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A TRUST IS A TRUST, OF COURSE OF COURSE?

THE LIMITATION ACT 1950, SECTION 21 AND THE CONSTRUCTIVE TRUST

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" Equity does not then conveniently take an afternoon nap."

-*Powell v Thompson* [1991] 1 NZLR 597, 614 per Thomas J (HC)

I ABSTRACT

What is a constructive trust? This paper will grapple with that question by exploring the relationship between 'constructive trust' and 'constructive trustee'.[1] It will use section 21 of the New Zealand Limitation Act 1950 as a vehicle for this investigation and conclude by suggesting that constructive trusteeship should, under certain circumstances, create a legitimate constructive trust. This hypothesis explains current developments in New Zealand trust cases,[2] and reflects fundamental equitable principles of trust law.

More specifically, section 21 creates indefinite liability for fraudulent breach of trust, but leaves unanswered whether constructive trusteeships amount to legitimate trusts. In effect, section 21 cases become disputes over the basic definition and scope of constructive trust. The decisions contend with issues of judicial creation or recognition of constructive trusts and the significance of rigorous trust property requirements. This paper investigates relevant common law, underlying trust principles, and then explores the proper status of certain constructive trusteeships analogous to legitimate express-like constructive trusts. Ultimately, it identifies the most valid interpretation of section 21 for New Zealand law.

The text of this paper (excluding contents pages, footnotes, bibliography and annexures) comprises approximately 12,523 words.

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[1] See generally: Lionel Smith "Constructive Trust and Constructive Trustees" [1999] (July) C.L.J. 294, 298-300. The term 'constructive trust' usually refers to an express-like trust which has merely failed to explicitly call itself so. 'Constructive trustee' usually denotes nothing more than equity imposing personal liability.

[2] This paper will investigate current New Zealand trust law with specific reference to bribery, de facto, knowing receipt and knowing assistance cases.

II INTRODUCTION

Section 21 of the New Zealand Limitation Act 1950 (LA) is a demand for fundamental debate about constructive trusts. It challenges the law of equity to define the constructive trust and to apply that definition consistently. Inherent in section 21 is the need for a final resolution over the status of trusts as an equitable remedy and constructive trusteeship arising from fiduciary relationships. In effect, section 21 requires a commitment from equity to a comprehensive and integrated conception of constructive trust.

This paper will argue that a recognisable trust can exist in the absence of clearly identifiable trust property. It will suggest that obscured in current trust cases are criteria which identify fiduciary relationships that merit treatment akin to express trusts. This argument recognises that a constructive trustee accepts certain trust obligations which are not related to the separation of legal and equitable title. These obligations are part of a fiduciary relationship with specific characteristics, capable of judicial recognition and analogous to express trusteeship. Such an analogy, if accepted, would clarify the application of section 21 and offer a framework for equity to grapple with burgeoning constructive trust debate.

Section 21 is concerned with limiting actions for breach of trust. It imposes a six year limitation on these actions, while allowing indefinite liability for two exceptions. One of these relates to fraud or fraudulent breach of trust. The difficulty with section 21 arises when equity imposes liability as a constructive trustee due to equitable fraud. In these circumstances, the defendant has not held property in trust for the beneficiary, but instead, attempted by fraud to take it absolutely. The issue becomes whether alleging the defendant is liable as a constructive trustee is merely to allege that he is personally liable to account to the plaintiff, or whether it goes further and acknowledges there is a legitimate trust making the defendant a real trustee. In effect, the question becomes whether imposing liability to account as a constructive trustee actually creates a 'real' trust. In practice, if constructive trusteeship is merely an equitable remedy to account, then it can not activate the section 21 indefinite liability for fraudulent breach of trust, because no legitimate trust would actually

exist. Put simply then, every constructive trust imposed because of fraud may never be recognised as a legitimate trust and may always be subject to a six-year limitation. This paper disagrees.

English law provides New Zealand with the benefit of hindsight. While both countries have similar section 21 provisions, only England has common law establishing how the legislation should be interpreted. However, this common law has inherent weaknesses and should be rejected, providing an opportunity for New Zealand to develop an approach superior to England which better understands trust concepts and avoids difficulties which beset English law.

In summary, this paper will argue that certain fiduciary relationships should give rise to express-like constructive trusts. These trusts would be consistent with underlying trust principles and equitable policy. They would also allow indefinite liability under section 21 for fraudulent breach and recognise the realities of contemporary New Zealand trust law.

This paper is an investigation of the history and possible interpretation of section 21. It is divided into six parts: this introduction; an exploration of statutory analysis; an investigation of English method and reasoning; a critical analysis of the English approach; a new understanding of constructive trust; and conclusion.

III STATUTORY FRAMEWORK

A Introduction

This paper investigates section 21 of both the English and New Zealand Limitation Acts, reproduced below:

The English Limitation Act 1980, section 21

21. Time limit for actions in respect of trust property- (1) No period of limitation prescribed by this Act shall apply to an action by a beneficiary under a trust, being an action-

(a) In respect of any fraud or fraudulent breach of trust to which the trustee was a party or privy; or

(b) To recover from the trustee trust property or the proceeds of trust property in the possession of the trustee, or previously received by the trustee and converted to his use ...

(3) Subject to the preceding provisions of this section, an action by a beneficiary to recover trust property or in respect of any breach of trust, not being an action for which a period of limitation is prescribed by any other provision of this Act, shall not be brought after the expiration of six years from the date on which the right accrued.

The New Zealand Limitation Act 1950, Section 21

21. Limitation of actions in respect of trust property- (1) No period of limitation prescribed by this Act shall apply to an action by a beneficiary under a trust, being an action-

(a) In respect of any fraud or fraudulent breach of trust to which the trustee was a party or privy; or

(b) To recover from the trustee trust property or the proceeds thereof in the possession of the trustee, or previously received by the trustee and converted to his use.

(2) Subject as aforesaid, an action by a beneficiary to recover trust property or in respect of any breach of trust, not being an action for which a period of limitation is prescribed by any other provision of this Act, shall not be brought after the expiration of six years from the date on which the right accrued.

Section 38 of the Limitation Act 1980 stipulates that the expressions 'trust' and 'trustee', for the purposes of limitation, have the same meanings as in the Trustee Act 1925. Section 68(1) paragraph 17 of that Trustee Act extends those expressions to include "implied and constructive trusts". Accordingly, section 21 of the Limitation Act 1980 governs both express and constructive trusts, but does not offer a definition of them. Section 2 of the Limitation Act 1950 specifies that "Trust" and "Trustee" have the same meanings respectively as in the Trustee Act 1956. Section 2 of the Trustee Act defines "Trust" and

provides that "it extends to implied and constructive trusts, and to cases where the trustee has a beneficial interest in trust property." Therefore, section 21 governs implied and constructive trusts, but again, fails to define them.

The issue for both New Zealand and English legislation is the correct interpretation of the word 'trust'. English Courts have decided that imposing constructive trusteeship in response to fraud provides only an equitable remedy and does not create a legitimate trust. Therefore, trusteeship is unable to activate the section 21 exception for fraudulent breach and consequently, has become a general rule for interpreting 'trust' under section 21. This rule should be thoroughly examined before being accepted in New Zealand.

Part II will identify how the English statutes have established this approach. It will offer a brief historical review of English law and discuss the relevant legislation for both England and New Zealand. It will then recount statutory arguments over interpretation and finally, explore limitation argument by analogy and the scope for an alternative approach.

B Historical Review

Prior to 1890, English common law refused time limitation for actions by a beneficiary against a trustee.[3] The reason for this rule reflected the conscience of equity: Possession of trust property by a trustee is taken on behalf of the beneficiary and time should not run against that beneficiary.[4] This rule applied not only to express trustees but also to people assuming a position akin to express trustee.[5] The rule did not apply where constructive trusteeship arose as a remedy to fraudulent behaviour.[6]

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[3] *Hovendon v Lord Annesley* (1806) 2 Sch & Lef 607.
Indefinite liability subject to the absence of laches or acquiescence.
[4] The possession of trust property by a trustee being valid only because the trustee takes on behalf of the beneficiary.
[5] *Taylor v Davies* [1920] AC 636, 652-653 (PC); *Soar v Ashwell* [1891-4] All ER Rep 991, 994-995 (CA).
To assume a position akin to express trustee was to hold property for the benefit of another.
[6] *Taylor v Davies*, above n 5, 653; *Paragon Finance plc v D B Thakerar & Co (a firm), Paragon Finance plc v Thimbleby & Co (a firm)* [1999] 1 All ER 400, 407-412 (CA) *[Paragon Finance]*.

The Trustee Act 1888 defined 'trust' as "a trust which arises by construction or implication of law".[7] It was argued this extended definition fundamentally changed the law and allowed remedial constructive trusteeships to fall under the limitation exception for breach of trust actions.[8] This extension was refused by the Chancery courts, citing a conservative view of trust law.[9] The 1888 Act also provided the first formulation of the English and New Zealand section 21.[10] This new rule was a response to perceived unfairness in holding trustees indefinitely liable for innocent or negligent breaches of trust. However, two exceptions, including fraudulent breach by a trustee, remained subject to indefinite liability.

Section 19 of the English Limitation Act 1939 reflected the current section 21 six-year limitation for breach of trust, and codified previous common law. However, the fraudulent breach exception continued to use Trustee Act (1925) definitions of 'trust'. Again, arguments arose suggesting that the new Limitation Act, in conjunction with the Trustee Act definitions, subjected remedial trusteeship to the scope of section 21 and the indefinite liability exception.[11] Again, the argument was rejected.[12]

New Zealand has yet to make this decision. Without binding statutory authority, New Zealand may accept remedial trusteeship as a true constructive trust, under certain circumstances. The English made their decision in 1888 and have been restricted by it since. Explosive contemporary development in fiduciary law and recognition of

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[7] Trustee Act 1888, section 47 (1).

[8] *Taylor v Davies*, above n 5, 650-651.
This case provides an excellent summary of the law under the 1888 Act.

[9] *Taylor v Davies*, above n 5, 651.
Viscount Cave argued that defining trust without determinative reference to taking possession of property on behalf of another would be "fatal to the security of property".

[10] The Trustee Act 1888, section 8(1):
"In any action or other proceeding against a trustee or any other person claiming through him, except where the claim is founded upon any fraud or fraudulent breach of trust to which the trustee was a party, or is to recover trust property, or the proceeds thereof still retained by the trustee, or previously received by the trustee and converted to his use, the following provisions shall apply ..."

[11] *Paragon Finance*, above n 6, 407-412; *Coulthard v Disco Music Club* [1999] 2 All ER 457, 470-480 (HC) *[Coulthard v DMC]*.

[12] *Paragon Finance*, above n 6, 407-412; *Coulthard v DMC*, above n 11, 470-480.

relationship-based trusts like knowing assistance, de facto relationships and bribery, outdate this English view. New Zealand law has moved beyond a nineteenth century approach and so should our statutory interpretation.

C *Statutory Arguments*

Many statutory arguments have been advanced in England to establish the correct interpretation of section 21. Most notable is an argument requiring an express-like trust relationship that pre-dates the fraudulent breach. Therefore, only trusts which do not arise as a response to fraud are consistent with the statutory language. The section 21 exception to six-year limitation applies to "... an action by a beneficiary under a trust ... [to which] ... the trustee was a party..."[13] These words imply the trust arose prior to breach. This interpretation voids remedial trusteeship because it is an equitable response to fraud. However, if certain remedial trusteeships were recognised as pre-existing fraud, then they would also fall under this interpretation of the section.

A second argument characterises constructive trusteeships as equitable remedies, which do not create trust powers or duties. Imposed trusteeship does not provide rights of investment, sale or dealings with property; it merely makes a wrongdoer liable to return property.[14] This may be so, but if a trusteeship was based on a pre-existing fiduciary relationship and recognised that the trustee had those powers in practice if not in law, then by analogy, the trusteeship may be legitimate.

To offset these interpretations, the Manx High Court in a recent unreported judgment held that their section 21, worded exactly as the English section, was capable of accepting all equitable trusteeships as valid trusts.[15] This view may be extreme, but no more so than the

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[13] The Limitation Act 1950, section 21.

[14] *Paragon Finance*, above n 6, 412.

[15] *Barlowe Clowes International Limited v Eurotrust International Ltd* (31 March 1998, unreported), Manx HC; *affg* (1998/9) 2 OFLR 42. Unfortunately, at the time of preparing this paper the author was

current English position of recognising none. Ultimately, a balanced approach based on the underlying relationship between parties is the best method for resolving these issues.

D Argument by Analogy to the Limitation Act

Argument by analogy is a clear concept often distorted by application: If an equitable remedy corresponds to a remedy in common law, and a limitation period applies to the common law remedy, then by analogy equity will apply the same limitation.[16]

The argument comes in two forms. Firstly, where equity is exercising a concurrent jurisdiction to common law, then an analogous limitation period will apply. Secondly, where equity offers a broader remedy or limitation period for substantially the same claim as one in common law, it will also, by analogy, apply the limitation period. The significance of these arguments for section 21 purposes is clear: If constructive trusteeship claims in equity are based on the common law claims of fraud, then there is concurrent jurisdiction. Therefore, by analogy, the six year limitation for fraud could apply to these claims.[17]

English courts have decided that express-like constructive trusts do not reflect a common law claim of fraud, they are purely equitable claims for breach of trust, based on a pre-existing trust agreement. However, the constructive trusteeship offered as an equitable response to fraud is considered analogous to common law remedies and subject to a six year limitation. New Zealand has yet to decide the status of constructive trusteeship for analogy purposes and can elect not to apply limitation by analogy. If, as I propose, certain circumstances exist which allow constructive trusteeships to be treated akin to express trusts, then by analogy those trusteeships would also be outside the scope of limitation.

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unable to locate a copy of this judgment. It is discussed and criticised in *Paragon Finance*, above n *6*, 411-13 per Millet LJ.

[16] *Coulthard v DMC*, above n 11, 477-458; *Knox v Gye* (1872) LR 5 HL 656, 674.
In fact, Limitation by analogy is specifically preserved by section 4(a) of the Limitation Act 1950.

[17] *Paragon Finance*, above n 6, 407.

E The Duty to Account

The duty to account usually applies where a fiduciary wrongfully takes profits.[18] It is equity's method of returning monies taken as a result of dishonesty by a fiduciary.[19] Equity uses constructive trusteeship as the vehicle for returning that property, and the duty is usually considered an equitable remedy. The duty to account is important because it is the formula most often used by equity to create trusteeships. Section 21 must decide whether all duties to account give rise to mere trusteeship, or whether some allow for a legitimate trust. England has decided the duty only creates trusteeship,[20] whereas New Zealand has yet to face this issue.

An example of New Zealand's willingness to reconsider English approaches to arguments by analogy, and resulting trusteeship, is provided by the duty to account.[21] In England the fiduciary duty to account was recently affirmed as analogous to common law claims of fraud.[22] The Court of Appeal (Chancery Division) used *Coulthard v Disco Music Club* as a vehicle for making this explicit.[23]

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[18] Ian Davidson, "Taking Accounts" in Patrick Parkinson (ed) *The Principles of Equity* (The Law Book Company, Sydney, 1996) 880.

[19] Davidson, above n 18, 881.

[20] *Coulthard v DMC*, above n 11, 478.
A duty to account arises on the negligent or fraudulent act(s) of the fiduciary. These acts would tend to be the grounds for a trust action and therefore, would never provide the basis for recognising a legitimate pre-existing trust. Only a pre-existing trust-like relationship would allow the possibility for the duty to create more than a trusteeship.

[21] *FAI (NZ) General Insurance Co Ltd v Blundell and Brown Ltd* [1994] 1 NZLR 11, 16 per Richardson J *[FAI (NZ)]*. Richardson, while discussing the duty to account as it relates to section 4(2) of the New Zealand Limitation Act 1950, identified the duty as purely equitable. If this finding is reproduced in section 21 analysis, it would allow certain trusteeships to escape limitation by placing them outside the scope of analogy.

[22] *Coulthard v DMC*, above n 11, 478.

[23] *Coulthard v DMC*, above n 11, 478.
"[T]he allegations of deliberate and dishonest under-accounting, are based on the same factual allegations as ... common law claims of fraud. ... [B]reaches of fiduciary duty are thus no more the equitable counterparts of the claims at common law. The court of equity, in granting relief for such breaches would be exercising a concurrent jurisdiction with that of the common law. I have little doubt but that to such a claim the statute [of Limitations] would have been applied."

The effect of *Coulthard* was to place, by analogy, claims to account under a six year limitation. However, New Zealand adopted a different approach. In *FAI (NZ)*, the Court of Appeal decided that the duty to account was purely equitable and that the Limitation Act would not apply by analogy.[24] *FAI* demonstrates New Zealand advancing a purposive and pro-active role for equity, protecting equitable jurisdiction from unnecessary limitations by analogy. This purposive approach should be brought to section 21. The duty to account is both an example of New Zealand's willingness to make independent decisions, and a basis for recognising certain trusteeships as inherently equitable and worthy of analogy to express-like constructive trusts.

F Conclusion

New Zealand has a statute based on English law, but without binding authority to follow their interpretation. The English approach to section 21 offers a general rule that excludes many types of trusteeship from founding legitimate trusts. Conservative English use of limitation by analogy further erodes the value of trusteeship by characterising the duty to account as equity's version of common law fraud, and imposing limitation by analogy regardless of section 21. *FAI* appeared to reject possible common law fraud limitation by analogy and New Zealand must now struggle with the debate over section 21. Significantly, the Isle of Man has already grappled with the English interpretation of section 21 and adopted a different approach.

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[24] *FAI (NZ)*, above n 21, 16-17 per Richardson J; 22-24 per Robertson J.

IV THE ENGLISH POSITION

A Introduction

England has already decided section 21 interpretation. It has become part of a English common movement law using traditional express trust concepts to curb the applicability of the constructive cousin. While not denying equitable remedies, section 21 cases boldly enter into broader English trust debate by suggesting the constructive trust can only exist if closely related to the express trust.

The conflict in section 21 is the definition of constructive trust. The two objectives of Part IV are; firstly, to provide an understanding of the English approach; and secondly, to explore the underlying trust property bias obscured within that approach. Part IV is divided into five parts: introduction; a description of the English approach; a case study; an investigation of the underlying trust law; and conclusion.

B The Current English Common Law Approach

1 Introduction

English law has grappled with section 21 since 1893.[25] From this complicated common law history two cases have recently emerged which describe a comprehensive approach to interpreting the section.[26] These cases propose a universal template which distinguishes between real constructive trusts, and equitable remedies correctly identified as a mere trusteeship. I will call it the two-type template.

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[25] *Soar v Ashwell*, above n 5, 992-994.
[26] *Paragon Finance*, above n 6; *Coulthard v DMC*, above n 11.

2 The two-type template

The cases identify two different types of circumstances where equity might grant constructive trust relief, called the 'type-one' and 'type-two' situations. Type-one situations allegedly constitute legitimate trusts, but type-two situations amount only to discretionary equitable remedies. In individual cases, this test reveals whether a plaintiff can allege a trust exists under section 21. However, the significance of the test is that it defines what is or is not a true constructive trust. This wider implication of the section merits investigation.

(a) A type-one situation/trust

Elements:

The defendant is not expressly appointed as trustee, but does assume the duties of a trustee.[27] Identifiable trust property exists and a limited power over that property is vested in the defendant, akin to mere legal title, with the equitable title usually retained by the plaintiff. A lawful transaction independent of and preceding fraud has put the defendant in the trustee position, and that initial transaction is not impeached by the plaintiff.[28]

Discussion:

This definition is closely linked to express trusts and institutional constructive trusts.[29] The defendant does not receive trust property in his own right, but by a preceding lawful transaction intended by both parties to create separate legal and equitable title, akin to an express trust relationship.[30] Equity will be required to impose a trust in these

[27] For example, a lawyer can be recognised as a trustee of money or property deposited with him or her by a client. Usually, there will be an express trust relationship agreed to by the parties, but where this is not done, and the client still entrusts property or money with their lawyer, the courts will recognise an express-like constructive trust.

[28] *Paragon Finance*, above n 6, 409-412; *Coulthard v DMC*, above n 11, 479-481.

[29] The definition of institutional constructive trusts and their relationship to the two-type template will be explored in the next section. However, the link between the type-one trust, the express trust, and the institutional trust reflects the fact that they are all created by the parties, and merely recognised (rather than created) by the courts.

[30] In effect, a quasi-express trust.

circumstances because of precedent dictating a mandatory trust as the remedy and/or by direct analogy to the express trust.[31]

(b) A type-two situation/equitable remedy

Elements:

The trust obligation (trusteeship) arises as a direct consequence of an unlawful/fraudulent transaction, impeached by the plaintiff.[32] It is a discretionary equitable remedy available to the court as a response to the wrongdoing. It holds the defendant liable as a constructive trustee, but does not create a 'legitimate' constructive trust. It does not acknowledge a pre-existing trust relationship or separation of legal and equitable title.

Discussion:

This definition is far removed from express trust law, and describes remedial constructive trusts and fiduciary 'trusteeship'. The defendant takes property from the plaintiff because of an unlawful transaction and no division between equitable and legal title is intended or created. Therefore, a type two remedy will apply in more situations because it is not restrained by requiring a pre-existing property relationship. The type-two 'trusteeship' is a discretionary equitable response available to an unlawful transaction.

3 The institutional & remedial constructive trust

In England, the constructive trust is closely related to the express trust.[33] The two-type template confirms this relationship by emphasising that a legitimate constructive trust (a type-one trust) must have clear trust intention and property. The template itself can be interpreted as an English response to growing international scope for constructive trusts and

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[31] This type of mandatory trust is usually called an institutional constructive trust and is created when a pre-existing quasi-trust relationship is breached.

[32] For example, a bank robber can be made a constructive trustee of the money he/she takes. There is obviously no pre-existing trust relationship, and the 'transaction' (theft) which provides the robber with the money, is directly impugned by the plaintiff bank. The court may place a constructive trust over the money as a discretionary equitable remedy, usually to gain priority over third party creditors.

[33] *National Westminster Bank Plc* v *Morgan* [1985] AC 686, per Lord Scarman (HL).

is really an attempt to limit that scope by narrowing the factual circumstances in which they can be recognised.[34]

The United States, Canada, Australia and New Zealand have embraced a broad approach to constructive trusts by recognising two distinct types.[35] Firstly, there is the 'institutional' constructive trust, closely related to express trusts and the only type of constructive trust available under the two-type template.[36] Secondly, there is the remedial constructive trust which is more fluid and based on equitable principles of fairness, and unconscionability.[37] This second type of trust threatens theoretical niceties of trust law and is exactly the 'trusteeship' which the two-type template aims to invalidate through category two.

New Zealand recognised the two different types of trust in *Fortex*.[38] Our Court of Appeal defined them thus:[39]

> An institutional constructive trust is one which arises by operation of the principles of equity ... whose [sic] existence the Court simply recognises in a declaratory way. A remedial constructive trust is one which is imposed by the court as a remedy in circumstances where, before the order of the Court, no trust of any kind existed.
>
> The difference between the two types of constructive trust, institutional and remedial, is that an institutional constructive trust arises upon the happening of the events which bring it into being.

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[34] More radical elements in the English judiciary have attempted to broaden the scope of constructive trusts, but have so far failed. See: *Lloyds Bank Ltd* v *Bundy* [1975] QB 326, per Lord Denning (HL)

[35] Pound, "The Progress of the Law 1918-1919 - Equity" (1920) 33 Harv L Rev 420, 420-421. (U.S.).
Pettkus v *Becker* [1980] 2 SCR 834 (Canada).
Hospital Products Limited v *US Surgical Corp* (1984) 156 CLR 41 (HC) (Australia).
Fortex Group Ltd (In Receivership and Liquidation) v *MacIntosh* [1998] 3 NZLR 171 (CA) (New Zealand) *[Fortex]*.

[36] The classic example of an institutional trust is bribery, though this will be challenged later in Part V. Supposedly, a company accountant, auditor... are all in a position analogous to a trustee, owing their employer (the analogous beneficiary) trust-like duties to perform and to preserve the position of their employer. In any bribery case, *as a mandatory operation of law*, the bribe will be considered trust property held for the benefit of the person or organisation who the fiduciary was induced to deceive. See generally: *Attorney General for Hong Kong* v *Reid* [1994] 1 NZLR 1 *[Reid]*.

[37] An example of this is the Quistclose trust. In that case a company in receivership accepted money for the specific purpose of paying a particular debtor. The court held that there was a remedial constructive trust in favour of the debtor because it would be inequitable for a company already in receivership to accept funds and make them part of the general creditors pool. See generally: *Barclays Bank* v *Quistclose Investment Ltd* [1970] AC 567.

[38] *Fortex*, above n 35, 171.

[39] *Fortex*, above n 35, 172.

> Its existence is not dependant on any order of the Court. Such order simply recognises that it came into being at the earlier time and provides for its implementation in whatever way is appropriate. A remedial constructive trust depends for its very existence on the order of the Court; such order being creative rather than simply confirmatory.

Clearly, there is significant overlap between the two categories of the two-type template, and the institutional and remedial trust. Institutional trusts exist where a person voluntarily assumes the duties of trustee. They require identifiable trust property and some recognition of a split between legal and equitable title. Remedial trusts impose trusteeship, usually because of unconscionable behaviour. They are discretionary and provide a proprietary remedy when there is no legal requirement to do so.

Judicial recognition rather than creation of the institutional trust is the significant point. In effect, courts acknowledge that institutional trusts are akin to express trusts: Both exist without the imposition of the Court (unlike remedial trusts). Institutional trusts can never be categorised as type-two trusteeships because they exist independently of the Court, rather than being created by the Court as an equitable response to fraud. Therefore, the two-type template is predisposed to favour institutional constructive trusts, and reject remedial ones. The challenge for the template is explaining why some remedial trusteeships are treated in law as being institutional constructive trusts. The answer can only be found by investigating and developing the conception of constructive trust.

C A Case Study: Paragon Finance

1 Facts

Paragon Finance begins with mortgage fraud.[40] In 1990, Paragon Finance plc lent approximately three million pounds in mortgages. The mortgages were procured by lawyers acting for supposed purchasers (the borrowers) of a block of flats.

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[40] *Paragon Finance*, above n 6, 401-403.

After settlement, Paragon Finance Plc discovered that the borrowers were fictitious, and that their mortgage money had vanished. The flats were not worth half of their supposed valuation and on realising the security interest in them, Paragon Finance Plc was left with a 1,260,000 pound shortfall.[41] Paragon Finance Plc sued the lawyers in the transaction for negligence, attempting to recover their loss from the only defendants in existence.

2 Alleging fraudulent breach of trust

For a variety of reasons, six years passed before the plaintiff alleged fraud.[42] Paragon Finance Plc sought to escape their lawyers' six year limitation defence by relying on section 21, which denies any limitation defence for actions of fraudulent breach of trust. Therefore, if the plaintiff could establish their lawyers took mortgage money under a trust,

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[41] A full description of *Paragon Finance* (above n 6) facts:
In 1990 Rosehaugh Co-Partnership Developments Ltd (Rosehaugh) wanted to sell a collection of flats at Vogans Mill in Docklands. Rosehaugh was approached by a Mr Shefket, and the newly formed company Belgravia Estates Ltd, both of which wanted to buy a number of flats. Mr Shefket was represented by the law firm Thimbleby & Co, Belgravia Estates by Thakarar & Co. Mr Shefket was to purchase 5 flats, Belgravia Estates 7.

The flats were valued at approximately $165,000 pounds each, and contracts for sale and purchase were drawn up by the purchasers lawyers. However, Mr Shefket and Belgravia Estates had, supposedly, a number of wealthy business people wanting to purchase these flats from them. Conveniently, Mr Shefket's and Belgravia Estates' lawyers acting in unison, and also acting for the highly credit worthy business people, approached Paragon Finance Plc Ltd to supply mortgages. Surprisingly, the mortgages are set for $270,000 pounds each.

Transfer day arrives and title is passed. The borrowers do not take possession and instead immediately default. Paragon Finance steps in, realises a security interest in the properties, discovers that they are overvalued, and faces a shortfall of approximately $1,260,000 pounds. Mr Shefket and Belgravia Estates Ltd have disappeared, if they ever existed, and the keen wealthy business people were never on the electoral register, never paid taxes, and never existed. Paragon Finance (the plaintiff) sues the lawyers (the defendants) for negligence.

[42] To recover their shortfall, Paragon Finance Plc sued their lawyers for negligence, alleging that they should have discovered and prevented the fraud. However, part of the loss suffered by Paragon Finance Plc was caused by a collapse in the property market after the transaction. Following a decision of the House of Lords in *South Australia Asset Management Corporation* v *York Montague Ltd* [1997] AC 191, Paragon Finance Plc could not recover any money lost during the collapse unless it successfully established fraud. Accordingly, they applied for leave to amend pleadings and allege their lawyers committed negligence *and* fraud.

The Court rejected the amendment. Six years had passed since the initial claim and the relevant six year statutory limitation period for fraud had expired. Paragon Finance Plc argued that pleading a new cause of action after the expiry of the limitation period was allowed. The Court agreed, but limited the right to cases where the facts needed to establish the new cause of action were already in evidence. In applying this rule, Millett LJ decided that Paragon Finance Plc could not succeed.

then they could allege that the solicitors actions were a fraudulent breach of that trust, and that no limitation period would apply.[43]

3 The trust argument

The Court noted the plaintiff's claim could only succeed if a type-one constructive trust was established.[44] While there was initially an express trust between Paragon Finance plc and their lawyers, this trust was technically adhered to and provided no grounds for avoiding limitation.[45]

Instead, the plaintiff argued that the express trust never came into being. Due to fraud, any intended express trust was displaced ab initio by a constructive trust in the plaintiff's favour. Put simply, the defendants obtained the mortgage advance dishonestly, and consequently, equity should hold that the defendants received the money on constructive trust, to return immediately to the plaintiff. Therefore, payment of the money to the borrowers constituted a fraudulent breach of this constructive trust.[46]

4 How the court decided

Millett LJ asked whether the plaintiff's argument, if successful, constituted a legitimate constructive trust. In effect, whether the plaintiff would be the beneficiary of a trust, or merely the recipient of an equitable remedy. He decided that the facts only gave rise to an equitable remedy, mistakenly called a constructive trust.[47]

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[43] The Court of Appeal accepted that a fraudulent breach of trust claim would be outside any statutory limitation period. It also agreed that such a claim would constitute fraud and therefore allow the plaintiff to recover in spite of the property collapse.

[44] *Paragon Finance*, above n 6, 409.

[45] *Paragon Finance*, above n 6, 409-412.
Initially, when the plaintiff gave the mortgage money to their lawyers, they did so under a legitimate trust. While the lawyers were not expected to manage trust property (the money) they were under a duty, intended by both parties, to hold and transfer nominal title to the borrowers. This arrangement constituted an express trust with the borrowers being beneficiaries. That duty was duly carried out. The borrowers did in fact receive their trust monies, so Paragon Finance Plc could not sue for failure of this trust

[46] *Paragon Finance*, above n 6, 409-412.

[47] *Paragon Finance*, above n 6, 409.

The Court noted that the lawyers for Paragon Finance Plc were only used for the mortgage fraud deal and had no pre-existing trust relationship with the plaintiff. The transaction which created the supposed trust was impeached by the plaintiff and the remedial trust claimed was never intended or created by the parties at the time. Therefore, equity could choose to respond to the alleged fraud by imposing a constructive trusteeship, but could not recognise an express-like constructive trust. This trusteeship was not a legitimate trust and in the absence of a trust, there was no basis for allowing the claim under the fraudulent breach exception of section 21. Therefore Paragon Finance Plc could not allege fraud, would not be able to recover their money, and lost the case.

5 Conclusion

Paragon Finance is a reaction to greater trust pressure. The case outlines an interpretation of constructive trust which restrains the potential and scope of trusts as equitable remedies. The decision is a denial of remedial constructive trusteeship status and is motivated by a desire to return trust law to supposed first principles. It does not halt the use of the type-two trust (it simply renames it) and it does not identify why remedial trust development is undesirable. The decision must be rejected as an extreme rule and must not be allowed to corrupt the understanding of remedial trust in New Zealand.

D Underlying Policy

1 Introduction

The decision in *Paragon Finance* and the two-type template may both be accurately interpreted as an attempt to limit the definition of trust. It is this wider implication of the rule that merits investigation. Section 21 cases are not simple decisions to allow or deny relief, they are a conflict over what constitutes a constructive trust.

English courts have advanced a significant argument in support of the two-type test, which belies a bias in English law for using trust property as a determinative factor in recognising trusts.[48] This section outlines that argument, with specific reference to the pre-eminence of trust property. The objective of this analysis is the unmasking of a fundamental link between trust property and the type-one trust. In effect, the overwhelming influence of trust property on constructive trust law is the basis for the development of the two-type template and the restraint of constructive trusteeships.

2 The importance of clear trust property

The two-type template is based on a belief that the primary element of legitimate trusts must be trust property. More specifically, the creation of separate legal and equitable title by intention. This view is closely linked to the express trust and has a subsequently limiting influence on the scope of constructive trusts.[49] Essentially, this approach to trust law only acknowledges a trust where the legal title is in one party and the equitable title can be interpreted as residing in another.

The latest section 21 case, *Coulthard v Disco Mix Club*, is a blatant example of property bias.[50] Jules Sher QC dismissed a claim under section 21 with the phrase "[t]he touchstone of a true trusteeship is trust property."[51] The judge rejected a trust claim solely

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[48] There have been other less successful arguments advanced, usually recognising the sanctity of property rights and the fact that recognising all constructive trusteeships as a legitimate form of trust would greatly affect those rights. The granting of proprietary interests should be done according to principle, otherwise it would allow any wrongdoing, argued any length of time after it took place, to divest innocent third parties of title. Access to Equity's wider tracing powers and claims for proprietary relief avoid stringent common law rules for causation and remoteness. Proprietary remedies should granted under clear criteria so that those with an interest in property, especially third party creditors, can have certainty before, during and after property transactions. The significance and effect of equity's proprietary trust remedy should have the stability of identifiable criteria and objective evidence. Supposedly, manifesting an intention to create a separate equitable and legal title provides clear criteria to apply to evidence, to decide a case, and to warrant a trust remedy.

[49] Limiting in that it restrains the full status of trust to only those circumstances analogous to an express trust, leaving all other alleged trusts to be considered as equitable remedies, mistakenly called trusts.

[50] *Coulthard v DMC*, above n 11. Jules Sher QC acting as a Deputy Judge of the High Court (Chancery Division).

[51] *Coulthard v DMC*, above n 11, 480.

because the supposed trust property was able to be mixed. In all other respects, a legitimate trust based on solid equitable principles was founded.[52]

This fatal bias in constructive trust law is repeated throughout many of the section 21 cases.[53] In 1893 the courts put forward their first approach to legitimate trusts in this context.[54] Kay LJ used trust property as a key to identifying trusts, suggesting the law legitimately bound a person as trustee because of his/her dealings with trust property.[55] He considered trust property to be property over which a trustee had legal power and control.[56] These initial formulations of trust property reflected modern preoccupations with equitable title, but also recognised that relationships could give rise to significant control over property without creating equitable title. Therefore, these judgments included scope to recognise legitimate trusts without clearly created equitable title, where practical control over another's property existed.[57]

Twenty-seven years later, in *Taylor v Davies*, the Privy Council began to develop further the property requirements for trust recognition.[58] Viscount Cave believed that a true trustee was one who took possession of property on behalf of others, and a remedial trustee simply took possession in his own right, but because of conduct would be declared trustee in a court of equity.[59] *Taylor v Davies* emphasised the importance of separate legal and equitable title for identifying trust property, and the necessity of trust property for recognising a legitimate trust.[60] A person taking possession in his own right, an absolute

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[52] A further investigation of these points, and the *Coulthard* (above n 11) decision, takes place in Part VI.
[53] See generally; *Paragon Finance*, above n 6; *Coulthard v DMC*, above n 11; *Taylor v Davies* above n 5; *Soar v Ashwell* above n 5; *Selangor United Rubber Estates Ltd v Craddock* (No 3) [1968] 2 All ER 1073; *Clarkson v Davies* [1923] AC 100 (PC).
[54] *Soar v Ashwell*, above n 5, 394-396.
[55] *Soar v Ashwell*, above n 5, 399.
[56] *Soar v Ashwell*, above n 5, 399. Kay LJ states that the case of *Barnes v Addy* (1874) 9 Ch. App. 251, 251 stands as authority for this view and defines "as accurately as is perhaps possible" the concept of express and constructive trustee in relation to property.
[57] *Soar v Ashwell*, above n 5, 994-995.
[58] *Taylor v Davies*, above n 5, 651-653.
[59] *Taylor v Davies*, above n 5, 651. Viscount Cave delivered judgment on behalf of all their Lordships.
[60] *Taylor v Davies*, above n 5, 651-653.

possession, would merely be liable for constructive trusteeship.[61] Only where possession was taken on trust, "for or on behalf of others"[62] would a legitimate trust exist. Originally, the reason behind the separation of legal and equitable title was the principle that trust property should not be freely available to a trustee. However, beginning with the *Taylor* decision, courts appeared to forget this underlying rationale and simply demanded trust property be encumbered by equitable title.[63] The separation of legal and equitable title, either expressly or by analogy to encumbered possession, became inherent in constructive trust law analysis as an end in itself.

This predilection for property greatly influenced the reformulation of the test by the Privy Council in *Clarkson v Davies* (1922).[64] In following Viscount Cave, the Privy Council held that a legitimate trust arose only before the occurrence of the impeached transaction, rather than because of an impeached transaction.[65] Inherent in this distinction was a belief that only a pre-existing trust or intention to hold property for the benefit of another would be sufficient for a legitimate trust. Evidence of equitable title now went to prove both the pre-existing nature and property requirements of trust arguments. The *Clarkson* test identified remedial trusteeship as an equitable response to fraud, supposedly divorced from basic trust concepts of property and therefore, illegitimate.

This view forms the basis of the latest Chancery Court formulation.[66] This version continues to use the pre-existing trust property relationship as a defining characteristic and now appears to be settled English law. All it adds to the 1922 test is a complete description of underlying reasoning:[67]

> A constructive trust arises by operation of law whenever the circumstances are such that it would be unconscionable for the owner of property (usually but not necessarily the

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[61] *Taylor v Davies*, above n 5, 653.
[62] *Taylor v Davies*, above n 5, 653.
[63] *Taylor v Davies*, above n 5, 651-53.
[64] *Clarkson v Davies*, above n 53.
[65] *Clarkson v Davies*, above n 53, 110-111. The judgment prepared by the Lord Justice-Clerk (Lord Scott Dickson) who died before its delivery. It is the sole judgment delivered by their Lordships.
[66] *Paragon Finance*, above n 6, 407-415; *Coulthard v DMC*, above n 11, 479-481.
[67] *Paragon Finance*, above n 6, 409 per Millet LJ.

> legal estate) to assert his ... beneficial interest in the property and deny the beneficial interest of another. In the first class of case, however, the constructive trustee really is a trustee. He does not receive the property in his own right but by a transaction by which both parties intend to create a trust from the outset and which is not impugned by the plaintiff. His possession of the property is coloured from the first by the trust and confidence by means of which he obtained it, and his subsequent appropriation of the property for his own use is a breach of that trust. ... In these cases the plaintiff does not impugn the transaction by which the defendant obtained control of the property. He alleges that the circumstances in which the defendant obtained control make it unconscionable for him to assert a beneficial interest in the property.
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> The second class of case is different. It arises when the defendant is implicated in a fraud. Equity has always given relief against fraud by making any person sufficiently implicated in the fraud accountable in equity. In such a case he is traditionally though I think unfortunately described as a constructive trustee and said to be 'liable to account as a constructive trustee'. Such a person is not in fact a trustee at all, even though he may be liable to account as if he were. He never assumes the position of a trustee, and if he receives the trust property at all it is adversely to the plaintiff by an unlawful transaction which is impugned by the plaintiff. In such a case the expression 'constructive trust' and 'constructive trustee' are misleading, for there is no trust and usually no possibility of a proprietary remedy; they are 'nothing more than a formula for equitable relief'.

This is the complete formulation of the two-type template and the apex of importance for trust property in trust law. The recurring theme throughout these conceptions of trust has been the voluntary and intended creation of equitable and legal title as a trust necessity. This presupposes trust property, and places the constructive trust squarely in reliance of such property. Effectively, this template limits the applicability of legitimate trust status to those circumstances that are precisely analogous to an 1890s conception of express trust. This approach is both flawed and outdated.

E Conclusion

English law has a propensity to overvalue trust property. This emphasis comes from the rigid application of precedent over one hundred years old and has culminated in the two-type template. The template continues the traditional approach to trust law by including the separation of legal and equitable title as a precursor to establishing a legitimate type-one trust. While based on a desire to protect a principled approach to trust development, the necessity of separate equitable title for trust property fails to recognise circumstances

analogous to legitimate constructive trusts. Where a person in a trust-like relationship exercises trustee-like control over another's property, without equitable title, equity may want to intervene.[68] In effect, requiring equitable title for trust property limits the scope of the trust concept and, as will be demonstrated in Part V, fails to explain important recent developments in trust law.

[68] For example, assume a manager and a musician sign a management agreement. The manager agrees to receive all the musician's earnings, pay expenses from that, and then pay out an amount equal to 80% of the remaining money, keeping 20% as a management fee. The manager has a fiduciary duty to account to the musician, but no express or express-like type-one trust over the musicians earning's would exist. The right of the manager to mix, spend and invest the musician's earnings negates the possibility of clear equitable title existing in those earnings, and that negates trust property, which in turn negates any trust. However, all the other aspects for a trust, and the principled basis for recognising one, still may exist: There could be a pre-existing relationship, an agreement to allow another's control over the property, and a beneficiary-like vulnerability on the part of the musician. This kind of argument is explored fully in Part VI.

V Criticising the English Approach

A Introduction

The two-type template is a deceptively simple test that hides inherent weaknesses and a lack of trust understanding. It reflects the supremacy of trust property in English thinking and a lack of willingness to recognise new trust law concepts. Part V will investigate the value of the two-type approach. It will look at bribery, de facto, and knowing assistance relationships. These examples will demonstrate the artificiality behind the two-type template and the fluidity between it's two categories. It will conclude by rejecting the template as a proper basis for discriminating between trusts under section 21 and for usefully identifying legitimate trusts.

Part V begins by examining bribery trust law and the theoretical basis for categorising it. That analysis will include applying the two-type template and then assessing the template's success and value. These steps will be repeated for de facto, knowing receipt and knowing assistance cases. The objective of this section is to reveal the substantial failure of the template to accept or restrain constructive trusteeship in dynamic areas of our law. Part V will prove that the template is already failing New Zealand and that a new approach is required.

B Bribery Trust Law

The current authority for bribery trust law is *Attorney-General for Hong Kong v Reid*.[69] In *Reid*, the Hong Kong government claimed that Mr Reid was a constructive trustee of bribery monies paid to him in his capacity as Crown Counsel, Deputy Crown Prosecutor

[69] *Reid*, above n 36, 1.

and finally as Acting Director of Public Prosecutions. Specifically, he was bribed to avoid or obstruct the prosecution of specific criminals.[70]

Debate in the case centred on whether the Crown held a proprietary interest in the bribe monies. While it was accepted that Mr Reid was a debtor in equity to the Crown, argument centred over the appropriateness of imposing trust liability as a proprietary remedy. The Privy Council ultimately found Mr Reid liable as a constructive trustee but the reasoning behind this decision casts doubt over the two-type template.

Mr Reid was never an express trustee. There was never an agreement or intention for him to hold secret profits (bribes) for the benefit of the Crown. From this it is clear that there was no actual creation of separate legal and equitable title between the parties. Applying the two-type template, Mr Reid would be a type-two constructive trustee of the money rather than a real trustee under a legitimate trust: Mr Reid never took property for the benefit of the Crown, but instead took it for himself. He had no pre-existing trust relationship, but instead, had trust-like liability imposed on him as an equitable response to his fraudulent acts.[71] Finally, the Crown was clearly impugning the 'transaction' which gave rise to proceedings. These facts demonstrate a type-two equitable trusteeship under the two-type template.[72] The consequences of this categorisation will be explored in Part VI section C.

However the Privy Council appeared to prefer an entirely different method for establishing trustee obligations. The Court began by stating "[b]ribery is an evil practice which threatens the foundations of any civilised society."[73] Never before had the seriousness of the fraud been relevant to establishing the type of constructive trust. More interesting was

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[70] *Reid*, above n 36, 3.

[71] *Reid*, above n 36, 3-5.
The Court clearly acknowledges that Mr Reid did have a pre-existing fiduciary relationship.

[72] *Reid*, above n 36, 8.
Equity demanded that Mr Reid not benefit from his inequitable behaviour and responded with the imposition of constructive trust.

[73] *Reid*, above n 36, 3 per Lord Templeman delivering the sole judgment of Their Lordships.

the Court's discussion of the property rights that pass in bribery: "The legal estate in freehold property conveyed to the false fiduciary by way of bribe vests in him."[74] This statement suggests that, as a result of bribery and not the imposition of the court or the intention of the parties, a split between legal and equitable title had been created. Let us be clear, the two-type template tells us that this should not happen. Either the parties intend to create an equitable title (have one take possession for the other) which creates an express constructive trust, or the court imposes constructive trusteeship holding one party liable to account as trustee.

The Court then noted "[a]s soon as the bribe was received, whether in cash or in kind, the false fiduciary held the bribe on a constructive trust for the person injured."[75] The significance of this statement is that by it, the Court asserted it was not imposing trusteeship, but rather merely recognising an existing one. This recognition transformed the bribery trust into an institutional constructive trust because it freed it from judicial creation. Once gifted extra-judicial existence, the bribery trust became categorisable as a type-one trust under the two-type template. In effect, *Reid* decided the factual circumstances of bribery satisfy the requirements for acknowledging an express-like constructive trust.

Clearly, the lack of mutual intention to create a trust means bribery cases can not satisfy express-like trust requirements. *Reid* must be understood as a policy decision. In cases of bribery, courts are to recognise an institutional constructive trust. *Reid* identifies the moment of receipt as the beginning of the trust, the bribe monies as trust property, the "master or principal whose interests have been betrayed"[76] as the beneficiary, and recognition of a legitimate trust as the remedy. The policy behind this decision: Bribery is evil and should be punished and discouraged. The principle used to effect this: "It is unconscionable for a false fiduciary to obtain and retain a benefit in breach of duty."[77]

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[74] *Reid*, above n 36, 3.
[75] *Reid*, above n 36, 4.
[76] *Reid*, above n 36, 3.
[77] *Reid*, above n 36, 3.

The vehicle to bring the policy to fruition: A Constructive trust. Acting in personam, equity would require Mr Reid to pay back the actual bribery amounts but allow any profits from the bribe to remain his. Only a trust remedy would make Mr Reid accountable for increased value and thus fulfil Equity's concern that no benefit from breach be obtained and secure.

In harmonising *Reid* with the two-type test, the Court was ambiguous. It did turn its mind to the problem, but offered no solution. *Metropolitan Bank v Heiron*[78] was identified as an authority for the rule that a proprietary interest arises independently of judicial action when the bribe is accepted.[79] However, it was also briefly considered as authority for the substance of the two-type template.[80] These two concepts were never reconciled with each other. The Court simply described the two-type template as "inconsistent with ... authorities which make the recipient of the bribe liable..."[81] It went on to distinguish the case, and presumably the argument that the Court was needed to impose trusteeship, on the grounds of delay and as:[82]

> [A] decision of a distinguished Court of Appeal heard and determined in one day, 5 August, perilously close to the long vacation without citation of any of the relevant authorities.

What does this mean? Most likely the policy behind the decision was of supreme importance and nothing was to detract from it. Unfortunately, the effect is a breakdown in the two-type template. In reality, the Court elevated a remedial constructive trusteeship to an institutional trust. It argued that bribery was an especially evil wrongdoing, and that policy required acceptance of the entire field of bribery case law as legitimate trust law.

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[78] *Metropolitan Bank v Heiron* (1880) 5 Ex D 319.
[79] *Metropolitan Bank v Heiron*, above n 78, 324; *Reid*, above n 36, 7.
[80] *Metropolitan Bank v Heiron*, above n 78, 324; *Reid*, above n 36, 7 per Lord Templeman:
"This observation does draw a distinction between moneys which are held on trust and are taken out by the trustee and moneys which are not held on trust but which the trustee receives in circumstances which oblige him to pay the money into the trust."
[81] *Reid*, above n 36, 7.
[82] *Reid*, above n 36, 6.

While it is possible to argue that bribery is a discrete area of law and capable of 'transplantation' into institutional trust law, there is no principled basis for doing so.

Why is this important? Section 21 relies on the two-type template and *Reid* tells us that the template will not identify all express (institutional) constructive trusts because courts can elevate remedial trusteeship to that class on a basis outside the parameters of the test.

C De Facto Trust Law

1 Introduction

The current authority for de facto trust law is *Lankow v Rose*.[83] This decision accepted the two-type template but was revisited with a different interpretation by the Court of Appeal in *Fortex*.[84] Mirroring bribery trust law, the *Fortex* Court identified de facto trusts as legitimate express-like constructive trusts, even though the two-type template was both unable to explain, and significantly, unable to accept this result. De facto trusts are another example of the breakdown in the current two-type template and a serious argument for a new trust conception.

This section briefly describes the facts of *Lankow* and then applies the two-type template. It will argue that the *Lankow* Court correctly identified de facto 'trusts' as a type-two trusteeship and that *Fortex* rebuffed the template by unilaterally altering the status of the trust. It will conclude by demonstrating that the *Fortex* Court substituted an incomplete analysis of de facto trusts for the outcome under the two-type template. Disturbingly, that means the template could not even require its replacement be coherent. De facto trusts place a dark shadow over the value of the template.

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[83] *Lankow v Rose* [1995] 1 NZLR 277.
[84] *Fortex*, above n 35, 178.

2 *Lankow v Rose*

Ms Rose claimed Mr Lankow should be made a constructive trustee of assets developed or acquired by him during their ten year relationship. She argued her significant contributions to those assets merited the imposition of a trust and would prevent Mr Lankow's unconscionable denial of a beneficial interest. More specifically, Ms Rose contributed twenty-nine thousand dollars to their home and paid for living expenses throughout their ten year relationship, allowing Mr Lankow to develop business interests.[85]

Mr Lankow was never an express trustee. He made no agreement and had no intention for any interest in his assets to be held for the benefit of Ms Rose. This rejects consensual creation of separate legal and equitable title. Applying the two-type template reveals Mr Lankow as a type-two constructive trustee: He never held property for the benefit of Ms Rose, rather for himself. There was no pre-existing express-like trust relationship, indeed the Court was required to impose trust liability on him. Most importantly, Ms Rose was impugning the 'transactions' which created her trust argument. These facts reveal a type-two equitable trusteeship. Mr Lankow had liability imposed by the Court because of inequitable behaviour impugned by the plaintiff.[86]

3 *Fortex*

The Court of Appeal rejected the two-type template for de facto cases in the 1998 *Fortex* decision.[87] This later case provided a new approach to the trust identified in *Lankow*:[88]

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[85] The *Lankow* (above n 83) facts:
Ms Rose was 26 and Mr Lankow 44 when they began living together in 1980. During the relationship the parties lived substantially off Ms Rose's income while Mr Lankow developed his concrete placements business and rental properties. By the end of the relationship, Mr Lankow had paid off all the debts of his businesses and had assets valued at $625,000. Ms Rose, having contributed all her economic resources to the partnership and Mr Lankow's investments, only had assets valued at $30,000.

[86] *Lankow v Rose*, above n 83, 294 per Tipping J:
Equity demanded that Mr Lankow not avoid accounting to Ms Rose for her interest and responded with the imposition of a constructive trust. The basis for the trust being contributions to the property which equity considered unconscionable to deny. In effect, equity was repulsed by the economic advantage Mr Lankow took of Ms Rose.

[87] *Fortex*, above n 35, 178.

[88] *Fortex*, above n 35, 178:

> *The constructive trust which arises in de facto matrimonial property cases is of an institutional, rather than remedial kind ...* (Emphasis added)

In one sentence the theoretical basis of the de facto constructive trust was overturned. This decision elevated the de facto trust into the rubric of type-one trusts, against the express determination of the two-type template. Recognising de facto cases as 'institutional' trusts clothes them in express-like constructive trust status. That means they arise "by operation of the principles of equity ... whose existence the Court simply recognises in a declaratory way."[89] Let us be clear, this allows de facto trusts to exist independently of judicial imposition and for the mere existence of a de facto relationship to create a split between legal and equitable title.[90] The template tells us that this should not happen. Either parties intend to create equitable title and therefore, an express-like constructive trust, or the court imposes trusteeship. In *Fortex*, these basic criteria of the two-type template are abandoned.[91] The value of de facto trust analysis for our purposes is this abandonment.

4 How does this new trust operate?

The trust created in *Lankow* was remedial, per Tipping J:[92]

> It is better to acknowledge openly that a constructive trust is being imposed in equity without the consent, express, implead or imputed, of the constructive trustee. The trust is imposed because equity will not allow the legal owner to deny the claimant a beneficial interest.

The parties had never agreed to create a separate beneficial interest. The Court created that interest and imposed it on the legal title as an equitable response to unconscionable

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The rest of that passage continues "[t]he party with legal title to the asset or assets in question is required to yield to the claimant party a beneficial interest because it would be unconscionable for the first party to deny the claimant such an interest. Hence, equity intervenes."

[89] *Fortex*, above n 35, 172.

[90] *Fortex*, above n 35, 172.

[91] *Fortex*, above n 35, 172-173.

[92] *Lankow v Rose*, above n 83, 293.

behaviour.[93] However, the *Lankow* Court did apply a unique set of criteria for determining the trust. A de facto claimant must show:[94]

1. Contributions, direct or indirect, to the property in question.
2. The expectation of an interest therein.
3. That such expectation is a reasonable one.
4. That the defendant should reasonably expect to yield the claimant an interest.

These four steps constitute the 'reasonable expectations' test for de facto trusts. Again, the predilection for trust property is reflected in the test, but there is a movement away from requiring clear intention of an express trust-like relationship. Remember, this was a critical part of the institutional constructive trust and yet here it is jettisoned. The expectations test will likely be satisfied were there is evidence of a mutually agreed trust-like relationship. However, a reasonable expectation will often be found where evidence would not usually be sufficient to satisfy trust requirements.[95] There is not a ready correlation between the expectations of parties and the necessities of recognising an institutional trust.[96]

Two further issues arise from the institutional categorisation of de facto trusts. The first reflects shifting attitudes to the relationship. What begins as casual co-habitation may develop into a loving and committed relationship in the nature of marriage. Parties attitudes to financial independence may change with time, the birth of children or the advancement of career. The focus on a couple's expectations, be it at the time of purchase or court hearing, will be but a snapshot and may provide a distorted vision of the relationship and the status of property contributions.[97] This is not a sound basis for

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[93] *Lankow v Rose*, above n 83, 285 per Hardie Boys J: "It is these contributions that in my judgment justify the ***imposition*** of a constructive trust." (Emphasis added). At 288 per Gault J: "... the underlying principle for ***imposing*** a constructive trust ..." (Emphasis added). In short, the *Lankow* Court is unanimous in finding that the circumstances warrant the imposition of a constructive trust, where no previous express-like trust existed.

[94] *Lankow v Rose*, above n 83, 294.

[95] See generally: *Muschinski v Dodds* (1986) 60 ALJR 52; *Hohol v Hohol* [1981] VR 221.

[96] Patrick Parkinson "Doing Equity Between De Facto Spouses" (1988) 11 Adel LR 370, 396.

[97] Parkinson, above n 96, 398.

establishing either the certainty of intent or the specific date of inception, both of which are vital to institutional trusts.[98] The *Fortex* Court appears to have forgotten the flexibility of the type-two trusteeship necessary to provide equity in individual cases.

The second issue relates to trust inception. *Fortex* does not provide a clear statement of when the independently existing trust is created. Presumably, it will be at the time the supposed trust property is acquired. This is unable to account for situations where property is acquired prior to cohabitation but paid for afterwards. If the trust is created when post cohabitation payments begin, over a period of twenty-five years (an ordinary mortgage) the amounts contributed will vary considerably and may be difficult to assess.[99] Having a rigid date of inception limits the broader analysis available to a court under the type-two trusteeship and would allow inequities to occur.[100]

5 *Conclusion*

The *Fortex* Court wanted to help de facto partners. A type-one trust would better provide certainty and protection for partners who had contributed a great deal to the material well-being of their partnership and stood to receive nothing. Elevating the de facto trust to type-one status means the trust becomes entrenched. Where the criteria are met, it becomes mandatory to recognise the trust and that better guarantees trust protection. The policy behind the *Lankow* Court decision reflects the motivation for this:[101]

> The Judge's assessment that she had put her all into the relationship had been amply justified ... Her contributions had been more extensive and more direct than in the care of the home. In a

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[98] The Court in the bribery case *Reid* (above n 36) see above, Part V section B, were notably anxious to provide a beneficiary, a clear commencement of trust, and a reason for imputing intention. *Lankow* is a further step in the relaxation of the principles necessary for the type-one constructive trust (an institutional trust by default).

[99] Parkinson, above n 96, 398

[100] It is conceivable that even the Statute of Limitations could be said to run against the de facto trust. If it is self-existing then it must have some clear beginning independent of judicial imposition which would satisfy a starting point in time for the Act. It is unlikely to be relevant for Section 21 analysis because the other partner will usually retain the property and therefore be indefinitely liable under Section 21(1)(b) as a trustee still in possession.

[101] *Lankow v Rose*, above n 83, 285 per Hardie Boys J.

> very real sense they had assisted the appellant to accumulate the assets which he had now. *It was those contributions that justified the imposition of a constructive trust.* (Emphasis added).
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> *His* [Mr Lankow's] *unwillingness to acknowledge or allow her an interest represented unconscionable conduct on his part justifying the intervention of equity and the imposition of a constructive trust.*[102] (Emphasis added).

The *Lankow* Court recognised that a type-two trusteeship could be regularly applied in de facto cases, and provided the reasonable expectations test as criteria. The *Fortex* Court elevated the test, and the trust, to type-one status to better protect people who provide otherwise unrecoverable and significant contributions to their partner's assets. Again, the two-type template fails to accept this decision or restrain it. The template is the basis of section 21 analysis and *Fortex* tells us that it is redundant because it can be overturned without even substituting a fully developed trust analysis.

D Knowing Receipt & Knowing Assistance

1 Introduction

This section investigates third party (stranger) liability to a trust, with specific reference to knowing receipt and knowing assistance cases. It suggest these trusts are correctly identified as type-two trusteeships, but that courts are in the process of re-classifying them into type-one trusts. The two-type template is again unable to either explain or restrain this development and consequently, confidence in the template is further eroded. This section begins by defining the two different types of liability and then applying them to the template. It then examines the obscured re-classification in the cases and, finally, comments on the role of the template.

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[102] *Lankow v Rose*, above n 83, 300 per Tipping J.

2 Defining the two types of liability

These two equitable claims are based on the dictum of Lord Selborne in *Barnes v Addy*[103] and are affirmed by the Privy Council in *Royal Brunei Airlines v Tan.*[104] Legal shorthand recognises them as 'knowing receipt' and 'knowing assistance'. These categories extend the application of the constructive trust to circumstances involving third parties. Where any person knowingly receives or deals with trust property, or without receipt, becomes involved with the property in a manner inconsistent with a pre-existing trust, equity will impose a constructive trusteeship. Our focus is on the nature of this imposed liability and the treatment of these categories under the two-type template.

(a) Knowing receipt

Any person who receives or deals with trust property knowing that such receipt or dealings are in breach of trust, will be held liable as a constructive trustee of that property.[105] The underlying basis of liability is unjust enrichment of the defendant at the expense of the plaintiff beneficiary.[106] The defendant has knowingly taken the benefit of trust property at the cost of the beneficiary and equity imposes trusteeship because of the defendant's unconscionable behaviour.[107]

(b) Knowing assistance

Any person who knowingly assists or induces a trustee to act in a manner inconsistent with the trust can be made personally liable for resultant gains or losses by the imposition of constructive trusteeship.[108] This reflects a policy decision to ensure innocent beneficiaries

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[103] *Barnes v Addy*, above n 56, 251-252.

[104] *Royal Brunei Airlines v Phillip Tan Kok Ming* [1995] 2 AC 381, 382 *[Royal Brunei]*:
"[T]he responsibility of a trustee] may no doubt be extended in equity to others *who are not properly trustees*, if they are found ... actually participating in fraudulent conduct of the trustee to the injury of the cestui qui trust. But ... strangers are not to be made constructive trustees merely because they act as the agents of trustees in transactions within there legal powers, transactions perhaps of which a court of equity may disapprove, unless those agents receive and become chargeable with some part of the trust property, or unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees." (Emphasis added).

[105] *Royal Brunei*, above n 104, 392; *Powell v Thompson* [1991] 1 NZLR 597, 610-613.

[106] *Powell v Thompson*, above n 105, 607.

[107] *Powell v Thompson*, above n 105, 607.

[108] *Royal Brunei*, above n 104, 386.

have some recourse when dishonest trustees alienate trust property, and to generally discourage capricious third party behaviour.[109] The touchstone of liability is the conduct of the third party who participated in a breach of trust.[110] Notably, the stranger's liability is not related to trust property but rather fraudulent design.[111]

3 *Applying the two-type template: theory*

Returning to the classic formulation of third party liability to a trust, Lord Selbourne noted:[112]

> Responsibility may no doubt be extended to those *who are not properly trustees* ... Strangers are ... *to be made* constructive trustees... (Emphasis added)

Third party liability is simply that, liability of those who are not express trustees. It is a judicial method for imposing trusteeship on a relationship outside the scope of express-like constructive trusts. There is no pre-existing trust relationship, no agreement to create separate legal and equitable title, and the transaction which creates the trusteeship is impugned by the plaintiff. In short, both these doctrines are the very proto-type examples of type-two trusteeships. However, it is interesting to note that as early as 1893, the courts were willing to attribute these trusts with institutional status.[113]

4 *Applying the two-type template: knowing receipt*

A leading New Zealand decision on knowing receipt is *Powell v Thompson*.[114] In *Powell*, Mrs Powell sold a house, owned as tenant in common with her two daughters, without

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[109] *Powell v Thompson*, above n 105, 607.
[110] *Powell v Thompson*, above n 105, 607; *Royal Brunei*, above n 104, 386.
[111] *Powell v Thompson*, above n 105, 613; *Royal Brunei*, above n 104, 385.
[112] *Barnes v Addy*, above n 56, 251-252.
[113] *Soar v Ashwell*, above n 5, 994:
"[W]here he has knowingly assisted a nominated trustee in a fraudulent and dishonest disposition of the trust property. Such a person will be treated by a court of equity as if he were an express trustee of an express trust."
[114] *Powell v Thompson*, above n 105.

their knowledge or consent.[115] She sold the property to Mr Thompson in partial satisfaction of moneys she had embezzled from him. Mr Thompson was aware of the daughters' interests and that Mrs Powell did not have their permission for the sale, but continued with the transfer to recoup his losses.[116]

Mrs Powell was subject to a type-one trust for the benefit of her daughters. There was a pre-existing trust-like relationship, a form of separate legal and equitable title, and clear trust property. Mr Thompson had knowledge of this trust and yet attempted to assert ownership inconsistent with the interests of the beneficiaries and the trust.[117] The Court acknowledged unjust enrichment at the expense of innocent beneficiaries and imposed a constructive trusteeship. In accepting property subject to a trust, the defendant had accepted the obligations of the trust, making himself a trustee.[118] This is correctly interpreted as type-two trusteeship. The Court has imposed trusteeship where none was previously, and created liability.

5 Applying the two-type template: knowing assistance

The leading decision in this area is *Royal Brunei v Tan*.[119] In *Royal Brunei*, an insolvent travel company owed money to an airline. Royal Brunei Airlines appointed BLT as a general agent for the sale of passenger and cargo transport under an agreement providing that all moneys collected by BLT on the airline's behalf would be property of the airline.[120] However, BLT breached this agreement by using Royal Brunei's trust money in its ordinary business accounts. BLT subsequently went into receivership and the airline

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[115] Mrs Powell was able to do this pursuant to powers of attorney given her by the daughters before an overseas trip and never revoked.

[116] *Powell v Thompson*, above n 105, 602-604.

[117] *Powell v Thompson*, above n 105, 608.

[118] *Powell v Thompson*, above n 105, 609.

[119] *Royal Brunei*, above n 104, 381.

[120] *Royal Brunei*, above n 104, 383-384.
This initial agreement constituted an express-like constructive trust requiring BLT to hold the money on trust for the airline until BLT accounted to Royal Brunei for their profits. These facts give rise to a type-one constructive trust: There was a pre-existing trust-like relationship, not impugned by the plaintiff, and there was a separation of legal and equitable title.

attempted to recover from Mr Tan, the managing director and controlling shareholder of BLT. Mr Tan admitted to knowingly assisting in his company's breach of trust.

The case focussed on whether third party liability existed in the absence of dishonest conduct by the trustee. The Court decided it did, citing the gross anomaly of dishonest third parties being insulated from liability solely because of an honest trustee. This would encourage third parties to try taking advantage of trustees.[121] Therefore, the Privy Council emphasised the underlying dishonesty of third parties as the basis for liability.[122]

Mr Tan never entered into a trust agreement with Royal Brunei. His liability was founded on inequitable behaviour. He never acknowledged a separation of legal and equitable title and there was no pre-existing relationship giving effect to traditional trust obligations between him and Royal Brunei. Mr Tan was a type-two trustee.

6 A mandatory trust?

At first blush, all seems well. However, the issue for equity is the categorisation of knowing receipt and assistance trusts. Repeated application of these trusts has demonstrated a "straight-jacket" effect.[123] Courts now recognise a constructive trust whenever the circumstances meet the criteria.[124] In effect, there is no exercise of judicial discretion. Following the path of de facto trusts, courts appear to be moving toward recognising knowing receipt and assistance cases as institutional constructive trusts. The judgments take care to identify the moment of receipt or fraudulent assistance as the moment the trust begins, identify the third party as a trustee and identify property affected by the fraud as trust property.[125] This classification process is unnecessary under type-two trusteeship but lays a foundation for elevation into the type-one trust category.

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[121] *Royal Brunei*, above n 104, 383-384.
[122] *Royal Brunei*, above n 104, 392.
[123] *Royal Brunei*, above n 104, 385.
[124] *Royal Brunei*, above n 104, 392-393.
[125] *Royal Brunei*, above n 104, 392; *Powell v Thompson* above n 105, 610-613.

Obscured in the cases are references to type-one trust categorisation, most notably in *Powell*. Thomas J identified the knowing receipt third party trustee as "trustees de son tort".[126] That implies liability as if appointed a trustee, and is usually used in the context of type-one institutional trustees.[127] More significantly, Thomas J stated that the criteria used in assistance cases "determine whether a constructive trust has been created..."[128] This acknowledges independent creation of the trust outside judicial imposition. That is clearly beyond type-two trusteeships. While much of the judgment reflects type-two trusteeship, the case is far from a definitive statement of that.

The parallel with de facto trust law is alarming. The development of an objective test for dishonesty and easily applicable criteria mirrors the reasonable expectations test which formed the basis for elevating the de facto trust. The Court of Appeal has yet to provide a contemporary definitive statement on the place of these trusts under the two-type template, but such a case will likely follow bribery and de facto lines. This prospect does nothing for longterm acceptability of the current two-type template.

7 *Conclusion*

The judicial approach to knowing receipt and assistance belies a desire to elevate these trusteeships into legitimate trusts and demonstrates the passage of remedial trusteeship into institutional trust, merely by judicial acceptance and repetition. The long history of these cases serves to slow this process by requiring incremental steps of development. However, the trend is clear. The remedial concept of searching for requisite knowledge has been replaced with the institutional approach of simply recognising a factual circumstance.[129] No longer does the Court enquire into third party subjective knowledge; instead it merely looks for objective dishonesty and acknowledges that a trust exists.[130] The two-type

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[126] *Powell v Thompson*, above n 105, 609 per Thomas J.
[127] *Mara v Browne* [1896] 1 Ch 192. This case is the classic formulation of self imposed trusteeship and is recognised as creating an institutional constructive trust.
[128] *Powell v Thompson*, above n 105, 609.
[129] *Royal Brunei*, above n 104, 390-392.
[130] *Royal Brunei*, above n 104, 392-393.

template can not accept this development and is powerless to stop it. Therefore, its value as a legitimate tool must be questioned.

Building on this negative evaluation, knowing assistance trusts exist as a personal liability, without requiring ownership of trust property:[131]

> These trust obligations are imposed, not because the third part has received and benefited from the receipt of property which is subject to a trust, but because he or she has acted in such a way that they deserve to be treated as if they were a trustee in respect of the trust in issue.

Confidence in the two-type template will be further eroded by recognising the knowing assistance trust as a type-one trust because it exists without trust property. In effect, the template has not only failed to identify an exhaustive approach for categorising trusts, but also for requiring trust property. Knowing receipt and assistance cases present the challenges conspiring against the two-type template: The inability to predict trust law development or affect that development and the relaxation of traditional trust property requirements. These aspects of the template are vital to its application in section 21 cases and provide a powerful critique of maintaining it in its current form.

E Conclusion

Part V has provided an analysis of bribery, de facto and knowing receipt and assistance trusts. These trust concepts were assessed against the two-type template and found to be type-two trusteeships. Part V identified a judicial interpretation of these trusts that rejected their status under the template and elevated them into the type-one constructive trust category. Immediately, this raises questions over the validity of the template. It can not explain this elevation, supply a rationale for it, or even protect itself from judicial rejection. The template is failing to reflect the realities of trust law in the most significant and developing areas. Section 21 has come to rely on the template because it was a reliable

[131] *Powell v Thompson*, above n 105, 610.

tool; but it is this no longer. While an outright denial of the template is extreme, a recognition of its weaknesses and a revitalised approach is warranted.

Section 21 deals with fundamental trust identification. Our law represents a new vision of trusts which the template does not adequately reflect. Applying it as the default rule for section 21 without investigation of this new vision and subsequent reformulation of the template would be wrong. Part VI of this paper will attempt this investigation provide an answer to the challenges raised in this part.

VI A Wider Understanding of Constructive Trust

A Introduction

The two-type template, as demonstrated, is no longer a sound basis for distinguishing between legitimate trusts and mere trusteeships. Courts have repeatedly elevated remedial type-two trusteeships into type-one institutional constructive trusts without the acceptance or restraint of the template.[132] However, continued use of remedial type-two trusteeships in specific circumstances may in itself create grounds for courts to recognise a type-one trust.[133] Clearly, there is a need for the template to be revisited.

This paper offers a new vision, explaining judicial departure from the current template as a movement away from constraints of trust property and toward relationship-based trusts. Put simply, pre-existing fiduciary relationships of trust, confidence and influence should, under certain circumstances, be capable of creating type-one constructive trusts. Therefore, property not technically subject to equitable and legal title could be considered trust property, creating a legitimate trust. This approach reflects underlying equitable principles and explains current New Zealand law.

Part VI will illustrate this argument in detail. It will begin by identifying a relationship-based trust motif obscured in early section 21 judgments and forgotten in the current. This motif provides support for certain fiduciary 'trustees' being treated akin to express trustees. Next, it will outline specific fiduciary relationships which allow for express-like trusteeship and the scope of that trusteeship. It will demonstrate that the fiduciary trust would not open floodgates but instead, offers a discreet and limited doctrine easily applied. Finally, a

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[132] Part V examined this phenomenon with reference to bribery, de facto and knowing receipt and assistance cases.

[133] While elevating bribery and de facto trusteeships to legitimate trust status was amenable to a basic policy motivation (the evil of corruption and the protection of weaker parties respectively) knowing receipt and assistance cases appear to be elevated simply because of common use and practice.

case study based on the latest English section 21 judgment will be presented as a practical example of the fiduciary trust.

B The Unknown History of Relationship-Based Trusts

Current section 21 cases reflect a preoccupation with trust property inherent in the two-type template which demands that property evidence a separation of legal and equitable title. However, this was not always the case. Early common law, as this section will illustrate, provided both the basis and rationale for relationship-based express-like trusts.

In 1893, the English Court of Appeal acknowledged possible fiduciary trusteeship.[134] The Court outlined the traditional position of express and constructive trustees, and noted that many constructive trusteeships were not legitimate trusts.[135] Then, Lord Esher M.R. remarked "[t]here are cases not falling strictly within either of those... [categories]."[136] These 'cases' reflected situations where a person occupying a fiduciary position had "command or control" over property.[137] Inherent in Lord Esher's formulation of 'command and control' were two important points: fiduciary trusts did not require the clear separation of legal and equitable title; and the fiduciary trustee need never have actual possession of the property:[138]

> Where ... a fiduciary ... has ... been in possession of *or* has exercised command *or* control over such money or property, a court of equity will impose upon him all the liabilities of an express trustee, and will class him with and will call him an express trustee of an express trust. (Emphasis added)

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[134] *Soar v Ashwell*, above n 5, 995:
"[A] *man may be bound by an express trust where moneys, which in no sense belong to him, and in which he has no kind of interest*... are placed in his hands by the real owner." (Emphasis added)
[135] *Soar v Ashwell*, above n 5, 993.
[136] *Soar v Ashwell*, above n 5, 993.
[137] *Soar v Ashwell*, above n 5, 994.
[138] *Soar v Ashwell*, above n 5, 994-995.

This quote reveals no mention or requirement of a legal interest and no requirement for actual possession. Instead, possession or command or control are possible triggers for the fiduciary trust. 'Command' and 'control' fall outside the language of traditional trust analysis and support an assessment of influence over property rather than requiring legal and equitable interests. While the case forms the basis for the development of the current two-type template, my contention is that it also provided a basis for fiduciary express trusts. The basis for this liability was a fiduciary relationship of command or control. While the case predominantly focussed on command and control as evidenced by traditional express trustees, there was scope for a fiduciary relationship to meet the standard without the separation of legal and equitable title.

Lord Bowen stressed that an express-like trust can occur when the trustee has "no kind of interest" in property.[139] This clearly suggested that the trustee was not required to hold a legal interest in property. Rather, the relationship between the parties and its influence over property triggered the trust. In effect, the fiduciary trust speaks for cases where there is a pre-existing fiduciary relationship which allows one party to exercise command or control over another's property. The specific elements of this relationship have never been further identified because the fiduciary trust was never developed. The contemporary focus on trust property as a separation of legal and equitable interests has stymied its progress. However, modern trust cases suggest that a solid foundation for fiduciary trusts may already exist.

C Specific Fiduciary Relationships and Their Analogy to Trust Law

An express trustee voluntarily accepts legal ownership and management of trust property for the benefit of another. The legal owner is said to hold the property in trust for the

[139] *Soar v Ashwell*, above n 5, 995, quoting *Banner v Berridge* (1881) Ch.D 254, 264 per Kay J.

benefit of the equitable owner. This requires the trust property be controlled by the legal owner, subject to an encumbrance to act in the interests of the beneficiary.[140]

The fiduciary trust respects these concepts by analogy. It requires a pre-existing fiduciary relationship of commanding or controlling influence over property, then restrains that power to benefit the actual owner. The equitable basis for this approach is sound. In *Powell*, Thomas J declared that the judiciary should not be afraid of reinterpreting trust law.[141] *Powell* tells us equity uses the constructive trust to reverse unconscionability.[142] More specifically, Thomas J noted that the fundamental jurisdiction for equity's trust intervention was an intense concern with controlling unconscionable conduct.[143] This underlying principle supports acknowledging the fiduciary trust as a method of securing freedom from unconscionability in trust-like circumstances. It recognises that relationships of trust-like influence over property may fall outside strict equitable-legal interest distinctions, but nonetheless have the same effect.

The first proposed aspect of command or control is the fiduciary relationship of trust and confidence.[144] Usually this relationship arises where one party undertakes to act in the interests of another. The key aspect of this obligation is loyalty.[145] Loyalty manifests itself in many ways: the fiduciary must act in good faith, not make a profit from the trust, not place himself in a position where duty and personal interest clashes, and must not act for his own benefit, or a third party's, without informed consent.[146] This is not an exhaustive list, but importantly, it does describe almost exactly the obligations of an express trustee.

The second aspect of command or control is the fiduciary relationship of vulnerability. Equity acts to prevent unconscionable exploitation of one party by another. It

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[140] *Paragon Finance*, above n 6, 409.
Under a legitimate trust, the encumbrance will usually attach to traceable proceeds of trust property also.
[141] *Powell v Thompson*, above n 105, 611.
[142] *Powell v Thompson*, above n 105, 605.
[143] *Powell v Thompson*, above n 105, 613.
[144] *Bristol and West Building Society v Mothew* [1997] 2 W.L.R. 436, 449.
[145] *Bristol and West Building Society v Mothew*, above n 144, 449.
[146] *Bristol and West Building Society v Mothew*, above n 144, 449.

acknowledges a relationship of ascendancy and dependency.[147] More precisely, it arises when one party is at the 'mercy' of another's discretion.[148] It would best apply to the fiduciary trust where the beneficiary's property is susceptible to misuse by the fiduciary trustee as a result of the command or control relationship.[149] Together, these two aspects of command or control closely mirror the analysis used by courts to establish breach of express trust.

The paper discussed the elements for establishing a type-one express-like constructive trust in Part IV.[150] A fiduciary trust would mirror these elements by requiring a pre-existing fiduciary relationship of trust, confidence and influence. Breach of that relationship would need to be independent of its initial creation and not impugned by the plaintiff. There would not need to be a separation of legal and equitable title, but there would need to be a practical power of command or control over related property, exercised against the interests of the actual owner. These criteria represent a faithful expression of type-one trust law principles and recognise real circumstances which merit an express-like trust.

We can apply this theory to bribery, de facto and knowing receipt-assistance trusts. Bribery exists because one party is in a position of trust and confidence, and a third party wants that betrayed. Mr Reid was in a position of command and control over prosecutions and received money solely to betray that position. The Hong Kong government was uniquely vulnerable to Mr Reid because he was the ultimate authority for exercising the

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[147] *Commercial Bank of Australia v Amadio* (1983) 151 CLR 447, 474.

[148] *LAC Minerals Ltd v International Corona Resources Ltd* 61 DLR (4th) 14, 27.

[149] There is some debate about whether gratuitously making oneself vulnerable would constitute true vulnerability. This point, in part, reflects the greater fact that the relative intellectual and economic resources of the parties will influence the finding of vulnerability. For example, commercial transactions between large corporations will be less likely to allow for vulnerability, whereas dealings between a large organisation and an ordinary member of the public will be more likely to allow vulnerability. See the partial dissent by Sophinka J in *LAC Minerals Ltd v International Corona Resources Ltd* above n 148, 68-73 for a discussion of these issues.

[150] See above, Part IV section B. However, to briefly recap, the defendant is not expressly appointed as trustee, but does assume the duties of a trustee. Identifiable trust property exists and a limited power over that property is vested in the defendant, akin to mere legal title, with the equitable title usually retained by the plaintiff. Finally, a lawful transaction independent of and preceding fraud has put the defendant in the trustee position, and that initial transaction is not impeached by the plaintiff.

government's prosecutorial discretion. However, if he had accepted his position intending to be bribed or as part of a bribery package, he would not be a fiduciary trustee because there would be no unimpugned trust-like relationship pre-existing the fraud.[151]

Throughout her de facto relationship, Ms Rose's earnings and property were subject to the command and control by her partner Mr Lankow. Clearly, their de facto relationship required trust and confidence, and due to circumstances outlined in the case, Ms Rose's economic and property contributions were vulnerable to Mr Lankow. The *Lankow* Court wanted to step in because of this relationship, what I would characterise as a fiduciary trust relationship.[152]

Mr Powell's knowing receipt arose because of a position of trust and confidence. He had intimate knowledge of wrongdoing and, because of Ms Thompson's resulting vulnerability, could exercise command and control over her property. The same for Mr Tan. He knew of the wrongdoing, and in his position of company chairman was able to exercise command and control over the vulnerable and ultimately mishandled property.

The fiduciary trust theory provides a method of accepting these previously inexplicable trust law cases under the two-type template. It circumvents the traditional pre-occupation with trust property as a vehicle for equitable title, and operates on the practical effects of trust-like relationships. None of the previous examples would have satisfied the separation of legal and equitable title requirement, and yet the fiduciary trust embraces them all. It is in harmony with underlying trust principles and represents a clear and justiciable basis for

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[151] *Reid* (above n 36) was an attempt by equity to provide a proprietary remedy where one had previously not existed. Using fiduciary trust analysis, it is clear that not all bribery circumstances would be eligible for type-one trust status. This reflects the underlying reality of trust law requiring a real and unimpugned trust-like relationship. In effect, the fiduciary trust suggests that equity went beyond the natural scope of trust in *Reid* and perhaps should have investigated further the relationship between supposed beneficiary and trustee.

[152] Placing de facto relationships in the context of trust or fiduciary law is becoming more common. For example, in *Phillips v Phillips* [1993] 3 NZLR 159, 167-168, President Cooke noted that imposing a trust on a de facto union relied on both the reasonable expectations of the parties, and the history and nature of the relationship.

trust development. It is, at least, an answer to the current problems inherent in the two-type template.

D A Case Study of the Fiduciary Constructive Trust: Coulthard v DMC

1 Introduction

This section will investigate the latest English section 21 decision. It will identify why a trust was not found, and assess the value of applying the fiduciary trust approach. It will conclude by suggesting that the fiduciary trust is a legitimate type-one trust by analogy. The failure to acknowledge this reflects limitations inherent in trust property analysis.

2 The decision

This case concerned the liability of a musician's manager in respect of direct and indirect earnings which he had failed to account for. The Court decided there was no trust because there was no trust property. The alleged trustee was able to pay all the musician's earnings into his own account, mix those earnings with other monies, deduct any of his expenses, and account for the outstanding sum from any source. These factors mitigated against finding a trust because they negated the concept of separate trust property. Put simply, there was no analogy to the separation of legal and equitable title and, as a result, the Court felt only able to recognise a contractual claim.

3 *A fiduciary trust*

The *Coulthard* Court acknowledged the manager owed the musician a fiduciary duty of loyalty and fidelity. Presumably, this recognised that the relationship between manager and musician began and continued with the manager clearly in an advantageous position,

approximating one of trust, confidence and vulnerability. He was thirty-five, a famous Disc-Jockey, and completely responsible for the career finances of the nineteen year old musician, Mr Coulthard. The manager, Mr Prince, while initially honest, later systematically and intentionally defrauded the musician of earnings throughout his career.

Mr Coulthard never impugned the agreement which made Mr Prince his manager. Indeed, Mr Coulthard put great reliance on this as a basis for his claim. Ultimately, the Court was presented with a pre-existing relationship, whereby Mr Prince took possession and had command and control over Mr Coulthard's earnings. Conversely, Mr Coulthard was vulnerable to Mr Prince because he had no business experience and had entrusted his earnings to Mr Prince. However, Mr Coulthard could not convince the Court that the money was impressed with equitable title. The Court felt that the dealings with the money could not be interpreted consistently with the concept of trust property and ended its analysis there. Equity should not accept this.

Beginning from equitable principles, *Powell* tells us that equity demands a fundamental jurisdiction for trusts over unconscionable behaviour.[153] That behaviour is established on these facts. The policy behind recognising type-one constructive trusts acknowledges the importance of protecting one party from the fraudulent acts of another, when a pre-existing agreement of encumbered interest exists. We know there was an unimpugned pre-existing agreement here, and the effect of that agreement was to place Mr Coulthard's property (his earnings) under the command and control of Mr Prince. On a practical level, Mr Coulthard's power over the property is the same as a trustee under an intentional trust, if not more so. The facts suggest a practical encumbered interest arising from the terms of the management relationship and the fiduciary obligation of loyalty and fidelity to uphold them. Equity should impose a type-one trust because the *Coulthard* facts are an abuse of analogous trust powers, resulting from a mutually intended trust-like relationship. Only the two-type template and the fixation for trust property restrains equity's legitimate application of type-one trust by analogy.

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[153] *Powell v Thompson*, above n 105, 605.

E CONCLUSION

Part V has outlined the history of the fiduciary trust, and the equitable basis for its current application. Accepting the fiduciary trust is a natural development in constructive trust law and recognises the equitable basis for trust intervention. The trust would not become an unwieldy instrument because it is tied to traditional fiduciary trust concepts. Indeed, courts are already trained and experienced in discerning fiduciary relationships of trust, confidence and vulnerability. Those fiduciary relationships, which involve an influence over property, will provide the tools needed to distinguish between cases and provide a structured development.[154]

This principled basis can be evidenced from an analysis of *Paragon Finance*.[155] That case would not found a fiduciary trust because there was no pre-existing trust-like relationship, and arguably, a lack of vulnerability. More specifically, Paragon Finance's lawyers were never part of a pre-existing trust relationship, but were engaged solely for the one fraudulent transaction. The extremely commercial nature of the arrangement, and Paragon Finance's familiarity with it, would heavily mitigate against finding requisite vulnerability. *Paragon Finance* demonstrates the limited scope of the fiduciary trust and a coherent theoretical basis for its application.

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[154] There are, of course, fiduciary relationships which do not involve an influence over property, or indeed property at all. For example, the doctor/patient and parent/child relationship. These relationships are outside the scope of analogy to the express trust and therefore, the proposed fiduciary trust umbrella. See generally: *Attorney General v Prince & Gardner* [1998] 1 NZLR 262.

[155] *Paragon Finance*, above n 6, 407-415; The facts of this decision can be found above in Part IV section C.

VII CONCLUSION

A Introduction

This conclusion has two distinct parts. It begins by providing a general summary of the parts and sections of the paper, reiterating underlying arguments and a synopsis of section 21 debate. Following this, there is an investigation of the underlying themes and relationships central to section 21. This analysis explores the nature of constructive trust and the contribution of the two-type template.

B General Summary

This paper began by identifying New Zealand's section 21 as related to the English provision, but recognising no binding authority existed to follow their interpretation. The English approach to section 21 excluded many types of trusteeship from creating legitimate trusts, and further undermined trusteeship by imposing limitation by analogy regardless of section 21. However, New Zealand common law appeared to avoid these issues by a purposive and protective approach to the equitable jurisdiction.

The paper then established the English predilection for trust property. This bias was traced to the continued application of precedent beginning in 1893. That unbroken evolution was identified as the inspiration for the two-type template, which itself entrenched the necessity of separate legal and equitable title for legitimate trusts. The template distinguished between legitimate trusts arising from pre-existing unimpugned transactions creating equitable title (type-one trusts), and mere trusteeships arising as an equitable response to fraud (type-two trusteeships). In effect, requiring equitable title limited the scope of the trust concept by letting it apply only where clear trust property existed.

The problems inherent with the clear trust property requirement were examined with specific reference to bribery, de facto and knowing receipt and assistance trusts. These trusts were assessed using the two-type template and were categorised as type-two trusteeships. However, judicial intervention had elevated these trusts into the type-one constructive trust category. The template could not explain this elevation or protect it's original categorisation from judicial rebuff. That elevation revealed that our common law had moved beyond the rigid confines of the template's trust property requirement and was developing relationship-based constructive trusts. The template was criticised for failing to explain or restrain these developments and its relevance for section 21 was correspondingly questioned.

Finally, the fiduciary trust was introduced as a trust category which both accounted for the current rejection of the template and provided a principled formula for further development. The rationale for the fiduciary trust was an acceptance that trust-like 'command' or 'control' over property was analogous to the circumstances which required recognising an express-like trust. Pre-existing fiduciary relationships of trust, confidence and vulnerability, which allowed one party to exercise command or control over another's property, were identified as meriting type-one trust status. In effect, that a trust must exist where in all respects the practical effects of a trust exist.

B Problems, Principles and Possibilities

The section 21 debate reflects an underlying tension between the concepts of 'constructive trust' and 'constructive trustee'. That tension is expressed in trust property requirements because separate equitable title is used to distinguish between trusts and trusteeships. But is the absence of equitable title enough to exclude the trust concept? As demonstrated, the fiduciary trust is sufficiently analogous to constructive trust requirements that it should not escape fundamental equitable jurisdiction. Equitable title and the two-type template are too arbitrary for the conscience of equity.

The institutional and remedial trust are simply different approaches to the trust-trusteeship problem. This framework does escape equitable title but fails to substitute a consistent rule for identifying legitimate trusts. Institutional trusts are recognised 'ad hoc' and rely on repetition for legitimacy. Remedial trusts appear to be no different from type-two trusteeships. The development of the institutional and remedial distinction hides from the trust property problem and, as illustrated, confuses outcomes under the two-type template.

Embracing the fiduciary trust means that some type-two trusteeships will become the equal of type-one constructive trusts. Significantly, the fiduciary trust will be able to trigger the section 21 indefinite liability for fraudulent breach of trust. More importantly, the fiduciary trust will give greater legitimacy to the current bribery, de facto, knowing receipt and knowing assistance trusts, while maintaining constructive trust doctrine on firm equitable foundations. The fiduciary trust continues the original constructive trust ideal: Property should not be freely available to someone in a trustee-like position. Ultimately, this paper sought to build on this principle and substantiate an analogy between certain constructive trusteeships and the recognition of type-one trusts.