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The Hon Justice David J S Jackson

THE FIRST LIMB OF *BARNES v ADDY*: A TAXONOMY IN TATTERS

Acknowledgments

Chief Justice, Judges of this and other courts, Professor Lee, ladies and gentlemen.

This lecture is given in tribute to Tony Lee. That is only fitting. He is a scholar of international significance and he was personally responsible for much of the core statutory law reform in this State on the subjects of Trusts and Succession Law.

Not long after the High Court's decision in *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* ("*Farah*"),[1] I asked Professor Lee what he thought about it. He said this: "Well, David, after all these years of reading cases I think that cases where plaintiffs don't win generally don't decide very much about the law." Then he said: "But I don't know, what do you think?"

I was taken aback. At that time, I was full of the joys of the High Court's decision. First, I thought it had rescued indefeasibility from the scrap heap, particularly so far as

1 (2007) 230 CLR 89.

bank mortgages were concerned. Secondly, whilst I now agree with Professor Keith Mason's point of view that the High Court's treatment of the New South Wales Court of Appeal was intemperate, I was not unhappy then that the High Court had stemmed the tide of those who were intent on bending first limb *Barnes v Addy*[2] liability into a restitutionary framework.

That was seven years ago. This lecture represents my response now to Professor Lee's question – what do you think? The short answer is I think he was right. *Farah* does not say enough about what the law is. I also think he was right that, in part, the problem is that the plaintiff didn't win.

The difficulty in this area isn't confined to *Farah*. *Barnes v Addy* itself was a case where the plaintiffs lost. There were no facts upon which any principle engaged to establish the content of a cause of action. It is surprising that *Barnes v Addy* has formed the basis for so many attempts to formulate a taxonomy for a cause of action brought by or on behalf of a beneficiary against a person who receives trust property with knowledge or notice of a breach of trust.

To explore the problem, this lecture is divided into three time periods. The first period is from 1874 when *Barnes v Addy* was decided to 1968 before the decision in *Selangor United Rubber Estates Ltd v Craddock (No 3)* ("*Selangor*").[3] The second period is from 1968 to the decision in *Farah*. The third period is from 2007 to this year.

PART ONE: 1874 - 1968

Barnes v Addy itself

It is necessary to explain some details about what the case decided, the court that decided it, the Judge who gave the relevant speech and what else was going on at the time.

I will simplify the facts. A trustee held property on two separate trusts, one for each of the testator's daughters and the children of that daughter. The trustee, Mr Addy, had the power to appoint new trustees. He exercised the power for one of the trusts. The new

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2 (1874) 9 Ch App 244.

trustee was the husband of the primary beneficiary, Mrs Barnes. Her children were also beneficiaries. The husband predictably dissipated the trust funds, in breach of trust, by paying his personal debts.

Mrs Barnes' children sued Mr Addy for breach of trust in appointing their father as sole trustee. That was held to be a breach of trust by Mr Addy. However, the question on appeal was not about his liability. It was whether either of the solicitors, who had acted in the appointment of the new trustee, was liable to make good the loss of the trust property.

Mr Addy's solicitor, Mr Duffield, had advised Mr Addy against appointing a new sole trustee. But he decided to do so anyway. The husband's solicitor, Mr Preston, had advised Mrs Barnes against the appointment of her husband as sole trustee. But she requested the appointment, in any event. Neither Mr Duffield nor Mr Preston had any reason to think that the husband would in fact make away with or dissipate the trust property. An important fact was that neither of the solicitors had at any point beneficially received any of the trust property. One of them had received a sum which he held on trust for the new trustee and which was paid over to the new trustee, but as agent only.

The Vice Chancellor found both solicitors not liable. The appeal to the Court of Appeal in Chancery was dismissed. The respondents' counsel were not even called on. It was in this context that Lord Selborne LC made his famous speech which included the following:

> "Those who create a trust clothe the trustee with a legal power and control over the trust property, imposing on him a corresponding responsibility. That responsibility may no doubt be extended in equity to others who are not properly trustees, if they are found either making themselves trustees *de son tort,* or actually participating in any fraudulent conduct of the trustee to the injury of the *cestui que trust*. But, on the other hand, strangers are not to be made constructive trustees merely because they act as the agents of trustees in transactions within their legal powers, transactions, perhaps of which a Court of Equity may disapprove, unless those agents receive and become chargeable with some part of the trust property, or unless

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[3] [1968] 1 WLR 1555.

> they assist with knowledge in a dishonest and fraudulent design on the part of the trustees."[4]

The category of interest emerges in the last sentence of the paragraph. Having identified "agents" of trustees in transactions, Lord Selborne breaks them into two further categories; first, those who receive and become chargeable with some part of the trust property; second, those who assist with knowledge in a dishonest or fraudulent design on the part of the trustees. These are the so-called first and second limbs of *Barnes v Addy*.

So we can see that the case was not concerned with the liability of anyone who received and became chargeable with any part of the trust property.

As mentioned, the case was decided extemporaneously. The date was 12 February 1874. Allow me an historical side trip to explain some things about that.

The Court of Appeal in Chancery was created in 1851 to hear appeals from decisions of the Vice-Chancellors and the Master of the Rolls. The Lord Chancellor presided and sat with two Lords Justice of Appeal. The Court was abolished in 1875 on the creation of the permanent Court of Appeal under the *Judicature Acts* of 1873 and 1875.

On 12 February 1874, the Court sat in the Old Hall of Lincoln's Inn. What was that court like? The Old Hall dates from 1489, although in 1874 it had most recently been remodelled in 1819. There is a famous reference to it in literature. Charles Dickens' *Bleak House* opens with these words:

> "London. Michaelmas Term lately over, and the Lord Chancellor sitting in Lincoln's Inn Hall".

Dickens' vicious account in *Bleak House* of the fictional case, *Jarndyce v Jarndyce,* does not represent what proceedings were like in Chancery or the Court of Appeal in Chancery in 1874. *Bleak House* was published in twenty serial parts over 1852 and 1853. Holdsworth thought that *Jarndyce v Jarndyce* was set in about 1827. By 1874, there had been many reforms and even more significant changes were in train. It should also not be forgotten that Dickens was a disappointed suitor in Chancery. In 1844 he brought a breach of copyright case against a publisher of pirate copies of *A*

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[4] (1874) 9 Ch App 244, 251-2.

Christmas Carol. Dickens incurred considerable costs, said to be 700 pounds – equivalent to 500,000 pounds now. He won the case, only to find that the defendant had no money and went bankrupt.

I would not want you to think that the Old Hall was always a sombre place. It was also used for revels, moots and feasts, as well as a sitting place for a Court. I commend that idea to the Chief Justice for this place. So far, there have been moots here, but no revels or feasts, as far as I know.

So we have the stage. Who was the Judge?

Sir Roundell Palmer, who became the first Earl of Selborne, was both lawyer and politician. He had been a prominent member of the Chancery bar. He first entered the House of Commons on 29 July 1847. Between 1861 and 1863 he had been appointed Solicitor-General and from 1863 to 1866 he was Attorney-General. He was involved in the creation of the Incorporated Council of Law Reporting as it became, which was responsible for the production of the law reports from 1865.

In 1872, he was elevated to the Lords as the Baron Selborne and appointed the Lord Chancellor in Gladstone's reforming Liberal government. The *Supreme Court of Judicature Act* 1873 was passed during his term in office as Lord Chancellor. It was very much his Bill.

By the way, 12 February 1874 was a Thursday.

Attorney-General v Borough of Barnsley[5] was the first appeal heard and decided by the Court of Appeal in Chancery on 12 February 1874. The argument had started on the day before. The appeal in that case had been brought on swiftly. The trial was heard in December 1873. The Times described the case at first instance as "presenting the usual features of these sewage pollution cases which have been so frequent of late in the Court of Chancery", with voluminous pleadings and lengthy and conflicting evidence of scientific witnesses. The Borough was restrained from polluting the River Dearne with its outpouring of sewage effluent from the town of Barnsley. The urgency of the appeal was, perhaps, understandable.

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5 *The Times*, 13 February 1874, p 11.

The Lord Chancellor sat in that appeal as well, as did the other Lords Justice. The decision in that case was reported on 13 February 1874 in the Times. Apparently, it was considered to be of sufficient importance to report in the paper. *Barnes v Addy* was not.

What else was going on for Lord Selborne, as Lord Chancellor, in the background, on 12 February 1874? *The Supreme Court of Judicature Act* 1873 received Royal assent on 5 August 1873. As originally passed, it provided for the abolition of the courts of common law and equity and the creation of what was then described as the Supreme Court. That Court was to be constituted by a permanent Court of Appeal division and five other divisions, reflecting the amalgamated courts. The Act of 1873 also provided for the abolition of the appellate jurisdiction of the House of Lords from judgments of the courts of England and Wales. It was due to commence in November 1874.

During 1873, opposition to Gladstone's Government had been increasing. The opposition included a push to recall the abolition of the House of Lords appellate jurisdiction, even before it became law. Lord Selborne was an active political figure supporting the original proposal.

A general election was held in February 1874. According to *The Times,* published on Friday 13 February 1874, there was still some polling going on, but it was able to announce that 604 members had been elected to the new Parliament with 326 of them Conservatives to the Liberals 278. Despite having a substantial lead in the votes cast countrywide, Gladstone's Liberal Government was defeated by Disraeli's Conservatives. The reason seems to have been that in many seats Conservative candidates stood unopposed.

On 21 February 1874, the incoming Prime Minister, Disraeli, replaced Lord Selborne as Lord Chancellor with Lord Cairns. It was Lord Cairns who oversaw the amendments subsequently made to the 1873 Act, which retained the appellate jurisdiction of the House of Lords. I wonder whether Lord Selborne could see the writing on the wall as he sat in *Barnes v Addy* on 12 February 1874?[6]

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[6] The fascinating story of the tussle over the appellate jurisdiction of the Lords is told by David Steele, "The Judicial House of Lords: Abolition and Restoration 1873-6", in Blom-Cooper, Dickson and Drewry (eds), *The Judicial House of Lords 1876-2009*, (Oxford: Oxford University Press: 2009), Ch 2.

What should we draw from all this background? We should not be surprised that Lord Selborne's statement of principle is far from detailed. It was made extemporaneously, in an easy case, not really concerned with the problem of first limb liability, on a day when another significant case was decided and at a time when there were plainly other distractions for his Lordship to face.

Nevertheless, we should not be in any doubt that Lord Selborne had a pretty good idea of exactly what were the relevant principles and cases. His credentials as a judge who led or participated in many important decisions of his time are undoubted.[7] But what about our particular subject matter? We know that *Lee v Sankey*, decided on 14 January 1873, was referred to in argument. In that case, solicitors held money for the trustees of a testamentary trust. They paid the money to one of the trustees without the authority of the other. The liability of the solicitors was in respect of unauthorised payments to one trustee, not money received by them beneficially. Bacon V-C said:

> "… a person who receives into his hands trust moneys, and who deals with them in a manner inconsistent with the performance of the trusts of which he is cognisant, is personally liable for the consequences which may ensue upon his so dealing."[8]

Note the reference is to personal liability. The more important point, however, is that the solicitors did not receive the moneys for their own benefit. In *Rolfe v Gregory*,[9] decided in 1865, Lord Westbury LC said:

> "The wrongful receipt and conversion of trust property place the receiver in the same situation as the trustee from whom he received it and by the principles of this Court he becomes subject in a Court of Equity to the same rights and remedies as may be enforced by the parties beneficially entitled against the fraudulent trustee himself."

In 1869, Sir Roundell Palmer appeared as counsel in *Gray v Lewis*,[10] a significant case if the number of silks appearing is any measure. I counted ten. The facts were analogous to the facts in *Selangor* and *Karak Rubber Co Ltd v Burden (No 2),*[11] decided a century later. Hall V-C said that:

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7 For example, *Hughes v Metropolitan Railway Co* (1877) 2 App Cas 439, 450; *Maddison v Alderson* (1883) 8 App Cas 467, 470; and *Foakes v Beer* (1884) 9 App Cas 605, 610.

8 (1872) LR 15 Eq 204, 211.

9 (1865) 4 De G J & S 576, 577; 46 ER 1042, 1043.

10 (1869) 8 Eq 526.

11 [1972] 1 WLR 602.

> "…the transaction was one of so unusual and extraordinary a character that it became [the bankers] duty to inquire and investigate as to the rights of this company to enter into such a transaction in the very first hour of its existence and I must therefore treat the bank as having had express notice that what was being done was a gross breach of trust in which they consequently became participators."[12]

However, there was a successful appeal to the Court of Appeal in Chancery in *Gray v Lewis*.[13]

Another well known case of the time that may have informed Lord Selborne's statement of principle was *Gray v Johnston*.[14] It was decided in the House of Lords on 10 March 1868. It was a case brought against bankers alleged to have involved themselves in a breach of trust. The complaint was that the bankers had transferred a sum from the account of the testator's executrix to a partnership account. The partnership was one between the executrix and the testator's former partner by way of extension of the former business of the testator and the former partner.

Lord Cairns LC said this:

> "… in order to hold a banker justified in refusing to pay a demand of his customer, the customer being an executor, and drawing a cheque as an executor, there must, in the first place, be some misapplication, some breach of trust, intended by the executor, and there must in the second place, … be proof that the bankers are privy to the intent to make this misapplication of the trust funds".[15]

Subsequent references

Up to 1915, *Barnes v Addy* was mentioned in a number of relevant monographs dedicated to the law of trusts or equitable doctrines.

The ninth edition of *Lewin on Trusts*, published in 1891, gave a fairly full account of the case,[16] including the statement that:

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12 (1869) 8 Eq 526, 543.
13 (1873) 8 Ch App 1035.
14 (1868) 3 HLC 1.
15 (1868) 3 HLC 1, 11.
16 C Dale (ed), *Lewin's Law of Trusts,* (Sweet and Maxwell Ltd, London, 1891), 9th ed, Chapter XXX, Section III, headed "Of The Remedy For A Breach Of Trust Against The Trustee Personally", 1027.

> "… a solicitor (in common with any other agent) is not liable as a constructive trustee… unless he either receive some part of the trust property or assist with knowledge in some dishonest and fraudulent design on the part of his clients".

A more detailed reference appeared in the seventh edition, a special Australasian edition, of *Underhill's Trusts and Trustees*, published in 1913.[17] It included this:

> "…where a stranger to a trust receives money or property from the trustee, which he knows (1) to be part of the trust estate, and (2) to be paid or handed to him in breach of the trust, he is a constructive trustee of it for the persons equitably entitled, but not otherwise".

From the 1970s onwards, a number of relevant cases have referred to the treatment of *Barnes v Addy* in *Snell's Equity*. The 26th edition of Snell was referred to in both *Karak* and *Farah*. So how did the case find its way into Snell? The first appearance was in the 17th edition in 1915. The editors, Rivington and Fountaine, said this:

> "And a stranger to the trust may also incur the liabilities of a trustee by assisting with knowledge in a fraudulent design on the part of the trustee, even though he does not actually himself receive the trust property."[18]

Among other cases, *Barnes v Addy* was cited for that proposition, which is clearly recognisable as second limb liability.

However, on the prior page the editors had also said this:

> "A constructive trust also sometimes arises through a stranger to a trust already constituted becoming chargeable as trustee. It is clear that any one is a constructive trustee if he receives the trust property, even for value, with actual or constructive notice that the property is trust property and that the transfer to him is a breach of trust, or if, having received the trust property otherwise than by purchase for value without notice, he knowingly deals with it in a manner inconsistent with a trust."[19]

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17 H. S Nicholas (ed), *Underhill Trust and Trustees,* (Butterworth & Co (Australia) Ltd, 1913), 7th ed, Chapter III, "Constructive Trusts Which Are Not Resulting", 185.

18 H Rivington and A Fountaine (eds), *Snell's Principles of Equity,* (Stevens & Haynes Law Publishers, 1915), 17th ed, 118.

19 Ibid, 117.

This looks like first limb liability. But *Barnes v Addy* was not cited as authority for that statement. The cases relied on were *Lee v Sankey,*[20] *Soar v Ashwell*[21] and *Re: Blundell, Blundell v Blundell*.[22]

In these two statements we can see the threads of the fabric woven into later discussion of the two limbs of *Barnes v Addy*.

By 1954, and publication of the 24th ed of Snell, the editors were Megarry and Baker. The organisation of the work had altered. Section 1 of the part on Constructive Trusts was headed "Receipt of trust property by strangers to trust". The substance of the text on first limb liability from the 17th ed set out above appeared under that heading, with some immaterial changes. However, there were two additions. First, the liability of a person who receives the trust property was qualified by the following statement:

> "But to impose a constructive trust upon a person, more must be shown than that he has received property otherwise than by purchase for value without notice. He must have knowledge which may be imputed to him from the circumstances that the trust exists." (citations omitted)[23]

Nelson v Larholt[24] and *Re: Diplock*[25] were cited as authority for that addition. Second, a warning statement made by Lord Selborne in *Barnes v Addy* itself was added, namely:

> "…strangers are not to be made constructive trustees merely because they act as the agents of trustees in transactions within their legal powers, transactions, perhaps of which a Court of Equity may disapprove, unless those agents receive and become chargeable with some part of the trust property, or unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees."[26]

The substance of this structure of the discussion in Snell had not changed by the 26th ed in 1966, which was the form it took when *Selangor* was decided in 1968. Nor was there any change by the time of *Karak* in 1971.

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20 (1872) LR 15 Eq 204, 211.
21 [1893] 2 QB 390, 396.
22 (1888) 40 Ch D 370, 381.
23 R Megarry and P Baker (eds), *Snell's Principles of Equity*, (Sweet and Maxwell Ltd, London, 1954), 24th ed, 158.
24 (1948) 1 KB 339.
25 [1948] Ch 465, 478, 574 and 539.
26 R Megarry and P Baker (eds), *Snell's Principles of Equity*, (Sweet and Maxwell Ltd, London, 1954), 24th ed, 159, citing *Barnes v Addy* (1874) 9 Ch App 244, 251.

Megarry was still the editor of the 1966 edition, before his initial appointment to the High Court in the Chancery Division in 1967, and his later appointment as Vice-Chancellor in 1976. It is not to be overlooked that, as Vice-Chancellor, Sir Robert sat in the important first limb case of *Re: Montagu's Settlement Trusts*,[27] decided on 29 March 1985.

It is notable also that, even its most recent edition, Snell does not cite *Barnes v Addy* as authority for first limb liability.

Let us look to the early cases on first limb liability relied on by Snell. The first was *Lee v Sankey*.[28] As previously stated, it was not a case of first limb *Barnes v Addy* liability because the trust money was not received beneficially. The defendant solicitors' error was in paying moneys held on behalf of joint trustees to one of them without the authority of the other.

The second was *Soar v Ashwell*.[29] It was a decision of the Court of Appeal. The action was for an account against *Ashwell* who had been solicitor to a trust. The defence relied on was the statute of limitations. Kay LJ at 405 set out Lord Selborne's statement of principle and continued:

> "A stranger to the trust, who receives trust money with notice of the trust, or knowingly assists the actual trustee in a fraudulent and dishonest disposition of the trust property, is a constructive trustee. … He becomes bound by the trust by the construction which the law puts upon his dealings with the trust property."[30]

Kay LJ was prepared to treat Ashwell as coming within either the first limb or second limb of *Barnes v Addy*. The other members of the Court had different reasons which do not concern first limb liability.

The third of the cases relied on by Snell was *re Blundell, Blundell v Blundell*. That was a case where the plaintiff lost. Stirling J referred in some detail to *Barnes v Addy* and said this of the principles:

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27 (1987) 1 Ch 264.
28 (1872) LR 15 Eq 204, 211.
29 [1893] 2 QB 390.
30 (1888) 40 Ch D.

> "What is the general doctrine with reference to constructive trustees of that kind? It is that a stranger to the trust receiving money from the trustee which he knows to be part of the trust estate is not liable as a constructive trustee unless there are facts brought home to him which shew that to his knowledge the money is being applied in a manner which is inconsistent with the trust; or (in other words) unless it be made out that he is party either to a fraud, or to a breach of trust on the part of the trustee."[31]

There are other cases which referred to *Barnes v Addy* before 1968. However, there is no case of first limb liability among them except for a case not generally mentioned in the books, *Staniar v Evans*.[32] In that case, North J held that solicitors who received trust funds with notice of the trust could not set up any better right to retain the money than the trustee himself. The solicitors had kept the money as paid to them by the trustee in respect of their costs. The trustee was in breach of trust and therefore subject to the rule that he could not receive any costs out of the trust estate. Accordingly, the solicitors were held liable to pay over the trust funds kept on account of their costs.

Another case not often mentioned in the books is *Williams v Williams*.[33] It was a case where the plaintiff lost. Kay J held that a solicitor who had conflicting information as to whether or not there was a trust settlement affecting moneys paid to him for his costs on the sale of certain property did not have sufficient notice of the trust to be a constructive trustee. An interesting point about the case was that Kay J held that the solicitor may have been negligent (he expressed no final opinion) but considered that that was not enough to affect him with notice of the trust.

Across the Atlantic Ocean, *Pomeroy's Equity Jurisprudence* paid no attention to *Barnes v Addy*. That continued through to the fifth and last edition published in 1941. The treatment of a recipient of trust property is divided between a purchaser and a volunteer, a distinction not expressly made in Lord Selborne's statement of principle.[34] The case received recognition in Professor Austin Scott's, *Scott on Trusts*, first published in 1939, and by the 1967 edition was mentioned more than once, which is still so,[35] as authority that a solicitor who advises against a transaction is not liable "liable for the

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31 (1888) 40 Ch D 370, 381.

32 (1886) 34 Ch D 470, 478.

33 (1881) 17 Ch D 437.

34 Symons, *Pomeroy's Equity Jurisprudence*, 5th ed, (Lawyers Co-operative Publishing Co: New York: 1941), ss 753, 754, 770 and 1048.

35 Scott and Fratcher, *The Law of Trusts*, 4th ed, (Little Brown and Company: Boston: 1989), ss 326.4 and 326.6.

breach of trust committed by the trustee" and that "[o]thers who have dealings with a trustee should not be bound to supervise the conduct of the trustee and should be liable only if they can fairly be said to have participated…"

If one looks to the early United States law, there is a relevant statement of Oliver Wendell Holmes Jr's views. In 1897, he published a famous article, "The Path of the Law",[36] in which he urged that "the rational study of the law is still to a large extent the study of history." In the same year, he decided *Otis v Otis*,[37] where he said:

> "A person to whose hands a trust fund comes by conveyance from the original trustee is chargeable as a trustee in his turn if he takes it without consideration, whether he has notice of the trust or not. This has been settled for three hundred years, -since the time of uses."

Holmes J's use of the word "chargeable" is consistent with Lord Selborne's language as to the nature of the responsibility of a stranger to a trust. It signifies that the recipient is to be treated as if he or she were a trustee of the trust property.[38] The important point is that there is no requirement of notice where the recipient is a volunteer. That differs from Snell's treatment where notice actual or constructive was said to be required where a person receives property "even for value". Lord Selborne's statement of principle, of course, did not refer to notice or a volunteer.

For present purposes, two things emerge from the references that were made to *Barnes v Addy* up to 1968. First, as I have mentioned, there are only one or two cases in which a stranger to a trust was held to be liable under the first limb. Second, and this is also important, up to this point none of the cases is concerned with the liability of a third party in respect of a breach of fiduciary obligation by a company director, *Gray v Lewis* excepted. Up to 1968, the liability is of a stranger to the trust, normally a solicitor or a banker, in respect of a breach of trust by a trustee.

PART TWO: 1968 - 2006

Selangor to Belmont Finance

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36 10 Harvard Law Review 457 (1897).

37 167 Mass 245, 246; 45 NE 737 (1897).

38 And see Charles Mitchell and Stephen Watterson, "Remedies for Knowing Receipt", Mitchell (ed), *Constructive and Resulting Trusts*, (Hart Publishing, Oxford and Portland Oregon, 2010), 115, 129.

The first case which extended the principle of *Barnes v Addy* to liability of a third party for breach of duty by a company director was *Selangor*. It was decided on 30 May 1968. It was the first in a series of cases where *Barnes v Addy* was applied to a breach of duty by use of a company's moneys to fund an acquisition of its own shares.

In some of these cases, the real target is not the director who misuses the company's funds, or even the purchaser and vendor of the shares who obtain the benefit, but the deeper pocket of the banker who enables or permits the company's funds to be misused. There are numerous such cases, but the basis of liability is nearly always the second limb of *Barnes v Addy*.

The first of these cases of liability under the first limb is *Belmont Finance Corporation v Williams Furniture Ltd & Ors No 2* ("*Belmont Finance*").[39] It was decided on 31 July 1979.

The directors used the company's funds to enable a purchaser to buy its shares. The company bought all the shares in another company from the purchaser at an over value. Those funds were used by the purchaser to pay for the company's shares. The vendor of the shares who received the inflated purchase price in this fashion became the relevant defendant. What was a little unusual about *Belmont Finance* was that the transaction to put the purchaser in funds was adopted on the faith of counsel's advice.

The company alleged that the vendor had received the company's funds that were so misapplied with knowledge of the whole circumstances of the transaction. The leading judgment was that of Buckley LJ. His Lordship said this:

> "If a stranger to a trust (a) receives and becomes chargeable with some part of the trust fund or (b) assists the trustees of a trust with knowledge of the facts in a dishonest design on the part of the trustees to misapply some part of a trust fund, he is liable as a constructive trustee. …"[40]

That was a paraphrase of Lord Selborne's statement of principle. Buckley LJ went on to acknowledge that a company is not a trustee of its own funds. However, his

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39 [1980] 1 All ER 393.

40 Ibid, 405.

Lordship held that they were treated as if they were trustees of the company's funds so that:

> "… if the directors of a company in breach of their fiduciary duties misapply the funds of their company so that they come into the hands of some stranger to the trust who receives them with knowledge (actual or constructive) of the breach, he cannot conscientiously retain those funds against the company unless he has some better equity".[41]

A point of some interest is that Buckley LJ referred to another old case, *Russell v Wakefield Waterworks Co*[42] where Jessel MR said that a person taking the money of a company from the agents of the company with notice that it is being applied to purposes other than the special purposes of the company cannot say that he is not a constructive trustee. Buckley LJ found that it was impossible to hold that there was any dishonesty about the proceedings of the board of directors of the company. Nevertheless, the vendor was liable under the first limb of *Barnes v Addy* because of their "knowledge of the whole circumstances of the transaction".[43]

Consul to 1985

Turning, then, to Australia when is the first case of established first limb *Barnes v Addy* liability? Discussion of the Australian cases must start with *Consul Development v DPC Estates* ("*Consul*").[44] It is the first consideration of *Barnes v Addy* in the High Court. Further, it was carefully followed and applied in *Farah*. But *Consul* was a second limb case. And it was a case where the plaintiff lost.

Nevertheless, there was some discussion of first limb liability. Gibbs J identified first limb liability as the liability of "…a person who receives trust property and dealt with it in a manner inconsistent with trusts of which he was cognisant", citing *Lee v Sankey, Soar v Ashwell* and *Re: Blundell, Blundell v Blundell*.[45] Stephen J only mentioned the first limb in passing,[46] which was consistent with his conclusion that there was no trust property received.[47]

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41 Ibid, 405.
42 (1875) LR 20 Eq 474, 479.
43 [1980] 1 All ER 393, 406.
44 (1975) 132 CLR 373.
45 Ibid, 396.
46 Ibid. 408.
47 Ibid, 414.

It seems likely that Snell was resorted to by some members of the High Court. Not only was it referred to in the submissions of counsel,[48] but there is a tell tale sign in Gibbs J referring to all three of *Lee v Sankey*, *Soar v Ashwell* and *Re: Blundell, Blundell v Blundell*.[49]

The reported cases expressly applying first limb *Barnes v Addy* liability so far have turned on the existence of the following elements:

> (1) trust property held by the trustee or company property in the hands of directors;
> (2) beneficial receipt of the trust or company property;
> (3) knowledge or notice by the person receiving the property that it is trust property or company property; and
> (4) knowledge or notice by the person receiving the property of the breach of trust or breach of director's duty associated with the receipt.

The cracks in the first limb cases only really started to open up after *Belmont Finance* in 1979. However, they were there from 1968 in the tension between *Selangor* and *Carl Zeiss Stiftung v Herbert Smith & Co (No 2)*[50] on the question of knowledge or notice.

In April 1993, *Baden v Societe General SA*[51] heralded a significant development. In a second limb case, Peter Pain J said of the knowledge required:

> "What types of knowledge are relevant for the purposes of constructive trusteeship? Mr. Price submits that knowledge can comprise any one of five different mental states which he described as follows: (i) actual knowledge; (ii) wilfully shutting one's eyes to the obvious; (iii) wilfully and recklessly failing to make such inquiries as an honest and reasonable man would make; (iv) knowledge of circumstances which would indicate the facts to an honest and reasonable man; (v) knowledge of circumstances which would put an honest and reasonable man on inquiry."

These points have subsequently been labelled the *Baden* scale or the *Baden* categories. Often, points (i), (ii) and (iii) on the scale are described as knowledge, whereas points (iv) and (v) are described as notice. There is no error in doing so, provided that one keeps in mind that the notice connoted by points (iv) and (v) is not the same as strict constructive notice in other contexts. Where a conveyance of old system land and the

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48 Ibid, 375.
49 Ibid, 396.
50 [1969] 2 Ch 276. See, for example, the discussion in *Consul*, by Stephens J at 411.

investigation of title are the context, constructive notice includes notice of a fact that a reasonable person would have known or discovered to a relatively exacting standard. The actual "knowledge of circumstances" contained in points (iv) and (v) is not required.[52]

In March 1985, in *Re: Montagu's Trust Settlement*, Megarry V-C rejected the call to expand first limb liability fully into constructive notice. The reasons contain a penetrating analysis of the different species of liability as a constructive trustee under first limb liability. In particular, his Lordship separated the personal liability as a constructive trustee to restore or account for the trust estate for "knowing receipt" from the liability of a purchaser or volunteer through the maintenance of an equitable title and the application of the equitable doctrines of following or tracing. The personal liability as a constructive trustee, his Lordship held, "depends on the knowledge of the recipient, and not on notice to him". He eschewed the use of "notice" in this context. On the *Baden* scale of knowledge, he accepted that categories (ii) and (iii) were enough, but (iv) or (v) did not suffice, because carelessness was not want of probity. The battle lines between notice and knowledge were firmly drawn.

That looming battle royale did not develop as might have been expected. It was caught up in war on another front. In 1985, Professor Birks' revolutionary *"An Introduction to the Law of Restitution"* was published. Professor Birks' thesis was this:

> "In the midst of case-law which does not speak with one voice, the position taken in these last pages has been that, leaving on one side ministerial recipients and non-recipient accessories, the third party recipient incurs a liability in both restitutionary measures and that he does so irrespective of knowledge. That is, even an innocent recipient incurs not only the liability for what he has left but also the liability for what he received. The exception is, that knowledge does become relevant where the defendant seeks to rely on the defence of *bona fide* purchase."[53]

In contrast to Birks, at that time, Goff and Jones[54] only noted *Selangor* and *Karak* to illustrate the "tendency to extend the boundaries of constructive notice".

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51 [1993] 1 WLR 509, 575-6 [250].

52 See Gardner, "Knowing assistance and knowing receipt: taking stock", (1996) 112 LQR 56, 60-61.

53 P Birks, *An Introduction to the Law of Restitution,* (Clarendon Press, Oxford, 1985), 445.

54 Goff and Jones, *The Law of Restitution*, 2 ed, Sweet & Maxwell, London 1978, 544.

From there, the sinews of war gathered on each side. Cases and academic writings were many. It is neither feasible to survey them all in a lecture of this kind, nor useful to do so for Australian law, having regard to the effect of *Farah*. Some, however, should be noted. They begin in 1986 with Charles Harpum's luminous article, "The Stranger as Constructive Trustee".[55] Another major figure, Millett J, entered the lists in May 1989, with *Agip (Africa) Ltd v Jackson*.[56] Following his range-finding salvo in 1985, Professor Birks unleashed a broadside in support of his thesis in 1989, in "Misdirected funds: restitution from the recipient".[57] Lord Nicholls came on board Professor Birks' restitution-powered ship, as a supporter, in 1998, with "Knowing Receipt: The Need for a New Landmark",[58] as did Sir Peter Millett in "Restitution and Constructive Trusts".[59] Writing judicially, in 1995, Lord Nicholls had foreshadowed his view of restitution's role in the Privy Council in *Royal Brunei Airlines Sdn Bhd v Tan*[60], saying that: "Recipient liability is restitution-based; accessory liability is not."[61] Also writing judicially, Lord Millett reinforced his view of restitution's role in *Twinsectra Ltd v Yardley*[62] in 2002, saying that:

> "Liability for 'knowing receipt' is receipt-based. It does not depend on fault. The cause of action is restitutionary and is available only where the defendant received or applied the money in breach of trust for his own use and benefit… There is no basis for requiring actual knowledge of the breach of trust, let alone dishonesty, as a condition of liability. Constructive notice is sufficient, and may not even be necessary. There is powerful academic support for the proposition that the liability of the recipient is the same as in other cases of restitution, that is to say strict subject to a change of position defence."

It might be thought that it was uncontroversial for Lord Millett to express such views in a judgment in 2002. Far from it. The question of the knowledge or notice required for first limb liability had been an ongoing source of controversy in England and Wales. In 2000, the Court of Appeal was called on to resolve the dispute, as between the differing points of knowledge or notice on the *Baden* scale, in *Bank and Credit Commerce*

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55 (1986) LQR 114 (Part 1) and 267 (Part 2).
56 [1990] 1 Ch 265.
57 [1989] LMCLQ 296.
58 WR Cornish et al (eds), *Restitution: Past, Present and Future: Essays in Honour of Gareth Jones*, (1998), 231.
59 Ibid, 199.
60 [1995] 2 AC 378, 386.
61 No authority was cited for this view.
62 [2002] 2 AC 164, 194 [105].

International (Overseas) Ltd & Anor v Akindele.[63] The plaintiff wanted category (v) notice. The defendant wanted category (iii) knowledge. The Court of Appeal's response was to abandon the *Baden* scale altogether.

Nourse LJ had been one of the members of the Court of Appeal in *El-Ajou v Dollar Land Holdings PLC*.[64] In *Akindele,* his Lordship revisited the elements for "knowing receipt", including the element of knowledge, particularly those "in the last 20 years or so of cases in which the misapplied assets of companies have come into the hands of third parties".[65] His Lordship contrasted the instinctive approach of "most equity judges", that constructive knowledge is enough, with those first instance judges who had come to the contrary conclusion when commercial transactions were in point. I would argue that the leader of the push that knowledge was required had been Sir Robert Megarry in *Re: Montagu's Settlement Trusts*. That was not a commercial transaction case. In any event, Nourse LJ decided (1) that "dishonesty is not a necessary ingredient of liability in knowing receipt", and (2) to abandon prior differences of opinion as between knowledge and notice by reference to the *Baden* scale, in favour of a new test as follows:

> "… I have come to the view that, just as there is now a single test of dishonesty for knowing assistance, so ought there to be a single test of knowledge for knowing receipt. The recipient's state of knowledge must be such as to make it unconscionable for him to retain the benefit of the receipt. A test in that form, though it cannot any more than any other, avoid difficulties of application, ought to avoid those of definition and allocation to which the previous categorisation have led. Moreover, it should better enable the courts to give commonsense decisions in the commercial context in which claims in knowing receipt are now frequently made...".[66]

As a matter of precedent, for the law of England and Wales, that statement represented the law when Lord Millett expressed his contrary obiter dictum view in *Twinsectra*. In 2007, in *Charter plc v City Index Ltd*,[67] the Court of Appeal of England and Wales reaffirmed that *Akindele* "represents the present law".[68]

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63 [2001] Ch 437.
64 [1994] 2 All ER 685.
65 [2001] Ch 437, 450G.
66 Ibid, 455E.
67 [2008] Ch 313, 321 [8].

Before returning to Australian authority, I will mention Canada. In 1997, in *Gold v Rosenberg,*[69] the Supreme Court of Canada divided 4:3 on the facts of the case, but all Judges accepted, in effect, that *Baden* category (v) notice was sufficient for knowing receipt.[70] In another case decided on the same day, *Citadel General Assurance Co v Lloyds Bank of Canada*,[71] La Forest J, in the majority, said:

> "In 'knowing receipt' cases, which are concerned with the receipt of trust property for one's own benefit, there should be a lower threshold of knowledge required of the stranger to the trust. More is expected of the recipient, who, unlike the accessory, is necessarily enriched at the plaintiff's expense. Because the recipient is held to this higher standard, constructive knowledge (that is, knowledge of facts sufficient to put a reasonable person on notice or inquiry) will suffice as the basis for restitutionary liability."

And as I return from Canada, across the Pacific, may I stop over in New Zealand. In 1985, in *Westpac Banking Corp v Savin*,[72] the Court of Appeal decided that actual or constructive notice was enough in a receipt case. Richardson J said:

> "There are no reasons of principle and nothing in the authorities precluding in appropriate circumstances the attributing of constructive notice to banks where moneys are received to the credit of an overdrawn account. In a case such as the present what must be established is that the bank had actual or constructive knowledge (i) that the money it received was the property of the plaintiffs and (ii) that the payment of those moneys into the overdrawn account of Aqua Marine was a breach of fiduciary duty on that company's part."[73]

Restitution and first limb liability in Australia

What was the effect of these developments in Australia? In 1988, *Stephens Travel Service International (recvrs and mgrs apptd) v Qantas Airways Ltd*,[74] was yet another claim against a banker where a customer misapplied trust money to reduce the customer's overdraft. In finding the bank liable, Hope JA said:

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68 Although the House of Lords granted leave to appeal on 22 May 2008, there does not appear to have been a decision on the appeal.

69 [1997] 3 SCR 767.

70 [1997] 3 SCR 767, [53], [74] and [88].

71 [1997] 3 SCR 805, [13], [48], [53], [58] and [59].

72 [1985] 2 NZLR 41.

73 [1985] 2 NZLR 41, 52.

> "In these circumstances ANZ must be held to have had notice both of the existence of a trust in respect of moneys received for Qantas tickets not already paid for, and that the use of those moneys by Stephens to reduce its debt to ANZ would be a breach of trust. The more difficult question of fact is whether ANZ had notice that some of the moneys paid into the account between 1 May and 4 June 1984 were trust moneys."[75]

That was a finding of actual notice of the relevant facts but not "that what [ANZ] did was done consciously to give assistance to [the trustee] to commit breaches of trust. There is no evidence that it gave any consideration to the legal effect or consequences of what it was doing".[76]

The next Australian first limb liability case I would mention is *Kooratang Nominees Pty Ltd v Australia and New Zealand Banking Group Ltd*,[77] decided in 1997, after many of the English developments previously mentioned. It is noteworthy for a number of points.

First, it raised the interaction between indefeasibility and first limb *Barnes v Addy* liability. I will return to that question. Second, and most important for present purposes, there is a detailed discussion of first limb *Barnes v Addy* liability. Hansen J paid close attention to *Belmont Finance*[78] in the context of an exhaustive analysis of *Barnes v Addy* case law and first limb liability. Third, Hansen J discussed but did not apply a restitutionary framework to determine liability. Other cases have subsequently referred to his Honour's analysis.

By 2004, Professor Glover was able to describe the state of the Australian cases thus:

> "The 'weight of authority' in Australia is that the defendant's 'actual or constructive' knowledge is sufficient to establish knowing receipt. Probably, this is limited to constructive knowledge not in a stringent form. Dicta of Stephen J in *Consul*… suggest that *Baden* category (iv) might be applied to knowing receipt… The 'cold calculus of constructive knowledge is not an appropriate instrument for determining whether a man's conscience is sufficiently affected'. Nevertheless, recent authority is this strict. Various formulations of strict constructive knowledge have been found sufficient in lower

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74 (1988) 13 NSWLR 331.
75 (1988) 13 NSWLR 331, 359.
76 (1988) 13 NSWLR 331, 359.
77 [1998] 3 VR 16.
78 Ibid, 83-84.

> courts' decisions – although actual knowledge was additionally found in each case."[79]

PART THREE: 2007 - PRESENT

From there, it is convenient to jump directly to the effect of *Farah*, decided in 2007. The most emphatic feature of the High Court's decision was the utter rejection of the application of a restitutionary framework either as an explanation of or a substitution for, first limb *Barnes v Addy* liability. Given the High Court's savaging of the New South Wales Court of Appeal on that point, one might have expected the restitution lawyers' advocacy to have faded away.

Far from it. Instead, not only have they persisted in their cause, but they cry out that *Farah* is wrong. May I mention but two examples. One is Professor Bryan in "Recipient Liability Under the Torrens System: Some Category Errors",[80] who argued in 2008 that the High Court got *Farah* wrong. He expressed the hope that Professor Birks' views may yet be vindicated, even in Australia.[81] Another, on which I would focus, is Professor Burrows in the third edition of his work *"The Law of Restitution"*, published in 2011.[82] The rigor of his analysis calls for some response.

Application of a restitutionary framework to first limb *Barnes v Addy* liability would do away with the requirement of knowledge or notice that the property is trust property and that it is being misapplied in breach of trust. That is described by Professor Birks and Professor Burrows as "fault based" liability. They contrast it with common law liability under a restitutionary framework, as applied in *Lipkin Gorman v Karpnale Limited,*[83] imposing strict liability upon a third party recipient, subject to defences.

The principal argument made by Professor Burrows is that:

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79 Glover, *Equity, Restitution and Fraud,* Lexis Nexis Butterworths, Australia, 2004, 470-471 [8.32]-[8.33].

80 Rickett and Grantham (eds), *Structure and Justification in Private Law: Essays for Peter Birks*, Hart Publishing, Oxford, 2008, 339.

81 Ibid, 359.

82 Burrows, *The Law of Restitution,* 3rd ed, Oxford University Press, Oxford & New York, 2011, 416-431.

83 (1991) 2 AC 548.

> "Coherence in the law dictates that, unless there is good reason for the difference, one cannot have two different models of restitutionary liability applying to what is essentially the same fact pattern."[84]

Traditional equity lawyers see this as a fusion argument. The point is repeated by Professor Burrows in a careful catalogue of the possible arguments against strict liability. There he puts the point as follows:

> "It is thought by some that equity and common law are fundamentally different and, in any event, consistency between the two – elegance in the law – is not a good reason for disrupting well established equitable precedents."[85]

Professor Burrows describes this as the main argument of the High Court in *Farah*. Professor Burrows "coherence" or "elegance" argument is not said to be based on any particular organising principle. It is perhaps an appeal to common sense.

Let me put equity to one side for a moment. It will make the analysis simpler. The common law has numerous causes of action that operate as alternatives on overlapping facts. There is nothing unusual about that. The tort of deceit is an example of a cause of action with a particular fault based liability. *Derry v Peek*[86] was decided in 1889. It is still a leading case. The directors of a company issued a prospectus inviting investors to subscribe for shares. The prospectus misstated the rights of the company to conduct a tramway. The House of Lords held that the directors were not liable for the economic loss suffered by investors. It was not enough that the directors had been negligent. For liability in the tort of deceit, such a misstatement must be made knowing it to be false, or recklessly, not caring whether it be true or false.[87]

In later times, perhaps starting with *Nocton v Lord Ashburton* in 1914,[88] but at least since *Hedley Byrne & Co Ltd v Heller & Partners Ltd,*[89] in 1963, liability under the tort of negligence has expanded to cover some of the same ground.[90]

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84 Burrows, above n 80, 39.

85 Ibid, 427.

86 (1889) 14 App Cas 337.

87 That rule of law in respect of misstatements made in a prospectus was repealed by statute within a year.

88 [1914] AC 932.

89 [1964] AC 465.

90 As well, in Australia, the ubiquitous operation of the statutory prohibition against misleading or deceptive conduct which started in 1974 with s 52 of the *Trade Practices Act* 1974 (Cth) extends over some of the same ground.

Plaintiffs who are able to take advantage of the cause of action in negligence, where they do not have to allege or prove that the defendant made the impugned statements or conduct knowing them to be false, or recklessly not caring whether they be true or false, are doubtless more attracted to it than to the tort of deceit. But up to now I have not heard it suggested that the tort of deceit, as a matter of law, either has been, or should be, done away with, because there are alternative causes of action available at common law in the tort of negligence or under statute, which do not require the same fault element as the tort of deceit.[91]

Looking at the relationship between common law and equitable doctrines which extend over the same facts, no different answer appears. In *Andrews v Australia and New Zealand Banking Group Ltd*,[92] the High Court recently rejected the notion that the equitable doctrine of penalties had been absorbed by the common law, saying:

> "The developments in the practice of the common law courts in assumpsit actions before the introduction of the Judicature system did not somehow supplant the equity jurisdiction."[93]

Coming back to the argument that coherence or elegance in the law requires that the restitutionary framework be applied, because that is what happens at common law, and does not require a fault element, as does first limb *Barnes v Addy* liability, my response is the same. Coherence or elegance in that sense is not, per se, an organising principle of either common law or equity.

There is another point I would make in response to the siren's song of restitution lawyers who still urge that outcome. Professor Burrows says that the High Court got *Farah* wrong because they failed to endorse the New South Wales Court of Appeal's acceptance of the restitutionary framework as the explanation and cause of action for first limb *Barnes v Addy* liability. But he accepts that the result in the High Court, allowing *Farah's* appeal, was correct, because there was no trust property. That is, the result in the Court of Appeal was incorrect. He has made the same argument about two cases where the High Court rejected the application of the restitutionary framework in

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91 It may seem curious that the tort of deceit is no longer digested in the Australian Digest or its electronic equivalent, First Point, under the subject of "Torts" at all.

92 (2012) 247 CLR 205.

93 For those who would seek an orthodox analysis of how law and equity interact, see *Andrews* at 232-233 [60]-[63] and Leeming, "Five Judicature Fallacies", in Gleeson, Watson and Higgins (eds), *Historical Foundations of Australian Law,* (Federation Press: Sydney: 2013), 169, 186-188.

substitution for more traditional explanations or causes of action.[94] In each of those cases, the intermediate appellate court below the High Court also came to the wrong result, applying the restitutionary framework.

A few questions arise from this. If the restitutionary framework is better, why did the intermediate appellate courts in this country who adopted it in the three cases targeted by Professor Burrows get the outcome in the particular case wrong? Is it because the alternative theory of the restitutionary framework is itself difficult to apply? Perhaps the most important question is: does the existing case law produce wrong answers? There is likely to be some inconsistency in the results of the first limb *Barnes v Addy* liability cases. That follows from diverging views about the knowledge or notice requirement in the taxonomy.

The final point I would make in response to Professor Burrows is in response to his reliance on *Re: Diplock* or *Ministry of Health v Simpson*.[95] Professor Burrows treats that case as an example of strict personal liability. But to say that it supports a wider principle based on the application of the restitutionary framework ignores the statements within the case that remark upon its particular derivation from the case law concerned with distributions of deceased estates. Importantly, liability under the *Diplock* principle is a subsidiary or secondary liability, because the recipient is only liable personally to restore or pay back that amount which cannot be recovered first from the personal representative. That is not true of first limb *Barnes v Addy* liability.

At some time in the future, it may be that opponents of the application of restitution theory will be seen, like King Canute, to have tried to hold back an inevitable tide by which restitution theory will supplant first limb *Barnes v Addy* liability. But at this point, the rising of the tide has been stopped, at least in Australia. Just as the "imperial march of modern negligence law"[96] came to a halt in the area of economic loss, with the collapse of the concept of proximity,[97] it may be that the tide of restitution theory will not inundate first limb *Barnes v Addy* liability. So far, my own view is that the reasons advanced for the change, as described above, do not justify it.

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94 A Burrows "The Australian Law of Restitution: Has the High Court Lost Its Way?", 2009 Hearn Lecture, Melbourne; reprinted in Elise Bant and Matthew Harding (eds), *Exploring Private Law* (Cambridge University Press 2010) 67-85.

95 Professor Birks did so too.

96 *Astley v Austrust Ltd* (1998-1999) 197 CLR 1, 23 [48].

Still, it should be acknowledged that if first limb liability is to continue in a traditional form, the equity or cause of action should have well understood limits so that its application is clear. It is necessary therefore, to identify what difficulties persist, or have arisen, after *Farah*.

The persisting problem of knowledge or notice

Perhaps the starkest of the points left unresolved by *Farah* is the question: must the recipient have knowledge or notice that the property is trust property and that it is received in breach of trust? That question was not truly canvassed in *Consul*. But since the mid-1980s it has been a regular focus of different Judges and academics alike. In 2012, in *Grimaldi v Chameleon Mining NL,* the Full Court of the Federal Court of Australia said this:

> "The extent of discord both within and between common law jurisdictions as to what should be taken to be the contemporary burden of the principles enumerated by Lord Selborne is marked to the point of being Babel-like:…" [98]

That rumbling was just as loud in 2007 as it was in 2012. It might be thought remarkable, therefore, that the High Court in *Farah* did not descend to any statement of principle about what knowledge or notice is required under the first limb, particularly as they did exactly that for the second limb. In rejecting the Court of Appeal's reasoning as to the first limb of *Barnes v Addy* the High Court in *Farah* said:

> "It is not necessary to go beyond the considered dicta of the three members of the majority in *Consul* … Those dicta based on the numerous cases in the past, and conform with the numerous later authorities, in which the traditional understanding of the first limb of *Barnes v Addy* has been affirmed."[99]

In support of that statement, their Honours cross-refer[100] to Gibbs J's judgment in *Consul,* which in turn refers to the statement by Stirling J made in 1888 in *Re: Blundell*; *Blundell v Blundell* that:

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97 See, for example, *Perre v Apand* (1999) 198 CLR 180, 193-194 [9]-[10].
98 (2012) 200 FCR 296, 358 [249].
99 (2007) 230 CLR 89, 155 [147].
100 See footnote 215 and pars [134] and [135].

> "A stranger to the trust receiving money from the trustee which he knows to be part of the trust estate is not liable… unless to his knowledge the money is being applied in a manner in which is inconsistent with the trust." [101]

That passage was also referred to by Stephen J in *Consul*.[102]

From that, it might be thought that the High Court was saying that "knowledge" of the misapplication is required. However, throughout their reasons for judgment in referring to first limb liability the High Court otherwise referred to "notice". For example, they said:

> "… Lord Selborne LC's expression was 'receive and become chargeable'. Persons who receive trust property become chargeable if it is established that they received it **with notice of the trust**."[103] (emphasis added) (citations omitted)

That reference to first limb liability does not even require notice of the misapplication.

As mentioned, this treatment of first limb liability and the notice requirement under it can be contrasted with what was said in respect of second limb liability. On that subject, the Court said this:

> "The result is that *Consul* supports the proposition that circumstances falling within any of the first four categories of *Baden* are sufficient to answer the requirement of knowledge in the second limb of *Barnes v Addy*, but does not travel fully into the field of constructive notice by accepting the fifth category. In this way there is accommodated, through acceptance of the fourth category, the proposition that the morally obtuse cannot escape by failure to recognise an impropriety that would have been apparent to an ordinary person applying the standards of such persons."[104]

No vagueness there. It is a mystery why no similar articulation was made of the notice requirement under the first limb.

For present purposes, it doesn't matter whether Nourse LJ's new test in *Akindele* was a good idea or a bad idea. It does not represent the law in Australia. The embarrassing

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101 (1888) 40 Ch D 370, 381.
102 (1975) 132 CLR 373, 408 – 409.
103 (2007) 230 CLR 89, 141 [112].
104 (2007) 230 CLR 89, 163-4 [177].

acknowledgment one has to make is that it is impossible to say with any confidence just what the law in Australia as to knowledge or notice is.

A valiant attempt to overcome that shortcoming was made by the Full Court of the Federal Court in *Grimaldi*. Their detailed analysis of the point is clear and the acknowledgement that the High Court did not settle the controversy is telling. The Full Court continued:

> "…None the less, from at least the 1990s and in the wake of the *Baden* classification, judges had begun in recipient liability cases to generalise from what had been said both by Gibbs J (at CLR 398; ALR 252) and by Stephen J (at CLR 412; ALR 264) with whom Barwick CJ agreed, about the insufficiency of traditional, or category (v), constructive notice — though not of category (iv) notice—as a basis for personal liability. To allow that, as Stephen J commented, would be 'to disregard equity's concern for the state of conscience of the defendant'…
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> There is, in other words, an established line of judicial decision and opinion both at first instance and in intermediate courts of appeal spanning at least 20 years adhering to the view taken in the above cited cases. We do not consider that that view is plainly wrong and should be rejected. On the contrary!"[105]

However, there are other post-*Farah* statements on the point, also of intermediate appellate Courts, including two in the Court of Appeal of this Court, which are not so clear.[106]

Why does this problem persist? I suspect that the answer lies in the duality of first limb liability. When a third party to a trust acquires the legal title to what was trust property, and the acquisition is challenged because the disposition was made in breach of trust, the first question is whether the defendant is a bona fide purchaser of the legal title without notice of the breach of trust. If so, the defendant's title to the land will withstand a beneficiary's claim based on the equitable title to the trust property. But the notice relevant to answer that question is the notice under conveyancing or property law principles, including constructive notice. If the third party has notice of the equitable interest, it will bind or prevail against their later acquired legal interest. A

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105 (2012) 200 FCR 296, 363 [268]-[269].

106 *Bird v Bird* [2013] NSWCA 262, [22]; *Togito Pty Ltd v Pioneer Investments (Aust) Pty Ltd* [2011] QCA 167, [75]; *Quince v Varga* [2009] 1 Qd R 359, 379-80 [47]; and *Kalls Enterprises Pty Ltd (in liq) & ors v Baloglow & anor* (2007) 63 ACSR 557, 595 [199].

proprietary claim lies against them as recipient. An exception is that when the trust property is Torrens system land, this conclusion operates subject to any indefeasibility conferred by the statute.

However, when the claim is not a proprietary claim to the trust property, but a personal claim that the recipient account to the beneficiaries, as if a trustee, for what was trust property received by the third party consequent upon a breach of trust, the question is whether the touchstone for personal liability is notice or knowledge. And here lies the puzzle. If notice is enough for a proprietary claim, why is knowledge to be required for a personal claim? The answer must lie in the different purposes the two claims serve. The proprietary claim vindicates the pre-existing property rights in the trust property. The personal claim makes the recipient personally responsible for the loss of the trust property because of their fault.

The problem of trust property

A dealing by a trustee or by a company director, in breach of the fiduciary obligation not to act where there is a conflict between the fiduciary duty and another duty or self interest, is a common breach of fiduciary duty. The subject of the prohibited dealing may be trust property or company property. It is also common that the subject of the dealing is a business opportunity to acquire property. The question raised is whether that form of dealing involves trust property for the purposes of first limb *Barnes v Addy* liability, when the acquiring party is not the director or the trustee but a person who has knowledge or notice of the breach of trust or duty.

One answer is that, with the possible exception of confidential information comprising a trade secret, information giving rise to a business opportunity is not trust property for the purposes of first limb liability. That was the conclusion of the High Court in *Farah*.[107] The same conclusion can be supported by other cases of authority including *Consul Development Pty Ltd v DPC Estates Pty Ltd*.[108]

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107 (2007) 230 CLR 89, 142-144 [116]-[120].

108 (1975) 132 CLR 373, 414. See also Jacobs P in *DPC Estates Pty Ltd v Consul Development Pty Ltd* [1974] 1 NSWLR 443, 460-1.

Other cases support the same view. In 2010, *Commonwealth Oil and Gas Ltd v Baxter*[109] held that a commercial opportunity to enter into a contract taken by a third party with the assistance of a director acting in breach of his fiduciary duty to a company was not trust property in the sense relevant for first limb liability. And in 2004, in *Criterion Properties Ltd v Stratford UK Properties Ltd*[110] Lord Scott of Foscote said:

> "The word 'receipt' and the expression 'knowing receipt' refers to the receipt by one person from another of assets. A person who enters into a binding contract acquires contractual rights that are created by the contract. There may be a 'receipt' of assets when the contract is completed and the question whether there is 'knowing receipt' may become a relevant question at that stage. But until then there is simply an executory contract which may or may not be enforceable. The creation by the contract of contractual rights does not constitute a 'receipt' of assets in the sense that a 'knowing receipt' involves a receipt of assets."[111]

So far, information utilised by a third party in order to purchase an asset has not attracted first limb liability as a receipt of trust property. But there are potentially more complex cases.

For example, what is the situation where a company has a contract to purchase an asset which is not yet complete when a director, in breach of fiduciary duty, assists a stranger to acquire the same asset under a different contract? Does the equitable interest that the company had under its contract give the character of "trust property" to the recipient's acquisition? Secondly, if information in the nature of a trade secret is capable of constituting "trust property" where is the line to be drawn between information which is confidential and of that character on the one hand and information which is not?

The problem of indefeasibility

Another point clearly decided by the High Court in *Farah* was that first limb liability is not an equity arising from the act of the registered proprietor that operates as an exception to the protection of indefeasibility conferred by registration of the interest

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109 [2010] SC 156.
110 [2004] 1 WLR 1846.
111 Ibid, 1855.

under the Torrens system of landholding. The Court applied[112] a passage from the reasons for decision of the Victorian Court of Appeal in *Macquarie Bank Ltd v Sixty-Fourth Throne Pty Ltd.*[113] In *Farah,* the recipient acquired the land from an unrelated third party. The indefeasible title so acquired was protected against first limb liability to hold the land as constructive trustee for the claimant.

But a potential problem remains. Because liability under the first limb may involve a personal liability, and not just a proprietary claim, it has been argued academically and held at first instance that the recipient may be required to account to the beneficiary by a money payment, even though the recipient's title to land may be indefeasible. The argument was made by Professor Michael Brien in 2008, in an article entitled "Recipient Liability under the Torrens System: Some Category Errors".[114] The cases which support the same proposition are *Super 1000 Pty Ltd v Pacific General Securities Ltd,*[115] decided in 2008, and *Ciaglia v Ciaglia*[116] in 2010.

If the argument is right, it may support the contention that first limb liability should operate as an exception to indefeasibility. The absence of a proprietary liability seems inconsistent with the existence of a personal liability to account for the same property by payment of a money sum, when the recipient still holds the land. The point as to personal liability does not seem to have been argued in *Farah*.

Williams v Central Bank of Nigeria

Lastly, the nature of first limb liability was discussed earlier this year in the Supreme Court of the United Kingdom in *Williams v Central Bank of Nigeria*.[117]

In particular, Lord Sumption, with whom the majority agreed, said two things I would note:

> "In its second meaning, the phrase 'constructive trustee' refers to something else. It comprises persons who never assumed and never intended to assume the status of a trustee, whether formally or

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112 (2007) 230 CLR 89, 169-170 [193].
113 [1998] 3 VR 133, 156-157.
114 C Rickett and R Gratham (Eds), *Structure and Justification in Private Law* (Oxford: Hart: 2008) 339, 350 and 358.
115 (2008) 221 FLR 427, 477-478 [229]-[237].
116 [2010] NSWSC 341, [115].
117 [2014] 2 WLR 355.

> informally, but have exposed themselves to equitable remedies by virtue of their participation in the unlawful misapplication of trust assets. Either they have dishonestly assisted in a misapplication of the funds by the trustee, or they have received trust assets knowing that the transfer to them was a breach of trust. In either case, they may be required by equity to account as if they were trustees or fiduciaries, although they are not. These can conveniently be called cases of ancillary liability. The intervention of equity in such cases does not reflect any pre-existing obligation but comes about solely because of the misapplication of the assets. It is purely remedial…
>
> …
>
> The essence of a liability to account on the footing of knowing receipt is that the defendant has accepted trust assets knowing that they were transferred to him in breach of trust and that he had no right to receive them. His possession is therefore at all times wrongful and adverse to the rights of both the true trustees and the beneficiaries. No trust has been reposed in him. He does not have the powers or duties of a trustee, for example with regard to investment or management. His sole obligation of any practical significance is to restore the assets immediately. It is true that he may be accountable for any profit that would have been made or any loss that would have been avoided if the assets had remained in the hands of the true trustees and been dealt with according to the trust. There may also, in some circumstances, be a proprietary claim."[118]

Conclusions

What are the conclusions that can be drawn from all these observations?

First, those who would refine, restate or replace first limb *Barnes v Addy* liability are all confronted by the same starting point, namely that Lord Selborne's statement of principle was not made in circumstances that identify a clear basis of first limb liability.

Second, the cases of actual first limb liability decided before 1980 were relatively few, although it was referred to in passing or in analysis in second limb cases and there were cases where it was decided there was no such liability.

Third, starting with *Belmont Finance* in 1979, the growing number of subsequent cases has produced irreconcilable differences of opinion as to whether liability is fault based or strict and, if fault-based, what the relevant knowledge or notice requirements are.

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[118] [2014] 2 WLR 355, 361 [9] and 371 [31].

Fourth, the extension of first limb liability from the traditional ground of dealings by trustees with trust property into breaches of fiduciary by company directors has tested and will lead to more disputes about what is and what is not trust property for first limb liability.

Fifth, at least for a while, *Farah* may have cleared the decks of arguments about strict liability based on a restitutionary framework and also clarified that information comprising a business opportunity is not trust property but it did nothing otherwise to fill the apparent cracks in the taxonomy of first limb liability.

Why is it so? If I could borrow, in response, what Professor Lee might say: "Well, I don't know, but perhaps it has got something to do with the circumstance that the plaintiffs in *Barnes v Addy* and *Farah* lost, and cases where plaintiffs don't win, usually don't establish very much about what the law is. They tell us more about what it is not."

And then he would say: "What do you think?"