

PARTICIPANTS IN A BREACH OF FIDUCIARY OBLIGATIONS

A successful claim against the fiduciary may result in an award of compensation for loss, disgorgement of gain or restitution of property misappropriated by the fiduciary. But it will sometimes be impossible for the plaintiff to obtain complete relief, particularly if the fiduciary is insolvent or beyond the jurisdiction of the court. In such cases, the plaintiff may be able to pursue third parties who participated in the breach of duty

'Knowledge-based' test of liability → considers which money or other property was received, and the actual knowledge possessed by the recipient either at the time of receipt or subsequently.

Baden, Delvaux and Lecuit v Société Générale [1992] → Peter Gibson J → **Baden Scale** → scale of knowledge relevant to determining liability for 'knowing receipt' and 'knowing assistance'

1. actual knowledge;
2. wilfully shutting one's eyes to the obvious;
3. wilfully and recklessly failing to make such inquiries as an honest and reasonable person would make;
4. knowledge of circumstances which would indicate the facts to an honest and reasonable person; and
5. knowledge of circumstances which would put an honest and reasonable person on inquiry.

Third parties → The two limbs of *Barnes v Addy* (1874)

1. **Knowing Receipt**
2. **Breach of fiduciary duty**
 - a. Breach does not have to be dishonest
 - b. Can be a breach of trust
 - c. Can be a breach of other fiduciary obligation
 - i. *Hasler v Singtel Optus Pty Ltd (2014)* → The misappropriation of company property by a director or of client money by a solicitor

Farah Constructions Pty Ltd v Say-Dee Pty Ltd [2007]

- Being aware of the defendant's actions, it had therefore consented to what would otherwise have amounted to a breach of obligation.
- Even if the defendant had committed a breach of fiduciary obligation to which the plaintiff had not consented, Mr Elias' wife and daughters were not liable for having knowingly received property in breach of fiduciary duty or for having knowingly assisted a breach.
- Opportunities were "not open to Farah to exploit, consistently with its fiduciary duty, unless Say-Dee gave its informed consent to a contrary course." (Gleeson CJ, Gummow, Callinan Heydon and Crennan JJ at page 137 [103])

Third party liability: the rule in *Barnes v Addy*

- This dictum distinguishes between two types of third party liability:
- (a) liability for knowingly receiving property in breach of trust or other fiduciary obligation (sometimes referred to as liability under the 'first limb' of *Barnes v Addy*); and
- (b) liability for knowingly assisting a fiduciary to commit a breach of obligation (sometimes referred to as liability under the 'second limb' of *Barnes v Addy*).
 1. **Receipt of property by the defendant**

What is received?

- a. Property must have been received directly from the fiduciary or, → as X did from S
- b. Received from someone who has directly or indirectly received the property from the fiduciary → Y and Z

A third party is only liable under the first limb of *Barnes v Addy* (1874) if what is received constitutes, in law, property.

Property → original property or traceable proceeds of that property (ie. painting purchased with client money)

Did the third party receive legally recognised property?

Failure to prove this is one of the reasons the claim for 'knowing receipt' failed in *Farah*

- a. One of the reasons given for rejecting the 'knowing receipt' claim against the wife and daughters was that they had received information, which in law does not constitute property.
- b. No receipt of property within the meaning of the first limb. The information which the Court of Appeal

thought that Mr Elias ought to have disclosed was not confidential. So far as that information was in the Notice of Determination, that document was available for public inspection.

Stephens Travel Service International Pty Ltd v Qantas Airways Ltd → For an application of the concept of beneficial receipt so as to hold a bank liable for 'knowing receipt'

Agip (Africa) Ltd v Jackson [1990] → distinguishes the two types of receipt of property by the defendant → Millett J

- 1) Recipient must have received the property for their own benefit and use → Liable as a constructive trustee for breach of trust → from the time the property was received and from the time notice was acquired
- 2) Recipient receives the trust property lawfully and not for his own benefit but then misappropriates it or deals with it in an inconsistent manner with the trust instrument → liable as a constructive trustee if the property was received knowing it to be such, regardless of knowing all circumstances in relation to the exact terms of the trust

1. Knowledge of the breach of the fiduciary duty

A recipient is only liable in equity under the first limb of *Barnes v Addy (1874)* if she knows of the facts constituting the breach of fiduciary duty.

The recipient's knowledge must be of the breach of fiduciary obligation. He will not be liable if he was aware that he had received property from a fiduciary but was unaware of the breach. Liability is imposed from the time he becomes aware of the breach. So a recipient of money from a fiduciary who spends some of the money prior to becoming aware of the fiduciary's breach will not be accountable for the amount spent.

Farah → HC rejected the application of unjust enrichment principles to the law of 'knowing receipt' and confirmed that a recipient is not liable under this head unless he has knowledge of the breach of fiduciary duty.

- The wife and daughters had been unjustly enriched at the expense of the plaintiff (or, more accurately, at the expense of the plaintiff's share of the joint venture) and must make restitution of the properties so that they could be incorporated into the property development pursued by the co-venturers. Liability in unjust enrichment is strict, so on this analysis it was unnecessary for the plaintiff to show that the wife and daughters knew of Mr Elias' (assumed) breach of fiduciary duty

Grimaldi v Chameleon Mining NL (No 2) [2012] → Finn, Stone and Perram JJ → Put compendiously liability both for knowing receipt and knowing assistance turns on what the third party knew, or had reason to know, of the circumstances constituting the breach of 'trust' (recipient liability) or the 'dishonest and fraudulent design' (assistance liability).

1. Knowing Assistance

2. Was the breach dishonest and fraudulent?

Barnes v Addy (1874) → Lord Selborne stated that strangers are accountable if they 'assist with knowledge in a dishonest and fraudulent design on the part of the trustees'. Australian and English authority has diverged on the question of whether the breach of fiduciary duty must be dishonest and fraudulent.

Royal Brunei Airlines Sdn Bhd v Tan [1995] → Plaintiff is not required to prove that the breach of trust was dishonest and fraudulent → This analysis was not accepted by the High Court in *Farah*

- Defendant was liable if they dishonestly assisted the company be controlled to commit the breach of trust
- Where a third party dishonestly assisted a trustee to commit a breach of trust or procured him to do so, the third party would be liable to the beneficiary for the loss occasioned by the breach of trust, even though the third party had received no trust property and irrespective of whether the trustee had been dishonest or fraudulent
- The trustee will be liable in any event for the breach of trust, even if he acted innocently, unless excused by an exemption clause in the trust instrument or relieved by the court.

Farah → The High Court restated the requirement that the breach of fiduciary duty **must be dishonest and fraudulent** → they did not define 'dishonest and fraudulent' breach of fiduciary duty and there has been some disagreement on the meaning of the term.

Hasler → Leeming JA → that '[d]ishonesty amounts to a transgression of ordinary standards of honest behaviour' → This definition was accepted and applied by Gageler J in *Ancient Order of Foresters in Victoria Friendly Society Ltd v Lifeplan Australia Friendly Society Ltd [2018]*

1. Was the assistance in the breach significant?

Farah → High Court states that the accessory must participate 'in a significant way' in the commission of a breach of fiduciary duty

- Mr Elias' wife and daughters in that case had not participated significantly in Mr Elias' assumed breach of fiduciary duty.

Re-Engine Pty Ltd (in liq) v Fergusson (2007) → the assistance should 'forward or advance the primary breach or misconduct in some way. Mere passive acquiescence in the breach would not, in the ordinary case, suffice to establish liability on the ground of assistance.

Harstedt v Tomanek (2018) → Omissions, if not amounting to passive acquiescence, can nonetheless constitute assistance.

1. Was there knowledge of the breach of fiduciary duty?

Since the Privy Council decision in *Royal*, English decisions have renamed the second limb 'dishonest assistance'. Lord Nicholls' judgment substituted a dishonesty requirement for the knowledge test applied in *Barnes*. The High Court in *Farah* confirmed, however, that, at least for the time being, liability depends on proof of knowledge.

Royal → liability for assisting the breach of a fiduciary duty requires proof that the assister acted dishonestly → Lord Nicholls:

- "In the context of the accessory liability principle acting dishonestly, or with a lack of probity, which is synonymous, means simply not acting as an honest person would in the circumstances. This is an objective standard."
- "Dishonesty is mostly concerned with advertent conduct, not inadvertent conduct. Carelessness is not dishonesty. Thus for the most part dishonesty is to be equated with conscious impropriety. However, these subjective characteristics of honesty do not mean that individuals are free to set their own standards of honesty in particular circumstances. The standard of what constitutes honest conduct is not subjective. Honesty is not an optional scale, with higher or lower values according to the moral standards of each individual."
- "Honest people do not intentionally deceive others to their detriment. Honest people do not knowingly take others' property. Unless there is a very good and compelling reason, an honest person does not 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, and then proceed regardless."

Farah → third parties can be held accountable on other equitable grounds → knowingly inducing or procuring a breach of fiduciary duty → the corporation's liability is that of the trustee and not that of a third party participant in the breach of duty

- The High Court held, assuming that Elias had committed a breach of fiduciary duty, that his wife and daughters, who had taken title to properties in consequence of the assumed breach, had not knowingly assisted the breach.
- The second limb makes a defendant liable if that defendant assists a trustee or fiduciary with knowledge of a dishonest and fraudulent design on the part of the trustee or fiduciary.

Remedy for Knowing Receipt

Equitable compensation, assessed as the value of the property received, may be awarded, in some cases with compound interest → *Westpac Banking Corporation v Bell Group Ltd (in liq) (No 3) (2012)*

Alternatively, an **account of profits** may be ordered against a recipient who has profited from the receipt of the property; for example, by investing trust money successfully → *Michael Wilson & Partners Ltd v Nicholls (2011)*; *Grimaldi v Chameleon Mining NL (No 2) [2012]*

Farah → High Court stated that proprietary relief is available, and relief was not purely personal → It is unclear where the burden of proof is placed when a principal tries to recover specific property from a third party recipient.

- Where the subject matter of the constructive trust is land, a question will arise as to the trust's enforceability under the Torrens system of title registration.

If the recipient no longer holds the property, the principal will be limited to the **personal remedies** of equitable compensation or account of profits.

If the recipient still holds the property, the position is more complicated and, in part, depends on the property involved:

- a. The principal will not have to rely on the rule in *Barnes*. She will be entitled to trace the property to the recipient and claim it
- b. If the principal claims property traced, the onus of proof will rest on the recipient to defeat the claim by showing he is a good faith purchaser for value without notice of the trust.
- c. If the principal wishes to establish that the recipient is liable for knowing receipt, she will bear the burden of establishing the recipient had sufficient knowledge.
- d. Where the misappropriated property is registered land, the recipient will be entitled to the benefit of indefeasible title and will not have to return it unless one of the so-called exceptions to indefeasibility can be established
 - i. Except:
 1. The recipient was party to the trustee's fraud, in which case the land must be returned → *Assets Co Ltd v Mere Roihi* [1905] → Lord Lindley
 2. 'In personam' Principle → A registered proprietor is bound by interests he has created which affect his title, such as an express trust over the land.
 - a. The proprietor is also bound where his conduct entitles another to enforce an interest against him → *Baumgartner v Baumgartner* (1987)
 - b. *Farah* → High Court held that the principle only applied where the constructive trustee was the 'primary wrongdoer'. The recipient will usually be the secondary wrongdoer.

It has been argued that enforcing a personal claim against the recipient would undermine the principle of indefeasibility which is the cornerstone of the Torrens land registration system.

Remedies for Knowing Assistance

Only **personal relief** can be awarded in a claim for knowing assistance. Although the assister is described as a constructive trustee, the term 'constructive trust' does not imply that he holds identified property on trust. It is a shorthand expression for stating that he is personally liable to account as if he were an express trustee.

The usual remedy awarded is **equitable compensation**. The objective of the remedy is to compensate the beneficiary for loss caused by the breach of duty. The assister is liable to compensate for all the loss caused by the breach, although he can obtain a contribution from the fiduciary and other assisters

The assistant will be liable to pay equitable compensation for loss caused to the trust or to the principal by the breach which he has assisted:

- Compound interest may be payable → *Westpac Banking Corporation v Bell Group Ltd (in liq) (No 3)* (2012)
- Where the assistant has, independently of the fiduciary, made a profit from his participation from the breach, an account of profits will be ordered → *Michael Wilson & Partners Ltd v Nicholls* (2011); *Grimaldi v Chameleon Mining NL (No 2)* (2012)

When an assistant will be liable to account for a profit and how the profit will be quantified?

Ancient Order of Foresters in Victoria Friendly Society Ltd v Lifeplan Australia Friendly Society Ltd [2018] → account of profits being awarded against a knowing assister in a breach of fiduciary duty

- Foresters could not limit its liability to disgorge profits by claiming that only limited profits were caused by particular acts of knowing assistance when the consequences of those acts were inseparable from the consequences of Woff and Corby's general scheme of breach of fiduciary duty.
- HC ordered Foresters to account for the full value of the business connections obtained when it knowingly assisted former employees of Lifeplan and Funeral Plan Management Pty Ltd (FPM) to break their fiduciary obligations to Lifeplan.

Consul Development Pty Ltd v DPC Estates Pty Ltd [1975] → a person who knowingly participates in a breach of fiduciary duty is liable to account to the person to whom the duty was owed for any benefit he has received as a result of such participation.

Alternative grounds of personal recipient liability

Liability under the first limb of *Barnes v Addy* is not the only basis on which a recipient can be made to pay the value of property received in breach of fiduciary duty. For example, a recipient of property to which he is not entitled from an executor of a deceased estate can be ordered to make **personal restitution** of the value of the property received if the property, or its traceable proceeds, cannot be returned to those entitled under the will or intestacy → *Re Diplock [1948]* → affirmed on this point as *Ministry of Health v Simpson [1951]*

A **personal claim** can also be brought against a recipient of property in an action for money had and received (in substance a claim for unjust enrichment) in some circumstances.

Liability is strict, subject to the availability of defences such as **change of position** and **good faith purchase**.

Fistar v Riverwood Legion and Community Club Ltd [2016] → New South Wales Court of Appeal rejected the argument that the personal claim should be disallowed because it would outflank the principles governing equitable 'knowing receipt' liability laid down by the High Court in *Farah*.

Other forms of participatory liability

1. Claims based on tracing

Tracing is the process of identifying the claimant's property in the hands of the defendant.

Tracing claims can be combined with claims under both limbs of *Barnes* → C may be able to trace her money into the painting Y has bought and into Z's bank account.

A defence to a tracing claim in equity is that the claimant's property has been acquired by a good faith purchaser for value without notice of the claimant's interest in the property. If a knowing receipt claim also entitles a successful claimant to recover the property, it is uncertain whether a knowledge test or the doctrine of notice will be applied to determine whether a purchaser is entitled to retain this property.

1. Inducing a breach of trust

An important feature of this basis of liability is that it is not necessary to show that the fiduciary's breach was dishonest and fraudulent. It appears that level (4) knowledge on the Baden scale is also sufficient for liability under this head.

Before *Barnes* established the modern dichotomy of knowing receipt and knowing assistance, other forms of participatory liability were recognised in equity. For example, liability was imposed in some cases for knowingly inducing or procuring a breach of trust where the trustee had not acted with an improper motive.

Farah → High Court noted the existence of liability for knowing inducement. Although the High Court did not clearly state that the action is recognised in Australia, later decisions have proceeded on the basis that the cause of action exists in modern Australian equity

→ *Grimaldi* → Federal Court regarded the action of knowing inducement as an available cause of action and the Victorian Court of Appeal has upheld the imposition of liability under this cause of action.

Pittmore v Chan → Leeming JA → outlined two elements for this action: 'The first is the intentional conduct which causes, and is intended to cause, the breach of trust or fiduciary duty. The second is that the third party knew that he or she was bringing about a breach of trust or fiduciary duty.'

After *Farah*, the third party will not be liable for knowing assistance because the trustee's breach is not dishonest and fraudulent, but he might nonetheless be liable for knowing inducement. Remedies for inducement are personal only.

1. Trusteeship de son tort

'Trustee by his own wrong'

Someone who acts in the capacity of trustee without being properly appointed, and administers the trust → will be personally liable to compensate for any loss caused by the administration as if he had been properly appointed a trustee.

The defendant will not be held liable as a trustee de son tort unless he has sufficient control over the trust property to enable him to dispose of it.

Equity recognises the concept of

1. 'executor de son tort' → where a third party assumes the role of an executor of an estate

2. 'agency de son tort' → where the role of agent is assumed without proper appointment
→ subject to the fiduciary obligations for which they would have been accountable if they had been properly appointed.