Equity and trusts: barnes v addy second limb

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Introduction This paper examines the development and scope of accessory liability under the second limb of Barnes v Addy as it stands in both England and Australia. As to the law in England, the focus will be on the rearticulation of the principle of accessory liability under the second limb as stated in Royal Brunei Airlines Sdn Bhd v Tan. In particular, it will consider the extent to which the decision has reconciled inconsistencies in earlier authority and remedied those issues propounded to be inherent in the traditional formulation of the principle. At this stage, this traditional principle remains good law in Australia.

However, as suggested in Farah Constructions Pty Ltd v Say-Dee Pty Ltd, there is potential for the English approach to be adopted in the Australian context. Such an adoption may be advisable in light of the judicial and extra-judicial commentary suggesting that the orthodox approach is in fact not properly aligned with equitable principles. The discussion of this possibility involves not only an assessment of the advantages and disadvantages of each approach, but also a determination as to the extent to which the separate application of each approach could result in a divergent outcome.

The development of the second limb of Barnes v Addy in Australia- ‘ knowing assistance’ The classic authority on the circumstances in which third parties will be held accountable for their involvement in a breach of trust or fiduciary duty is the English case of Barnes v Addy. It was in this case that Lord Selbourne LC articulated the much cited and analysed statement of principle that has come to form the modern law: ... trangers are not to be made constructive trustees merely because they act as the agents of trustees… 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. This statement has come to be understood as allowing liability to be imputed on a party in two distinct circumstances, where the third party either knowingly receives trust property, or assists with knowledge in a breach of trust or fiduciary duty.

This paper seeks only to consider the latter. In what ostensibly remains the authoritative case on this second limb of Barnes v Addy in Australia, the High Court in Consul Development Pty Ltd v DPC Estates Pty Ltd, (‘ Consul Development v DPC’) not unlike other cases at the time, focussed predominantly on the level of knowledge which would be sufficient to attract accessory liability in the circumstances before them.

The primary question was not one of the dishonesty or otherwise of the actions of the third party, but of that third party’s knowledge of the dishonesty of the fiduciary. The majority, it seems, realised that the terms ‘ constructive notice’ and ‘ actual notice’ did not in themselves comprise the requisite sophistication for dealing with the matter of the knowledge of the third party.

They instead expressed the required degree of knowledge within particular parameters, with neither Stephen J nor Gibbs J willing to extend these parameters to include a negligentfailureto inquire on behalf of the third party. In EquiticorpFinanceLtd v Bank of New Zealand, Kirby P (in dissent) indicated support for the Consul test of knowledge, and attempted to clarify the judgement in Consul Development v DPC with reference to the decision in Baden, Delvaxs & Lecuit v Societe Generale pour Favoriser le Development du Commerce et de L’Industrie en France SA (‘ Baden’).

He equated the degrees of knowledge set out by the High Court in Consul Development v DPC with the first four categories as stated in Baden thereby confirming that both actual and constructive knowledge, but not constructive notice, would constitute the requisite degree of knowledge necessary to render a third party liable under the second limb of Barnes v Addy. Similar findings have been made in later cases where Consul Development v DPC has been declared authority on the matter, although such an explicit reference to the Baden scale is not always present.

Conversely, other judges have found the judgement in Consul Development v DPC to be inconclusive, adopting a narrow interpretation of the judgement of Stephen J and restricting the requisite knowledge only to the first three categories of the Baden scale. This tendency toward a narrow approach increased following the decision in Royal Brunei Airlines Sdn Bhd v Tan (‘ Royal Brunei’) as courts attempted to reconcile the UK and Australian lines of authority.

However in other cases, such as Gertsch v Atsas it was held that that the acceptance of the first four Baden categories was synonymous with accepting a standard of honesty. Given the discordant state of the Australian authorities, the High Court took the opportunity in Farah Constructions Pty Ltd v Say-Dee Pty Ltd, (‘ Farah Constructions’) to clarify the Australian position on knowing assistance.

Their Honours declared, in obiter, that Australian courts should continue to follow the decision in Consul Development v DPC, thereby continuing to see as necessary the requirement of a dishonest design on the part of the fiduciary, and subscribing to the proposition that where the third party’s

knowledge falls within the first four categories of the Baden scale it will answer the requirement of knowledge under the second limb of Barnes v Addy.

In what has been referred to as a “ profound shift in the rules of judicial engagement” following Farah Constructions, lower courts have regarded themselves as obligated to follow the obiter of the High Court and have thus returned to an orthodox approach. However, the law in Australia is far from settled on this point and a case is yet to come before the High Court with the facts necessary to allow for a reconsideration of the principles enunciated by the Privy Council in Royal Brunei. The development of the second limb of Barnes v Addy in England- ‘ dishonest assistance’

While in Australia the courts are returning to an orthodox approach towards accessory liability, in England, the courts are grappling with a reformulation of the principles under the second limb of Barnes v Addy following the decision in Royal Brunei. In this case, the Privy Council refocussed the relevant inquiry in cases concerning liability under the second limb of Barnes v Addy away from the third party’s knowledge of the trustee’s dishonesty, to the dishonesty of the accessory themselves.

Consequently, the dishonesty (or lack thereof) of the trustee or fiduciary is irrelevant as it is the dishonesty on the part of the accessory that attracts liability. There is nothing new about the application of a dishonesty-based in inquiry into the liability of accessories to a breach of fiduciary duty, with Lord Nicholls suggesting that before the inquiry “ donned its Barnes v Addy strait-jacket” judges hadn’t regarded themselves as confined to inquiries into the levels of knowledge of the accessory.

It may even be said that the dishonesty-based inquiry had retained its place in contemporary law prior to Royal Brunei, and that it was merely obscured by the additional and more tedious requirement of determining the level of knowledge of the accessory. For example, in Agip (Africa) Ltd v Jackson Millet J stated: There is no sense in requiring dishonesty on the part of the principal while accepting negligence as sufficient for his assistant.

Dishonest furtherance of the dishonest scheme of another is an understandable basis for liability; negligent but honest failure to appreciate that someone else's scheme is dishonest is not. This can be set alongside other cases which suggest that that the requirement of dishonesty on the part of the principle is in fact a compelling reason not to require dishonesty on the part of the fiduciary, as they are an ' accessory' who merely needs to be is linked to the conduct of the principle. Millet J, however, seemingly wishes to see this principle extended, so that dishonesty is required on the part of both parties.

The decision in Royal Brunei does not precisely echo this formulation of the dishonestly principle (Lord Nicholls ultimately went on to conclude that that the fiduciary need not be dishonest at all in order for the accessory to be held accountable), but instead clarifies and affirms a general principle in light of other commentary on the point. Consequently, Lord Nicholls in his judgement has set out what is necessary for the inquiry into the accessory's dishonesty, stating that courts should look to determine whether the person acted " as an honest person would in the circumstances" in light of their actual knowledge at the time.

He further explains that the question should be approached objectively and indicates that the test is not one of the ‘ reasonable person’. He seeks to clarify this test of dishonesty with the following examples: If a person knowingly appropriates another’s property, he will not escape a finding of dishonesty simply because he sees nothing wrong in such behaviour… Honest people do not knowingly take other’s property…[or] participate in a transaction if he knows it involves a misapplication of trust assets to the detriment of the beneficiaries.

Nor does an honest person in such a case deliberately close his eyes and ears, or deliberately not ask questions, lest he learn something he would rather not know, then proceed regardless. This passage, while meant to further explain the test for dishonesty, initially seems difficult to reconcile with later comments, where his Lordship makes explicit reference to the departure from the orthodox inquiry into degrees of knowledge, stating that the word “ knowlingly” should be avoided and that the Baden scale was “ best forgotten”.

While it seems unproblematic to abandon the Baden scale of knowledge, commentators and courts alike have found difficultly in divorcing the concept of dishonesty from knowledge itself and the most recent authoritative decision on the point Barlow Clowes International Ltd v Eurotrust International Ltd (‘ Barlow Clowes’) confirms that an inquiry into dishonesty does to some degree require an inquiry into the knowledge of the third party. Comparison of the English and Australian position One of the objectives of the court in Royal Brunei was to remedy some of the problems with the orthodox approach to accessory liability.

Such problems were not only present in English courts, but have also plagued Australian courts and were not resolved in by the High Court's affirmation of the knowledge-based test in Farah Constructions. Firstly, Lord Nicholls in Royal Brunei sought to realign the principles of accessory liability with equitable doctrines and focussed primarily on the conscience of the accessory themselves. In the orthodox approach, as expressed in Consul Developments v DPC, the inquiry is not into the state of mind of the accessory themselves but into the accessory's knowledge of another's state of mind.

It has been suggested that the inquiry has thus been misplaced, and that although it results in an indirect finding of dishonesty on the part of the accessory, it is much further removed from equitable principles than the Royal Brunei approach. Lord Nicholls also sought to do away with the confusion surrounding the need for judges to distinguish between the different levels of knowledge, in particular constructive knowledge and constructive notice.

However, as noted above, Lord Nicholls on several occasions makes reference to the knowledge of the accessory which is the reason that the degree to which the test of dishonesty is divorced from an inquiry into knowledge has been questioned. However, what must be realised here is that the inquiry into knowledge that is embarked upon as part of the dishonesty based approach is different to that which was required under the knowledge based approach.

This redirection for the knowledge inquiry was first considered in Twinsectra Ltd v Yardley where a difficulty arose in determining whether Lord Nicholls

had intended for an objective or subjective approach to be taken to dishonesty. In the leading judgement, Lord Hutton tendered the " combined test" which required that the third party's conduct be dishonest by the standards of the reasonable person as well as requiring an appreciation by the third party that by those standards his or her conduct was dishonest.

This combined test endured muchacademiccriticism and was seen as being inconsistent with the objective test enunciated by Lord Nicholls in Royal Brunei. The Privy Council, and in particular, Lord Hoffman (who was in the majority in Twinsectra Ltd v Yardley) had the opportunity in Barlow Clowes to clarify the comments made in Twinsectra Ltd v Yardley. It was stated that the majority in Twinsectra Ltd v Yardley had, in fact, always espoused a test in line with that which was conceptualised in Royal Brunei and it was commentators who had skewed this test into a different form.

Despite the contempt that many commentators had for this account, the statement of a complete principle of dishonest assistance was applauded. Incorporated in this principle was the conclusion that the liability of the accessory was not dependant on a requirement for fraud or dishonesty on the part of the fiduciary, but depended solely upon whether the accessory was at fault. This is the converse position of the orthodox approach, whereby a third party can escape liability even where they know they are assisting in a breach of fiduciary duty, provided that the fiduciary was not acting dishonestly.

Thomas J in Powell v Thompson held that protecting a person with a guilty conscience in this manner was not in line with equitable principles, and his consequent assertion that the conduct of the principle should be irrelevant

was later approved in Brunei. One significant consequence of the divergent approaches in what are currently the UK and Australian positions on this matter would be the substantial difference in outcome in cases where the fiduciary had acted innocently.

Provided that all other requirements are satisfied, in the UK the accessory would be held liable however in Australia they would not. Further to this, while some Australian judges have found it difficult to distinguish the traditional approach from that of Royal Brunei, the fact that the orthodox reliance on the Baden scale restricts investigations only to knowledge and not to other attributes or types of conduct, lends weight to the argument that in certain circumstances there would be divergent outcomes of the two approaches. Perhaps, it is best to take Farah

Constructions as authority on this point, with the High Court in this case imputing that one of the reasons it is directing courts to treat the approaches distinctly is due to the potential for the different formulations of the principle to lead to different results. Conclusion In line with the arguments presented in this paper, it is submitted that the approach to accessory liability espoused in Royal Brunei is preferable to that which was propounded in Consul Development v DPC due what is an ostensible irreconcilability of the latter case with conventional equitable doctrines.

This assertion turns on the manner in which the judges in Consul Development v DPC dealt with the requirement for a dishonest and fraudulent design on the part of the fiduciary as per Lord Selbourne LC in Barnes v Addy. Like many other cases at the time, Consul Development v DPC was concerned more with attempts to define what Lord Selbourne had

meant by a “ dishonest and fraudulent design” rather than questioning whether it was an appropriate criterion for the imposition of liability on a third party.

Consequently, when it came to fulfilling equity's calls as to inquiries into the conscience of the defendant, courts were misguided and came to focus instead on the conscience of the principle. The arguments in favour of the retention of this approach are largely set out in reliance on the requirement that the third party be implicated in the conduct of the fiduciary. However, as suggested in Royal Brunei, assistance in itself should be enough to draw a sufficient connection between the accessory and the fiduciary.

It was this realisation which enabled Lord Nicholls in Royal Brunei to reformulate the principle under the second limb of Barnes v Addy so as to redirect inquiries into the minds of defendants to their appropriate place in accordance with equitable principles. Although the adoption of the approach in Brunei may not result in major shift in the law of accessory liability in Australia, it’s contemplation of circumstances in which the third party can be held liable even where the fiduciary is innocent would at the very least resolve the seemingly inequitable approach to this point as it stands in current Australian law. Bibliography Articles/Books/Reports Aitken, L, 'Unforgiven: Some thoughts on Farah Constructions Pty Ltd v Say-Dee Pty Ltd' (2007) 29 Australian Bar Review 195 Andrews, G, ‘ The redundancy of dishonest assistance’ (2003) 8 Conveyancing and Property Law Journal 1 Birks, P, ‘ Misdirected funds: Restitution from the Recipient’ (1989) Lloyds Maritime & Commercial LQ 296 Chambers, R, 'Knowing Receipt: Frozen In Australia' (2007) 2 Journal of Equity 40 Cope, M, 'A comparative evaluation of

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