank's internal instructions. According to expert evidence, these instructions did not measure up to an acceptable banking standard. Blanchard J found the bank negligent, but there was no suggestion of dishonesty.

The case illustrates the concerns of the arguments against dishonesty. If the fraudulent customer had tried his scheme at another bank, he would probably have been caught. Why should the defendant bank escape liability when it has failed to attain an acceptable banking standard, and was indeed negligent in this respect?

This is not an easy question to answer. In defence of the bank, it is easy to be wise in hindsight. It is easy to analyse the facts in court, and point out where a reasonable banker might have done things differently. However, as highlighted previously, a bank faces daunting commercial pressure. It should be assumed that a bank is loathe to assist in fraud. The bank can best determine whether the risk of fraud is sufficient to warrant disruption to the normal efficient flow of banking business. A requirement of dishonesty allows banks to formulate their own practice to deal with fraud. They are in the best position to weigh the competing interests, and develop procedures to reflect this. With the expanding role of electronic payment systems, banks are particularly careful in developing systems which reduce the possibilities of fraud. It is fair to assume that banks are fully aware of their responsibilities in reducing fraud, without the necessity of imposing a duty of care to reinforce the point.

There are further arguments in principle against allowing negligence or notice to fix liability for accessory liability. In *Royal Brunei*, Lord Nicholls suggested that a bank already owes a duty of care to the trustee. The beneficiaries can enforce this duty if the trustee is unwilling to do so. Therefore, "it is difficult to identify a compelling reason why, in addition... third parties should also owe a duty of care directly to the beneficiaries."[133] Furthermore, "beneficiaries cannot reasonably expect that all the world dealing with their trustees should owe them a duty of care lest the trustee are behaving dishonestly."[134] Whatever one may choose to make of such an attitude,[135] it captures the

[132] Above n 19.

[133] Above n 12, 75.

[134] Above n 12, 76.

[135] For a critique, see above n 50, 73-76.

essential flavour of the matter. If a bank is to be held liable due to its carelessness, it is more appropriate to apply the comprehensive principles of the tort of negligence. In some circumstances, there may also be a contractual duty of care.[136]

If found liable, the bank will be exposed to the same range of remedies as are available against the primary wrongdoer. Why should a bank be asked to bear the risk of a fiduciary's disloyalty instead of the beneficiary?[137] Where a bank has retained no benefit from the transaction, it would seem unduly onerous to impose liability in the absence of dishonesty.

E Liability for Knowing Receipt

1 The 'mixed' account and constructive notice

Special considerations apply when the bank has received property. Equity has traditionally imposed more rigorous standards on those who retain the benefits of unconscionable conduct. This is illustrated by the cases where a bank has express knowledge that an account is fixed with a trust. If the bank receives funds into the customer's personal overdrawn account in breach of that trust, it cannot avoid liability b pleading ignorance of the trust's exact terms. The mere presence of the trust account puts the bank on inquiry:[138]

> It is said that they did not know what the trust was at the time. That appears to me, I confess, to be immaterial, because those who know that a fund is a trust fund cannot take possession of that fund for their own benefit, except at the risk of being liable to refund it in the event of the trust being broken by the payment of the money.

Difficulties arise when the bank's customer is a fiduciary in the practice of applying both trust moneys and personal funds to a single account. In the absence of inquiry, a bank can never be sure which funds are subject to trusts, and which are not. The simple solution is to request the customer to pay trust funds into a separate trust account.

[136] See *Lipkin Gorman* v *Karpnale* [1989] 1 WLR 1340, where the English Court of Appeal expressed a desire that contractual duties be used to resolve issues, with equitable rules providing a last resort.

[137] Above n 1, 210.

[138] *Foxton* v *Manchester and Liverpool District Banking Co* (1881) 44 LT 406, 408. Compare with *Coleman* v *Bucks and Oxon Union Bank* [1897] 2 Ch 243: where it was thought that the bankers must have "the slightest knowledge or reasonable suspicion" of a breach of trust. The authors of *Paget's Law of Banking* note that *Foxton* is probably the correct approach: above n 6, 91.

Accordingly, if trust funds were subsequently paid into a customer's overdrawn personal account, the bank would be entitled to assert a lack of notice if a trust was breached.[139] However, practice is rarely so straightforward, and a collection of cases have dealt with the situation where the bank's customer operates a 'mixed' account.

For example, in *Thomson* v *Clydesdale Bank Ltd*,[140] the bank's customer was a sharebroker who applied both personal and trust funds to his overdrawn account. Similarly, in *Stephens Travel Service* v *Qantas*,[141] it was a travel agent's overdrawn account which caused difficulties for the bank. In New Zealand, boat dealers have also created problems.[142]

As stated earlier, a consequence of *Foley* v *Hill* is that collecting bankers are generally not concerned with the source or nature of customer funds. Lord Herschell LC in *Thomson* v *Clydesdale Bank Ltd* took this proposal even further:[143]

> My Lords, I cannot assent to the proposition that even if a person receiving money knows that such money has been received by the person paying it to him on account of other persons, that of itself is sufficient to prevent the payment being a good payment and properly discharging the debt due to the person who receives the money.

Hence, a bank is not required to make inquiries simply because of a likelihood that a customer holds money for others. The bank is entitled to treat those funds as the absolute property of the customer.

Lord Herschell LC later said that it must be shown the recipient had "reason to believe" a breach of trust was being committed before inquiry was needed. However, Lord Watson used stronger language, and suggested a banker would not be liable unless the claimant "can shew that the recipient of the money *did not transact in good faith* with his agent."[144] Furthermore, "the onus of proving [the bank] acted in mala fides rests with the [claimants]."[145]

In *Westpac Banking Corporation* v *Savin*, Sir Clifford Richmond diffused this dishonesty requirement by suggesting it was inconsistent with the later House of Lords decision in

[139] See above n 64, 360.
[140] Above n 40.
[141] Above n 64.
[142] Above n 20; *Anderson* v *Chilton* (1993) 4 NZBLC 103,375.
[143] Above n 40, 288.
[144] Above n 40, 289 (emphasis added).
[145] Above n 40, 290.

Reckitt v *Barnett, Pembroke and Slater Ltd,*[146] where a car dealer was held liable for receipt despite an absence of dishonesty. In accordance with Richardson and McMullin JJ, he endorsed the application of an objective standard of knowledge when the bank receives funds into an overdrawn account. Therefore, the apparent position in New Zealand is that constructive notice is enough to fix liability for knowing receipt. This vie has not been challenged in the subsequent cases.[147]

Although constructive notice probably provides the threshold for liability, the judiciary has only dealt with banks which have acted dishonestly. The bounds of constructive notice have never been judicially tested.[148] In light of the potential implications for banking practice, this is a source of concern. Certainty as to the limits of constructive notice would greatly assist banks, as the rules presently suffer ambiguity. The burden fo banks is to identify when an inquiry into a proposed transaction is necessary.

2 *A benefit designed or stipulated for*

As the New Zealand cases illustrate, when a bank designs or stipulates for a reduction in an overdraft, it will inevitably possess knowledge which renders the subsequent receipt o funds dishonest.

The leading case is *Westpac Banking Corporation* v *Savin.*[149] The facts provide a stark example of bank misconduct. The bank knew that its customer was a dealer in boats, an that three out of four sales were 'on behalf of' transactions. It knew the customer treate 'on behalf of' funds as separate from ordinary trade funds, and was not entitled to pay them into the overdrawn account. Furthermore, the bank was constantly supervising th overdrawn account, and pressuring its customer to delay payments to prevent the overdraft from being increased further. Indeed:[150]

[146] [1929] AC 176.

[147] See above n 14, 88 for the most recent pronouncement against dishonesty. However, the correctnes of constructive notice as the applicable standard is not established beyond doubt: above n 84. The law o 'knowing receipt' has produced some remarkably divergent judgements in the English case law. There remain differences as to whether dishonesty is required (*Re Montagu's Settlement Trusts* [1987] 2 WLR 1192; above n 71; above n 72),or whether constructive notice of the breach of trust is enough to fix liability (above n 25; above n 48; above n 77; above n 65). The more recent authority tends towards constructive notice as the applicable standard, but see above n 50, 60-64 for a discussion on the variance in the definitions of notice.

[148] See above n 30, 367: "other fact situations in the future may not be so kind to the judges, and some clearer distinctions need to be drawn."

[149] Above n 20.

[150] Above n 20, 54.

> That actual knowledge of the bank was such that in receiving those cheques and applying them in reduction of the overdraft it must be concluded that it wilfully shut its eyes to the obvious... or, at least, that it wilfully and recklessly failed to ascertain and satisfy itself that the receipts were not in respect of 'on behalf' sales.

This was clearly a case where the imposition of constructive trusteeship upon the bank was warranted.

The next case in which the Court of Appeal assessed the position of a bank was *Westpac Banking Corporation* v *Ancell.*[151] The facts followed a similar pattern to *Westpac Banking Corporation* v *Savin*. This time the bank's customer was a sharebroker, whose overdraft facility was being closely monitored due to its perilous state. Throughout the supervision period, the bank knew that the sharebroker was continuing to carry out business on behalf of his clients, and that proceeds from share sales were received into the account. The bank encouraged the postponement of payments to clients so that the account could be maintained.

The finding of knowledge was inevitable. As Richardson J suggested, the "inference that the bank was consciously benefiting from the resulting use of the funds of the broker's clients is inescapable."[152]

So in these two cases, the facts highlighted the presence of dishonesty. In *Westpac Banking Corporation* v *Savin*, it was because the bank knew that "it was unthinkable that the boat owners would have agreed to what was going on if they had been made aware of the real position."[153] In *Westpac Banking Corporation* v *Ancell*, it was because "the bank must have known that it was unthinkable that the sharebroker's clients... would have agreed to what was going on if they had been made aware of the real position."[154] There was no need to consider the limits of a bank's duty to inquire into the source of funds when receiving them into an overdrawn account.

The same can be said of the relevant High Court decisions, where dishonesty has invariably fixed liability. In *Anderson* v *Chilton*,[155] the facts were almost identical to *Savin*, and the bank had closely monitored the boat dealer customer's overdrawn account.

[151] Above n 23.

[152] Above n 23, 103,272.

[153] Above n 20, 71 per Sir Clifford Richmond.

[154] Above n 23, 103, 272.

[155] Above n 142.

Again, in *Lankshear* v *ANZ Banking Group (New Zealand) Ltd*,[156] the bank stipulated fo a reduction in the overdrawn account. Furthermore, it was aware of the source of the funds, and the purpose for which its customer held them.

Even if dishonesty is not shown on the facts, it seems likely a court will impose liability if reasonable inquiries are not made. It is this type of situation which Richardson J had specifically in mind when expressing the opinion that constructive notice could suffice fo knowing receipt:[157]

> Clearly Courts would not readily import a duty to inquire in the case of commercial transactions where they must be conscious of the seriously inhibiting effects of a wide application of the doctrine. Nevertheless 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.... *Where the creditor is pressing for payment and designs and stipulates for that benefit*, it will be less easy for the creditor to contend that the regular pressures of commercial life must be taken to have ruled out any need for inquiry.

This is consistent with the notion that commercial entities who act in good faith should not be troubled with facts which are not obvious or easy to uncover.[158] However, if the bank is prepared to spend time closely monitoring the operation of an account, and make detailed inquiries into the state of its customer's affairs, then it is harder to argue against the imposition of a duty to inquire into the source of funds received. Furthermore, supervision occurs when the account is in a perilous state. Hence, if the bank knows the customer receives funds in a fiduciary capacity, it should appreciate that the risk of misappropriation is at its highest, and that an inquiry into the source of funds is desirable.

3 Funds received in the ordinary course of business

It has been argued, that following the Court of Appeal's decision in *Westpac Banking Corporation* v *Ancell*, a bank is put on notice of possible impropriety by its customer whenever it receives money into an overdrawn account.[159] This is supported by

[156] Above n 28.

[157] Above n 20, 53 (emphasis added).

[158] Above n 50, 91.

[159] P De Silva "Overdrawn Accounts: Bank's Liability" [1994] NZLJ 275, 276.

Richardson J's comment that in "accepting a cheque or other payment and crediting it against the customer's private overdraft the bank is advancing its personal interest."[160] This statement could indicate that whenever a bank receives money into an overdrawn account, liability for knowing receipt can arise upon a failure to make appropriate inquiries.

However, it is suggested that one must be more careful when drawing general conclusions from constructive trust cases, as so much turns on the particular facts. Even though it has been general in its comments, the Court of Appeal has only dealt with banks which have designed for a benefit and retained it, making it difficult to say with certainty what the appropriate rules are beyond such a situation. Indeed, in *Westpac Banking Corporation* v *Ancell*, Richardson J expressly noted that the Court of Appeal was not required to undertake a review of the authorities, since dishonesty was supported by the facts.[161]

When the appropriate case arises, the judiciary will be asked to consider whether funds received into an overdrawn account in the ordinary course of business can establish the bank as beneficial recipient. The answer is not clear.

Technically, a bank asserts a title of its own to funds paid into an overdrawn account, and therefore receives them. However, funds received in the usual course of business can be quickly offset by further drawings by the customer. This is commonplace in the operation of trading accounts. The bank merely acts as a channel for the allocation of funds, and does not seek to reduce its debt. Any real benefit to the bank is through the interest it charges on its loan. In short, it is arguable that the bank is not a beneficial recipient in such a case.

This issue was addressed in *Stephens Travel Service* v *Qantas*.[162] The defendant bank's customer sold tickets as agent for Qantas. The moneys received from sales were regularly paid into the customer's overdrawn account. Usually, the trust obligation to account to Qantas was satisfied when the bank honoured a cheque drawn every two weeks. Hence, when a cheque made out to Qantas was subsequently dishonoured, it claimed against the bank for knowing receipt.

[160] Above n 23, 103,270. Almost exactly the same words were used by him in above n 20, 52. See also Sir Clifford Richmond in above n 20, 69: where it is suggested that a bank receiving funds into an overdrawn account is in the same position as any other creditor.

[161] Above n 23, 103,270.

[162] Above n 64.

Hope JA reviewed the authorities, and decided that the bank could only be a beneficial recipient if it had designed and stipulated for a reduction in the overdraft. If the account had continued to be run in the ordinary way, the bank would not have been a beneficial recipient of the funds paid into the overdrawn account.[163] In the case before him, the bank had required a reduction in the overdraft prior to dishonouring the cheque, hence notice was enough to fix liability for knowing receipt.

In making his decision, Hope JA relied on the authority of *Gray* v *Johnston*. In that case the House of Lords indicated that a benefit must be gained by the bank to attract liability as a constructive trustee. In the words of Lord Westbury:[164]

> The question, therefore, resolves itself into one of fact. Can the payment of that money to the credit of the account of the new firm be properly treated as 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?

His Lordship decided that no such benefit was obtained by the bank, as the account continued to be a current account run in the ordinary way, and then continued:[165]

> If it had been so accomplished; if a balance had been immediately struck, and the sum of money so paid had been appropriated at once to the payment of the balance due on that account to the bankers... then we should want no more to compel restitution from the bankers, and the case would fall within the ambit of well-settled and firmly-fixed authorities.

Hence, there is a good argument that funds paid into an overdrawn account in the ordinary course of business do not make the bank a beneficial recipient. However, the problems with this analysis should not be ignored.

Firstly, such a conclusion runs against the general tenor of the New Zealand cases dealing with banks as recipients.[166] Secondly, the context of the *Gray* v *Johnston* decision is important. A benefit designed or stipulated for was merely a circumstance which tended to prove "privity" with the breach of trust.[167] In the words of Lord Cairns:[168]

[163] Above n 64, 365-366.

[164] Above n 70, 15.

[165] Above n 70, 16.

[166] See text at above n 160.

[167] See above n 111, 1101. See also Richardson J in above n 23, 103,271: "It is one but not the only means of establishing privity."

[168] Above n 70, 11.

> [I]f it be shewn that any personal benefit to the bankers themselves is designed or stipulated for, that circumstance, above all others, will most readily establish the fact that the bankers are in privity with the breach of trust which is about to be committed.

On the other hand, if money was applied to the overdrawn account as a matter of ordinary business routine, "it appears to me wholly impossible to imagine that the bankers can have been influenced, in any degree, in their conduct by the indirect and incidental benefit which they thus derived."[169]

This observation is even more pertinent to the modern context, where account balances change drastically depending on the daily fluctuations common to a dealer's business. An account could just as easily be in credit rather than debit. It is difficult to imagine a bank being influenced in its decision to execute a transaction simply because the payment is to an overdrawn account run in the ordinary way.

However, when a bank consciously strives to advance its own interests, it can be more readily assumed that the bank's conduct will be influenced by the reward it stands to receive. Therefore, as a matter of equitable principle, a more onerous duty of inquiry is justified to protect innocent third party beneficiaries from the influence which a bank exerts over trustees and fiduciaries.

However, these arguments assume that the conduct of the recipient is directly in issue. As will soon be illustrated, modern opinion employs a broader approach to knowing receipt, and emphasizes property protection as the basis for liability. Accordingly, constructive notice could be enough to fix liability for funds received in the course of normal business routine, notwithstanding that such receipt was irrelevant to the bank's decision to execute its customer's instructions.

It therefore remains unsafe, to say the least, for a bank to assume that it is immune from knowing receipt liability and the accompanying spectre of constructive notice, merely because an overdrawn account is run in the ordinary course of business. Banks are well advised to take special care to ensure that money received truly belongs to the customer, especially when those customers are operating mixed accounts in overdraft.[170]

Before these difficulties can be resolved, and the detailed rules clarified, the rationale for receipt based liability will need to be clearly articulated by the judiciary. The alternatives will now be looked at.

[169] Above n 70, 13.
[170] Above n 30, 366.

VI THE FUTURE OF RECEIPT BASED CLAIMS

A The Rationale For Liability

The judiciary has refrained from presenting a comprehensive analysis of the rationale fo receipt based liability.[171] In *Lankshear* v *ANZ Banking Group (New Zealand) Ltd*, the following was said about knowing receipt:[172]

> [I]t can be viewed simply as a claim for a personal remedy against the defendant for misapplying what it knew to be trust or partnership funds for its own benefit. Alternatively, it is possible to emphasize the concept of unjust enrichment as the unifying and essential basis for the imposition of a constructive trust in cases of knowing receipt.

There is no doubt that knowing receipt is a personal claim for value received. Its succes does not depend on whether the recipient still has the property in his or her hands. However, as the above comment illustrates, there is debate as to whether unconscionability or unjust enrichment provides the basis for liability.

1 Unconscionability

The clearest articulation of the unconscionability approach is Sir Robert Megarry VC's decision in *Re Montagu's Settlement Trusts*.[173] It was stressed that the equitable doctrin of tracing and the rules relating to the imposition of a constructive trust must be kept distinct. The property concepts of tracing are concerned with whether a recipient takes free of an existing equity, while the personal liability of knowing receipt is concerned wi imposing the obligations of trusteeship. Essentially, "there is more to being a trustee tha merely taking property subject to an equity."[174]
Consequently, notice is not the appropriate criterion for a personal liability:[175]

[171] One notable exception is *Powell* v *Thompson* [1991] 1 NZLR 597. This case is discussed further below. See also the detailed discussion in above n 10.

[172] Above n 28, 496.

[173] Above n 147.

[174] Above n 147, 1205. See also the comments of Scott LJ in *Polly Peck International* v *Nadir (No 2)* [1992] 4 All ER 769, 776: "Equitable tracing leads to a claim of a propriety character. A fund is identifie that, in equity, is regarded as a fund belonging to the claimant. The constructive trust claim... is not a claim to any fund in specie. It is a claim to monetary compensation."

[175] Above n 147, 1204 (emphasis added).

> It seems to me that one must be very careful about applying to constructive trusts either the accepted concepts of notice or any analogy to them. In determining whether a constructive trust has been created, the ***fundamental question is whether the conscience*** of the recipient is bound in such a way as to justify equity in imposing a trust on him.

When deciding whether the conscience of the recipient is bound to a degree which justifies liability, Sir Robert Megarry VC thought knowledge (or dishonesty) should be the determinant, not notice.[176]

The unconscionability approach also finds support in *Consul Development Pty Ltd* v *DPC Estates Pty Ltd,* where Stephen J thought it important that the rules did not "disregard equity's concern for the state of conscience of the defendant."[177]

However, it is not immediately clear why unconscionability must be equated with dishonesty in the knowing receipt cases. Depending on the situation, wrongful conduct could be equated with carelessness. Hence, those who oppose Sir Robert Megarry's view emphasize the benefit gained by the defendant upon the receipt of the plaintiff's property. Mr Harpum suggests that "it is necessarily unconscionable for a person to receive for his own benefit somebody else's property in circumstances in which he ought to have realised that it was transferred to him in breach of trust."[178]

Further considerations were articulated in *Equiticorp Finance Ltd* v *Bank of New Zealand*, where it was suggested that by following Sir Robert Megarry VC's approach, "the answer in each case depends upon the facts and impression they make on the decision maker."[179] The aim should be to share risks equitably, while providing adequate stimulus to commercial morality. Accordingly, dishonesty need not always be required , "especially where [obtuseness] is rewarded with the receipt of funds the subject of the breach."[180]

The common theme of these arguments is that a person who receives property for his or her own benefit in circumstances in which he or she ought to have realised that it was transferred in breach of trust, should not be allowed to retain it. Thus the nature of the benefit is crucial. As indicated previously, it is contentious whether benefits received by

[176] Above n 147, 1211.

[177] Above n 45, 412. Hence the imposition of a duty to inquire was viewed unfavourably.

[178] Above n 13, 19.

[179] (1993) 32 NSWLR 50, 104 per Kirby P.

[180] Above n 179, 105.

the bank in the ordinary course of business should be a pervasive consideration.[181] The concepts of notice should be used against those who advance their own interests, not those whose primary responsibility is to advance the interests of others. It is unreasonab for beneficiaries to expect banks to owe them a duty of care when dealing with their fiduciaries or trustees, unless the bank has actively pursued its own benefit to the detriment of the beneficiaries.

2 *Unjust enrichment*

The unconscionability approach to knowing receipt assumes the wrongful conduct of th recipient is in issue. Restitutionists argue that this is fundamentally mistaken. They clai that a recipient's liability is not wrong based at all, but is predicated upon the receipt of property subject to a trust. Liability stems from the defendant taking property that belongs to another as his or her own. Hence, liability is imposed to restore the plaintiff' wealth, and is therefore not concerned with compensating for loss or damage.[182] This restitutionary approach to knowing receipt is accumulating growing academic support,[183] and would now seem to be correct in law, following Lord Nicholl's commen that "[r]ecipient liability is restitution based; accessory liability is not."[184] However, the vagueness of this statement provides little guidance as to how an equitable restitutionary liability should operate in practice. There is no shortage of opinion from academic circles, where unjust enrichment is advanced as the guiding concept.[185]

An unjust enrichment analysis was used by Thomas J in *Powell* v *Thompson*, where it was claimed that "the underlying basis of the defendant's liability is the unjust enrichme of the defendant at the expense of the plaintiff."[186] The essence of the claim is that the defendant has gained an advantage, and retention of that benefit is regarded as unconscionable. Accordingly:[187]

[181] See text at above n 169.
[182] Above n 84.
[183] See for example above n 13; above n 50; and most notably in New Zealand, Professor Rickett above 24. See however Finn above n 1 for a strong argument in favour of wrongdoing as the basis for liability.
[184] Above n 12, 70. This approach was adopted by Smellie J in above n 84.
[185] The watershed article is P Birks "Misdirected Funds: Restitution from the Recipient" [1989] LMCLQ 296.
[186] Above n 171, 607. Rickett laments that the analysis undertaken by Thomas J "appears sadly to have been overlooked in most of the more recent airings that the subject has had in the Courts": above n 24,
[187] Above n 171, 608.

> In deciding whether or not the defendant's enrichment is unjust, a Court of Equity will then have regard to all the circumstances relating to the transfer of the trust property. Its determination will depend not just on the defendant's knowledge, but on all the circumstances including, no doubt, factors relating to the deprivations suffered by the innocent plaintiff.

Hence, the 'unjustness' of the enrichment is determined by reference to the circumstances as a whole. It is inappropriate to focus solely on the conduct of the defendant. The issue is whether the conscience of the court has been offended - not whether the defendant has acted unconscionably.
Therefore, depending on the circumstances, the knowledge required to fix liability could be very low. The idea "is to invoke a flexible yardstick"[188] to decide liability. An immediate concern is whether any sympathy is given to a bank due to its commercial obligations. It would seem that Thomas J is firmly against this notion. He stated that differing standards between commerce and ordinary citizens are undesirable, "nor should the threshold of equity's tolerance be raised to meet some perceived commercial need."[189] On the whole, Thomas J's analysis does not indicate to banks the standard of conduct they are required to meet to avoid liability. Indeed, it would be contrary to Thomas J's overall scheme to lay down solid guidelines which would guarantee immunity.

Powell v *Thompson* also raises conceptual issues about the legal nature of unjust enrichment. The predominant view is that unjust enrichment is merely a concept which explains existing legal rules, and is not a cause of action in itself:[190]

> Accordingly, it is not legitimate to determine whether an enrichment is unjust by reference to some subjective evaluation of what is fair or unconscionable. Instead recovery depends upon the existence of a qualifying or vitiating factor such as mistake, duress or illegality.

[188] Above n 171, 614.

[189] Above n 171, 614.

[190] *David Securities Pty Ltd* v *Commonwealth Bank of Australia* (1992) 175 CLR 353, 379. See also above n 84. Professor Rickett describes Thomas J's approach as one which "looks upwards to a loosely defined standard of morality, and carries with it dangers of uncertainty, inconsistency and confusion": above n 10, 600. Compare however to *Stronge* v *ANZ Banking Group (New Zealand) Ltd* Unreported, 11 October 1994, HC Wellington, CP 716/89, where McGechan J appeared to approach unjust enrichment as though a cause of action in its own right: see above n 75, 404.

If a situation fits within an established category, the inference is that liability is strict. Hence, it is unnecessary to prove 'unjustness' on the facts. Indeed, the uncertainties surrounding such an inquiry make it positively undesirable.[191] In Birk's terminology, the vitiating factor which gives rise to unjust enrichment in the knowing receipt case is the ignorance of the plaintiff, who reasonably expects the trustee to hold property for his or her benefit. Accordingly, enrichment is unjust "by reason of the plaintiff's being wholly unaware of a transfer from himself to the defendant."[192]

B The Beginnings of Strict Liability?

1 The foundation for strict liability

The House of Lord's decision in *Lipkin Gorman* v *Karpnale Ltd*[193] has injected vitality into the claim that equitable and legal receipt based claims should be synthesized into an all encompassing strict liability restitution action. There are two critical aspects of the decision.

Firstly, their Lordships recognized a general principle of restitution for unjust enrichment. In the case before their Lordships, it was manifested in the strict liability action for money had and received. Secondly, their Lordships endorsed a defence of change of position,[194] which would mitigate the harshness of strict liability.

In *El Ajou* v *Dollar Land Holdings*,[195] Millett J observed that knowing receipt was "the counterpart in equity of the common law action for money had and received." Both are receipt-based restitution claims, imposing a personal liability to account for the full value received. However, the House of Lords dealt with the common law action only, and has thus left the comparable equitable rules in the realm of speculation.

The logical argument is that the same rules should govern both the legal and equitable claims:[196]

[191] See P Birks "English Recognition of Unjust Enrichment" [1991] LMCLQ 486, 487: the inquiry into unjustness "cannot be allowed to degenerate into an intuitive application of the judge's perceptions of justice."
[192] Above n 185, 296.
[193] [1991] 2 AC 548.
[194] The change of position defence has now been recognized in New Zealand: *Martin* v *Pont* [1993] 2 NZLR 23.
[195] Above n 65, 736.
[196] Above n 65, 739.

> I do not see how it would be possible to develop any logical and coherent system of restitution if there were different requirements in respect of knowledge for the common law claim for money had and received, the personal claim for an account in equity against a knowing recipient and the equitable proprietary claim.

If fault remains an essential requirement of liability under equitable rules for knowing receipt, there will be an obvious inconsistency with the analogous rules at common law. In practice, a plaintiff could face a more difficult path to recovery depending on slight variations in the facts.[197]

Indeed, the House of Lords seemed to have a coalition of equity and law in contemplation, as the following indicates:[198]

> Even so, the recognition of change of position as a defence should be doubly beneficial. It will enable a more generous approach to be taken to the recognition of the right to restitution, in the knowledge that the defence is, in appropriate cases, available; and while recognizing the different functions of property at law and in equity, there may also in due course develop a more consistent approach to tracing claims, in which common defences are recognized as available to such claims, whether advanced in law or in equity.

This statement illustrates the feasibility of a move towards a restitutionary liability which encompasses in rem and in personam receipt based claims in equity and law, no matter what type of property is involved.[199]

It is therefore desirable to consider how a move to strict restitutionary liability would affect claims against banks which are currently dealt with under 'knowing receipt'. In particular, it will become increasingly important for the judiciary to ensure that the defences operate to protect banks who transact in good faith.[200]

[197] P Birks "Persistent Problems in Misdirected Money: A Quintet" [1993] LMCLQ 218, 225. The differences are due mainly to the variations in tracing rules between law and equity. For a full discussion of tracing rules, see *Agip (Africa) Ltd* v *Jackson* above n 25.

[198] Above n 193, 581.

[199] Above n 13, 18. S Gardner suggests that there is no reason why the principles in *Lipkin Gorman* should not apply to cases where loss is to a trust. Consequently, if knowing receipt is not made strict subject to defences, "it will be undercut and made irrelevant anyway": above n 50, 86.

[200] Above n 75, 403.

2 *Defence of change of position*

The change of position defence is necessarily at a formative stage, with its future subjec to uncertainty. Lord Goff was clear that "nothing should be said at this stage to inhibit the development of the defence on a case by case basis, in the usual way."[201] The essential features of the defence thus far are as follows:[202]

> The defendant must establish that he would suffer detriment if the plaintiff were to be awarded restitution; that is, restitution would leave the defendant in a worse position than the position he would have occupied if he had never received the enrichment. ... The defendant's detriment must also be attributable to the enrichment that he has received; that is, the detriment would not have occurred if the defendant had not received the enrichment. ... Restitution is rejected only to the extent that the defendant would otherwise suffer a net detriment.

Clearly the defence is not available to a bank which has notice of the breach of trust. Furthermore, money paid away in the normal course of business does not constitute a change of position.[203] Thus a bank will have a defence when it permits its customer to make further drawings on the faith of the payments received.[204] Beyond this, the situati is vague. Due to the nature of banking business, the situations where it can be said that the bank has incurred additional expenditure on the faith of the payments received will b rare. Hence, the effectiveness of the defence in the banking environment will depend o the degree of flexibility allowed in the nexus between enrichment received and expenditure incurred.[205]

Whether the defence will extend beyond the simple net enrichment model described above "must, disappointingly, be left hanging."[206] A lack of certainty as to the scope of the defence would pose problems for banks, who would no doubt like to be able to

[201] Above n 193, 580.

[202] P Key "Change of Position" (1995) 58 MLR 505, 507.

[203] This was anticipated by Millett J - "It is no defence, for example, if he spent money on ordinary livin expenses; there must have been some extraordinary expenditure which he would not have incurred if h had not received the money": above n 2, 82.

[204] *Stronge* v *ANZ Banking Group (New Zealand) Ltd* above n 190.

[205] It has been suggested that if the change of position defence is applied in too strict a manner, it will b "too refined for the realities of life": above n 50, 87.

[206] Above n 191, 489. Birks goes on to consider some possible paths of development, as does P Key in above n 202. Such discussion is beyond the scope of this paper.

organize their procedures in a way to minimize the potential costs of a strict liability regime.

3 Bona fide purchaser for value

An interesting feature of Professor Birk's original thesis is that his argument is based on authority.[207] Accordingly, those cases which allow constructive notice to fix liability for knowing receipt support his contention that liability is strict subject to a defence of purchase without notice. Any confusion has been caused by the courts' reluctance to distinguish between fault necessary to found liability and fault which eliminates the application of the defence.

When receiving into an overdrawn account, the bank is a purchaser for value.[208] Accordingly, if it does not have notice of the breach of trust, the bank may treat the funds as its own. The defence of purchaser for value is better suited to the nature of banking business than the change of position defence. Money received in good faith into an overdrawn account would be usable for ordinary business purposes, without the disruption of having to unexpectedly account to a deprived beneficiary at a later date. This can be compared to the change of position defence, where the bank would probably need to show the money received was paid away outside the ordinary course of business, on faith of the payment received.

Recently, Professor Birks has departed from his original position, and questioned whether a defence of purchaser for value is sustainable.[209] Lord Goff clearly thought it was, and distinguished it from the change of position defence by saying that the court is not concerned with adequacy of consideration in the purchaser for value analysis.[210] Professor Birks queries this, and suggests it makes no sense to allow a defence to a restitution claim simply because the defendant is a purchaser. To Birks, the true relevance of the purchaser rule is the value that has been given.[211] Thus, "it may come to

[207] C Harpum states that the article was "more notable for the excellence of its ideas than for its use of precedent": above n 13, 24
[208] Above n 40; above n 190.
[209] Above n 191.
[210] Above n 193.
[211] Above n 191, 490-491.

be recognized that the defence of bona fide purchaser for value is simply the paradigm change of position defence."[212] Ultimately, the position may be as follows:[213]

> [E]quity will not permit a defendant to set up a title to property in which the plaintiff has a beneficial interest unless he has given value or otherwise changed his position to his detriment without notice, actual or constructive, of the plaintiff's interest

It remains to be seen how the new defence of change of position will ultimately relate to other defences. In the commercial environment, the security in wealth which provides th foundation for an individual's business must be protected.[214] As argued above, a bank's interests are best catered for if something akin to the purchaser for value defence is preserved within the overall framework of defences.

4 *The fate of knowledge*

Whatever approach is taken to the applicable defences, the good faith of the defendant remains a central factor. Accordingly, the issues surrounding knowledge and notice will not conveniently disappear.

In *Lipkin Gorman* v *Karpnale*, their Lordships did not stipulate a degree of knowledge which would invalidate a defence. Furthermore, the argument for treating knowing receipt as a strict liability "seems to contain no message as to this question".[215] However it can be observed that those cases which suggest knowing receipt is equivalent to the action for money had and received, lean toward a standard of constructive notice.[216] Constructive notice is seemingly better suited than dishonesty to the property protection regime of unjust enrichment, as the conscience of the recipient is not in issue. Accordingly, a bank would be denied a defence if it failed to make reasonable inquiries into the source of funds received. The principles of notice in commercial dealings discussed earlier would determine when inquiry was required.[217]

[212] Above n 2, 82.

[213] Above n 2, 82.

[214] Above n 50, 89.

[215] Above n 50, 90.

[216] *Agip (Africa) Ltd* v *Jackson* above n 25; *El Ajou* v *Dollar Land Holdings Ltd* above n 65.

[217] See text at above n 65.

C The Implications for Banking Practice

In the pursuit of an orderly framework for equitable liability, the practical implications of change must not be ignored. Hence the following warning:[218]

> Unless and until the law clarifies what are its purposes when imposing liability on third parties who become implicated in fiduciary wrongdoing, ordering from within is apt simply to perpetuate the arbitrariness and ambiguity which presently besets the law.

A recurring theme of this article has been to stress the peculiar position of banks due to their roles as intermediaries. The case law has evolved to take account of this. Central to the principles of banking law is the rule from *Foley* v *Hill.*[219] A bank is not a trustee. This was expanded in *Thomson* v *Clydesdale Bank Ltd.*[220] A bank is not concerned with the source from which its customer has derived funds. These cases clearly establish that if a bank acts in good faith, it is entitled to treat funds received and dealt with as the absolute property of the customer. Banking practice would become excessively difficult if these principles were ignored, and a bank was required to make inquiries on a regular basis. These rules are subject to equity's requirement that a bank cannot always shelter behind its walls to avoid liability as constructive trustee. As illustrated earlier, the precise nature and scope of a bank's liability as recipient is far from settled.
Hence, it is logical to inquire whether a change to the preferred position of the restitutionists will offer greater certainty for banks, without violating the established banking law principles. If the scope and nature of a bank's liability can be defined with more precision, then banks can carry out their operations accordingly. At present, "there are no clear guidelines as to what standard of conduct will obviate the risk."[221]

In short, the preferred position is strict liability, subject to a defence of change of position. The defence would not be available if the defendant has constructive notice of the breach of trust.[222] This seems to preserve something akin to the current situation. A bank has a valid defence if money was received without notice of the breach of trust. There will simply be a shift in the burden of proof.

[218] Above n 1, 208.
[219] Above n 5.
[220] Above n 40.
[221] M Halliwell "The Stranger as a Constructive Trustee Revisited" [1989] Conv & Prop 328, 334.
[222] See above n 13, 24-25.

However, there are difficulties hidden beneath the simplicity of this position. It should remembered that the concept of notice is merely incidental to the true purpose of the change of position defence. The primary concern is to prevent restitution when its imposition would be inequitable, due to a subsequent change in the economic position the defendant. The defendant's state of mind is not of concern, as liability is strict. Indeed, the "innocent recipient of a mistaken payment has no defence grounded in his innocence. There is no defence of innocent receipt *simpliciter.*"[223] Notice is only relevant to whether the defendant changed position in good faith.

Thus, if the bank's customer is a trustee or fiduciary, then the bank also becomes truste upon receipt of trust funds. If a breach of trust is committed, not only is the trustee strictly liable, but so is the bank once it receives those funds. The established banking principles would be under serious threat. Accordingly, the operation of the change of position defence would be crucial to banking practice. However, in its current form, th defence would be of limited value to banks.

A defence of bona fide purchaser without notice would greatly assist. This is better sui to the situation where a bank receives funds into an overdrawn account. The defence would be even more effective if notice was taken to mean dishonesty. However, issues such as these remain unresolved. These loose ends will need to be tied if knowing recei moves to strict liability. The efficiency of banking business depends upon it.

The best solution is to define with more rigour exactly when the bank is a recipient. Th essence of unjust enrichment is that the defendant retains property for his or her own benefit. Hence, a defence of "ministerial receipt"[224] could be implemented. It would b accepted that "payment received in the ordinary course of business is not a personal benefit to the banker which he is liable in equity to restore to the equitable owner."[225] Furthermore, "there must probably be some conscious appropriation of the sum paid in the account in reduction of the overdraft."[226]

If the bank's liability as recipient was confined to when it actively pursued its own interest, then many of the concerns as to how a strict liability regime would affect norm banking transactions would be eliminated. If payments were received in the ordinary course of business, the bank would be treated as an accessory to the breach of trust, an would therefore escape liability if it acted without dishonesty.

[223] Above n 191, 491.
[224] Above n 185, 303.
[225] Above n 24, 82.
[226] Above n 2, 83 (fn 46).

So, a move to strict liability for knowing receipt may be logical, and may bring it into line with its common law equivalent, but it will not easily eliminate the uncertainty which knowing receipt liability currently presents to banks and other intermediaries.

VII CONCLUSION

The explosion of case law and academic commentary on strangers as constructive trustees in the last decade has been invaluable. The principles and concepts underlying liability have been more clearly articulated, which has paved the way for increased certainty in the specific rules. However, there are gaps left to be filled, especially when considering the application of the rules to banks.

The elements of liability for accessory liability have been finalised following the Privy Council's advice in *Royal Brunei Airlines* v *Tan* . However, it remains to be seen how the dishonesty requirement will be developed in future cases, and in particular, how it will be applied to banks.

On the other hand, the circumstances which must exist before a bank can be made liable as a recipient remain controversial. At present, there are no clear guidelines for a bank to follow. The Court of Appeal must pronounce with clarity the rationale for liability before the detailed rules can be established with certainty. The principal focus should be to develop the rules in a manner which takes into account the demands of banking practice.

The future is the concern. It would seem that the *Barnes* v *Addy* jurisprudence could be relegated to a mere historical anomaly. Indeed, it has been suggested that *Lipkin Gorman* v *Karpnale* is now the only relevant authority, with restitution being the true basis for recipient liability.[227] Amidst this enthusiasm for a move to strict liability, the present role of fault should not be lost sight of. The requirement of fault protects commercial dealers who act in good faith, and recognizes that commercial transactions should not be unduly impeded by the demands of equity. This is especially important in the case of intermediaries, who occupy a position at the heart of commercial dealings. Any restrictions placed upon their business will be felt by the commercial sector as a whole. Whatever the future may hold for recipient liability, the pursuit of a principled and logical legal approach must incorporate these important policy considerations, so that the

[227] Above n 13, 25.

efficient flow of an intermediary's daily transactions can be preserved. In short, it shoul be ensured that unreasonable risks are not imposed upon banks who transact in good faith.

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