Recipient Liability in Western Australia

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A person who receives trust property transferred in breach of trust may incur personal liability to the beneficiaries. Traditionally, that liability has been imposed by way of constructive trust for 'knowing receipt'. In Western Australia, as elsewhere, the courts have failed to agree on just how 'knowing' the recipient must be. This article examines the principles underlying this form of liability, and suggests a basis for determining the appropriate degree of knowledge. It also considers the arguments for a strict liability approach, in which knowledge is irrelevant except for defences. This form of liability already applies in cases covered by section 65 of the Trustees Act 1962 (WA). The question is whether a similar approach should be applied more generally to all unauthorised recipients of trust property.

THE beneficial owner of trust property has a range of remedies available when the trustee disposes of the property to someone not entitled to it. If the disposal constitutes a breach of trust, for which the trustee is not excused, the beneficiary may seek a personal remedy against the trustee for the loss suffered by the trust or for any profit made by the trustee from the misapplication. Secondly, the beneficiary can compel the trustee to take any action available to it against the recipient. Thirdly, the beneficiary may obtain a proprietary remedy against anyone who still has the property or its traceable proceeds. Fourthly, a beneficiary may have a personal remedy against the recipient or other persons involved in the breach. The focus of this article is on the scope of the personal remedy against the recipient, although

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some reference is necessary to the other remedial avenues. In particular, we examine the necessary elements for prima facie personal liability. Issues relating to the defences to such liability will be addressed in a future article.

A thorough review of the relevant law in Western Australia is warranted for three principal reasons. First, the existing authorities lack consistency. They reveal three different views as to the test for establishing personal recipient liability. Secondly, the courts in this State will need to address yet another approach, imposing strict liability on restitutionary principles, that has begun to command attention and support elsewhere. Thirdly, it is necessary to examine the scope and significance of the statutory regime for recipient liability established by section 65 of the Trustees Act 1962 (WA). To date, that section has been ignored in arguments about the position under the general law. The section is important not merely because it provides an alternative remedy against recipients; in several respects its provisions restrict the rights and remedies otherwise available under the general law.

LIABILITY IN EQUITY

The leading cases in Western Australia have been argued and decided on the basis that the personal liability of the recipient arises by way of constructive trusteeship pursuant to Lord Selborne LC's classic statement in *Barnes v Addy*:

> 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.[1]

From this dictum, courts have developed the two limbs of liability traditionally known as 'knowing receipt' and 'knowing assistance'. The focus on the *Barnes v Addy* dictum has not been entirely benign. The prominence given to these two categories has obscured the fact that a third party may incur liability by reason of other forms of involvement in a breach of trust, such as instigating or procuring the breach.[2] Further, the very labelling of the categories as 'knowing receipt' and 'knowing assistance' has been criticised for begging the vital question as to what knowledge, if any, is required for liability.[3] For this reason, we prefer the more neutral language of 'recipient liability' and 'accessory liability'.[4]

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1. (1874) LR 9 Ch App 244, 251-252.
2. C Harpum 'The Stranger as Constructive Trustee' (1986) 102 LQR 114, 141.
3. P Birks 'Misdirected Funds: Restitution From the Recipient' [1989] LMCLQ 296, 298.
4. This terminology has been adopted in recent cases: see *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378 and *Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd* [1998] 3 VR 16.

It is also easy to be misled by Lord Selborne LC's formulation of the rule in respect of recipient liability. First, the head of liability is not confined to agents. Liability can attach to any person who receives misapplied trust property.[5] Secondly, the defaulting 'trustee' need not be a trustee in the strict sense. It can include a fiduciary acting in breach of a fiduciary duty.[6] Thirdly, the misapplication of the trust property need not have been part of a 'dishonest and fraudulent design on the part of the trustees'. It is enough that the property was transferred in breach of trust or fiduciary duty.[7] Fourthly, it is necessary to appreciate that, where liable under this rule, the recipient merely incurs a personal obligation to pay a sum of money. While a proprietary remedy might also be available if the recipient still has the trust property or its traceable proceeds,[8] that is a separate question.[9] To reduce confusion, we prefer to reserve the term 'constructive trust' for cases where a proprietary remedy is available, in the form of a declaration that the defendant holds property on trust for the plaintiff or is required to transfer property in specie to the plaintiff.

Throughout the caselaw, in Western Australia as elsewhere, the principal judicial controversy regarding recipient liability has concerned the extent to which the recipient is required to have been aware that the property was trust property and that it was being misapplied. Two main lines of authority have emerged. The first requires that the recipient had actual or constructive notice that the property had been transferred in breach of trust. The second restricts liability to cases where the recipient's conscience has been sufficiently affected so as to warrant equitable intervention. The latter category can be further divided according to what is required to demonstrate unconscionability. On one view, dishonesty is required. On the other, it is sufficient that the recipient knew or ought to have known that there had been a breach of trust.

Before examining the differences between these approaches, it is necessary to refer to the scale adopted by Peter Gibson J in the *Baden* case,[10] where his Honour distinguished between five categories of knowledge:

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5. *Re Montagu's Settlement Trusts* [1987] Ch 264.
6. *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373, Gibbs J 397.
7. In some jurisdictions, dishonesty by the trustee is still regarded as a necessary condition for imposing accessory liability under the second limb of *Barnes v Addy*: see *Air Canada v M&L Travel Ltd* [1993] 3 SCR 787. However, the better view, that only the dishonesty of the accessory is relevant, has been accepted in Australia and in the Privy Council: *Consul Development v DPC Estates* ibid; *Royal Brunei Airlines v Tan* supra n 4.
8. *Re Diplock* [1948] Ch 465.
9. The distinction seems to have been overlooked in *Doneley v Doneley* [1998] 1 Qd R 603, where the court invoked the first limb of *Barnes v Addy* to impose a *proprietary* remedy on the recipients of trust property.
10. *Baden Delvaux v Société Générale Pour Favoriser le Développement du Commerce et de l'Industrie en France* [1993] 1 WLR 509, 575-576.

(1) actual knowledge;
(2) wilfully shutting one's eyes to the obvious;
(3) wilfully and recklessly failing to make such enquiries 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 enquiry.

The list is not free from difficulty. While categories (1), (4) and (5) describe states of knowledge, (2) and (3) appear to describe conduct in response to knowledge. Categories (2) to (5) are perhaps better understood as circumstances in which persons might be treated as if they had actual knowledge, even if they did not have it, and even if enquiries might not have revealed the facts.[11] In that sense, their knowledge is 'constructive'. In contrast to constructive knowledge, 'constructive notice' attributes to a person knowledge of facts that the person would have discovered had appropriate enquiries been carried out. Enquiries might have been warranted, either because of the circumstances of which the person had direct knowledge, or because of the accepted practices for enquiring into title when purchasing particular forms of property such as land.

The *Baden* list has also been used to distinguish between dishonesty (in the first three categories) and negligence (in the final two categories). However, it is quite unsuited to this task. For example, it would seem that further enquiry is needed to ascertain whether category (4) involves dishonesty. A person's failure to draw the appropriate inference from the facts known in category (4) may be due to 'moral obtuseness' or other reasons associated with dishonesty, or it may be attributable merely to negligence or foolishness.[12] Appropriately, the courts have begun to eschew the list when deciding issues of dishonesty.[13] However, because the courts have often referred to the list when promulgating one or other test of liability, it remains of some use at least as a means of identifying differences between the tests.

It is now possible to examine the different approaches to recipient liability and the authorities on which they are based. We do so by considering the three leading decisions of the Supreme Court of Western Australia.

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11. *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 295.
12. Contrast *Gertsch v Atsas* [1999] NSWSC 898, para 42, where Foster AJ equated the first four categories with dishonesty.
13. *Royal Brunei Airlines v Tan* supra n 4, 392; *Farrow Finance Company Ltd (in liq) v Farrow Properties Pty Ltd (in liq)* (1997) 26 ACSR 544, 586.

1. Actual or constructive notice

In *Ninety Five Pty Ltd (in liquidation) v Banque Nationale de Paris*,[14] the directors of the plaintiff company breached their fiduciary duty to it by using company funds to assist a third party to acquire shares in the company, contrary to section 67 of the Companies Act 1961 (WA). The funds were paid to the defendant bank to repay a loan made by the bank to the third party to enable it to purchase all the issued shares in the plaintiff. The bank was aware, through its manager, of the relevant facts, but failed to appreciate that the use of the funds in this way was improper. The plaintiff, through its liquidator, claimed against the bank for the amount of the company funds it had received on the basis that the bank was in knowing receipt of funds transferred by the directors in breach of trust.[15]

Smith J held that the recipient of misapplied trust property would be liable where it received the property for its own benefit[16] with actual or constructive notice that the property had been transferred in breach of trust. Relying on English and Australian authorities,[17] his Honour concluded that liability under this limb of *Barnes v Addy* depended 'not on dishonesty but on notice — which may be constructive notice — that is to say, liability can arise where the recipient does not know but ought to know'.[18]

In this case, the defendant knew all the relevant facts and ought to have realised that the directors' use of the company funds was in breach of their fiduciary duty. It was thus liable unless it could establish that it was a bona fide purchaser for value without notice. Again, the fact that the bank knew the relevant facts but failed to appreciate their legal significance precluded the bank from proving that it took without notice.

The rationale for this approach to personal liability was relatively clear. It flowed from the premise that a person who receives trust property becomes a trustee of that property, unless he or she is a bona fide purchaser for value without notice.[19] As a

14. [1988] WAR 132.
15. Directors are treated as if they are trustees of the company assets under their control, and their use of the assets for other than proper purposes of the company is regarded as a breach of trust: see *In Re Lands Allotment Co* [1894] 1 Ch 616, 631, Lindley and Kay LJJ 638; *Belmont Finance Corp Ltd v Williams Furniture Ltd (No 2)* [1980] 1 All ER 393, Buckley LJ 405; *Consul Development v DPC Estates* supra n 6, Gibbs J 396.
16. Different considerations apply where the person receives the property for the benefit or at the direction of another: see C Harpum 'The Basis of Equitable Liability' in P Birks (ed) *The Frontiers of Liability* (Oxford: OUP, 1994) vol 1, 9, 16-17.
17. *Belmont Finance Corp v Williams Furniture (No 2)* supra n 15; *Rolled Steel Products Ltd v British Steel Corp* [1986] Ch 246; *DPC Estates Pty Ltd v Grey and Consul Development Pty Ltd* [1974] 1 NSWLR 443, Jacobs J 459; *Consul Development v DPC Estates* supra n 6, Stephen J 410.
18. *Ninety Five* supra n 14, 174.
19. Ibid, 173, following *Lee v Sankey* (1873) LR 15 Eq 204, 211; *Nelson v Larholt* [1948] 1 KB 339; *Karak Rubber Co Ltd v Burden (No 2)* [1972] 1 WLR 602, 632; RP Austin

trustee in possession of the trust property or its traceable product, the recipient is subject to the personal and proprietary remedies that would be available against an express trustee. After the property has been disposed of, the proprietary remedies are no longer available, but the recipient remains personally liable in the same way as a trustee that has misapplied trust property. On this view, personal liability would complement proprietary remedies as a means of protecting equitable proprietary rights against all the world, except bona fide purchasers for value without notice.

An immediate difficulty with this explanation of recipient liability is that the test for liability does not correspond with the premise on which it rests. Most obviously, the knowledge of a volunteer recipient should, on this analysis, be irrelevant. A volunteer cannot ever fall within the exception of purchaser for value and would, therefore, always take the property on constructive trust.[20] More broadly, obtaining title to property in which another holds an equitable interest is usually regarded as enough to make the legal owner a trustee of that property,[21] unless the legal owner can discharge the burden of proving the defence of 'bona fide purchase for value without notice'.[22] Consequently, mere receipt of property, whereby the recipient obtains title, should be sufficient to attract the personal liabilities thought to flow from the status of trustee. On this analysis, the liability of the recipient should be strict, although subject to the defence of bona fide purchase.[23] Instead, the plaintiff is required to prove actual or constructive notice in all cases.

Further objections to this approach can be raised by challenging the correctness of the premise. For example, in *Westdeutsche Landesbank Girozentrale v Islington LBC*,[24] Lord Browne-Wilkinson rejected the assumption that a recipient of trust property is always a trustee of it unless a bona fide purchaser, stating:

> Innocent receipt of property by X subject to an existing equitable interest does not by itself make X a trustee despite the severance of the legal and equitable titles.

'Constructive Trusts' in PD Finn (ed) *Essays in Equity* (Sydney: Law Book Co, 1985) 196, 226.

20. It is notable that this test was developed in cases concerned with purchasers for value, where the issue of notice was undoubtedly relevant: P Millett 'Tracing the Proceeds of Fraud' (1991) 107 LQR 71, 82.
21. *Hardoon v Belilios* [1901] AC 118, Lord Lindley 123.
22. *Re Nisbet and Potts' Contract* [1906] 1 Ch 386; *US Surgical Corp v Hospital Products International Pty Ltd* [1983] 2 NSWLR 157, 258; RP Meagher, WMC Gummow & JRF Lehane *Equity: Doctrines and Remedies* 3rd edn (Sydney: Butterworths, 1992) 860. Uncertainty in allocating the burden of proof was evident in *Ninety Five* supra n 14, where Smith J required the plaintiff to prove that the defendant had notice and the defendant to prove that it did not.
23. Arguably, a defence might also be available under the Trustees Act 1962 (WA) s 75, by virtue of which a trustee who has acted honestly and reasonably may be excused from liability.
24. [1996] AC 669, 707.

In his Lordship's view, although the beneficiary may be able to enforce its equitable interest in the property in the hands of the innocent recipient, the recipient is not properly regarded as a constructive trustee unless it has sufficient knowledge that the property is trust property. However, it must be doubtful that this view, apparently at odds with long-standing principles, would be endorsed in Australia.[25]

Alternatively, one may question whether a person holding property on constructive trust always incurs personal obligations and liabilities identical to those of a trustee under an express trust.[26] Lord Millett has argued that 'a constructive trust does not necessarily attract personal obligations at all'.[27] Any personal obligations of a trustee depend on the circumstances by which the trustee came to hold the trust property, rather than on the mere existence of the trust.[28] This approach explains how it is possible for an innocent volunteer to hold property on constructive trust, but not incur 'the heavy burdens of trusteeship'[29] in the form of a personal liability to account for having disposed of that property.

In summary, the rationale for personal liability based on the defendant having held the property on constructive trust would require that liability should be strict, rather than dependant on notice of the breach of trust. However, it is questionable whether an inference of personal liability can, without more, be drawn from the recognition of a constructive trust. According to the second line of authority, to which we now turn, something further is required for personal liability to arise, namely 'unconscionability' on the part of the recipient.

2. Unconscionability

(i) Dishonesty

An insistence on showing a degree of fault on the part of the recipient can be found in *Lord v Spinelly*.[30] In that case, an employee stole funds from the plaintiff, her employer. Some of the funds were used to purchase household items for herself and her husband. The court[31] accepted that the husband could be held liable as the recipient of property transferred to him in breach of his wife's fiduciary duty to her

25. Among the criticisms, see P Birks 'Trusts Raised to Reverse Unjust Enrichment: The *Westdeutsche* Case' (1996) 4 RLR 3, 19-26; P Millett 'Restitution and Constructive Trusts' (1998) 114 LQR 399, 403-404; W Swadling 'Property and Conscience' (1998) 12 Trust Law Int'l 228.
26. HG Hanbury & JE Martin *Modern Equity* 15th edn (London: Sweet & Maxwell, 1997) 287.
27. Millett supra n 25, 403.
28. Ibid, 405.
29. *Re Diplock* supra n 8, 447-448.
30. (1991) 4 WAR 158.
31. Commissioner TE O'Connor QC.

employer, even though the husband did not actually know that she had stolen the money used to purchase the property. Without finally deciding the question, the court inclined to the view that liability could only be imposed on a defendant who had exhibited dishonesty or improbity. On the facts, the husband had accepted the wife's improbable story that the funds were gifts from her employer. He had deliberately shut his eyes to the more likely explanation as to how she had come by the money. In doing so, he had displayed sufficient 'want of probity' to warrant the imposition of personal liability to compensate the employer for any loss in the value of the assets received.[32]

The basis for this approach to recipient liability is most clearly stated in *Re Montagu's Settlement Trusts*,[33] on which the court relied. There Megarry V-C divorced the question of personal liability as a 'constructive trustee'[34] from the issue of whether a person takes property subject to some equity. In the latter case, where a defendant was required merely to restore property in its possession to the beneficial owner, it was appropriate to apply the rigours of the doctrine of notice. By contrast, a more cautious approach was warranted before imposing personal liability, since that could be more onerous. According to the Vice-Chancellor, the recipient's personal liability was equivalent to that of an express trustee and so included an obligation to make good any losses suffered by the trust or to account for any profits obtained from use of the trust property. In the Vice-Chancellor's view, this level of personal liability should only be imposed where the defendant's conscience was sufficiently affected at the time of dealing with the property. That required dishonesty, which could be established by showing that the recipient had one of the first three *Baden* categories of knowledge. Knowledge within categories (4) and (5) was not sufficient to impose personal liability because it did not normally involve improbity.

It is notable that on this approach there is no need to distinguish in principle between volunteer recipients and purchasers for value; in both cases, personal liability turns on improbity. Further, by identifying wrongdoing as the basis of the recipient's personal liability and treating 'knowing assistance' as the relevant analogy,

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32. The court's reasoning demonstrates how difficult it may be in a particular case to maintain the distinctions between the *Baden* degrees of knowledge. Having found that the husband took the property in circumstances in which an honest and reasonable person would have been put on enquiry — the fifth degree of knowledge — the court concluded that he must have been dishonest, because he made no enquiries. If this reasoning were routinely followed, then all five degrees of knowledge would satisfy a requirement of improbity.

33. Supra n 5, followed in *Cowan de Groot Properties Ltd v Eagle Trust Plc* [1992] 4 All ER 700; *Lipkin Gorman v Karpnale Ltd* [1987] 1 WLR 987 (recipient liability not discussed on appeal: [1991] 2 AC 548); *Eagle Trust Plc v SBC Securities Ltd* [1993] 1 WLR 484; *Bank of America v Arnell* [1999] Lloyd's Rep Bank 399.

34. The language of 'constructive trustee' was used by Megarry V-C to indicate that the recipient would be personally liable as if, and to the same extent as, a defaulting express trustee.

Megarry V-C foreshadowed a view that receipt and assistance were merely two forms of participation in a breach of trust and that dishonesty was the common test for liability. Following this lead, the court in *Lord v Spinelly*[35] adopted the view that the principles of liability should be the same whether the participation in the breach of trust took the form of assistance or receipt of trust property.

(ii) Actual or constructive knowledge

In its most recent decision on the issue, *Hancock Family Memorial Foundation Ltd v Porteous*,[36] the Supreme Court adopted a position that could be described as a compromise between the previous two tests. In that case, it was alleged that Hancock, the controlling director of the plaintiff companies, had misapplied their assets by making gifts to the defendant, who was at the time Hancock's wife. The plaintiffs claimed, among other things, that the defendant was liable for the value of the assets received by her under the first limb of *Barnes v Addy*. It was alleged that she had received the company assets, which were considered to be trust property in the hands of Hancock,[37] in circumstances where she knew or ought to have known that they were transferred to her in breach of Hancock's fiduciary duty to the company.

In the course of his judgment at first instance, Anderson J differentiated between the tests for recipient and accessory liability. His Honour held that, whereas 'dishonesty in an objective sense' is required for accessory liability, the first four categories of *Baden* knowledge, but not the fifth, would suffice for recipient liability:

> It is not necessary to establish that a recipient of trust property acted dishonestly or with want of probity. Recipient liability may be established if the defendant had actual or constructive knowledge at the time he received the relevant property that (a) it was trust property and (b) it was being misapplied. The defendant will be taken to have constructive knowledge if it is proved that he wilfully shut his eyes to the obvious; that he wilfully and recklessly failed to make such inquiries as an honest and reasonable man would make in the circumstances; and that he knew of circumstances which would indicate the true facts to an honest and reasonable man. If all that is proved is that the defendant had knowledge of circumstances which would put an honest and reasonable man on inquiry, that is not enough.[38]

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35. Supra n 30, 174.
36. (1999) 32 ACSR 124, affirmed [2000] WASCA 29.
37. On the basis that directors are trustees of the company assets under their control: see supra n 15.
38. [1999] 32 ACSR 124, 142. To similar effect, see *Belmont Finance Corp v Williams Furniture (No 2)* supra n 15, Goff LJ 412-413; *International Sales and Agencies Ltd v Marcus* [1982] 3 All ER 551, 558; *Linter Group Ltd (in liq) v Goldberg* (1992) 7 ACSR 580; *Equiticorp Finance Ltd (in liq) v Bank of New Zealand* (1993) 32 NSWLR 50, Kirby J 103. Contrast

In the final outcome, the question of knowledge did not prove to be significant. The court held that Hancock had committed no breach of duty as a director, in that the company funds were advanced by way of valid loans to Hancock, who in turn made gifts to the defendant.[39] In the absence of a breach of duty by the fiduciary, there could be no liability in the recipient, regardless of her knowledge of the facts.

Hancock v Porteous provides little guidance as to the rationale for the test of recipient liability adopted by the court. Anderson J was content to follow the reasoning and conclusions of Hansen J in *Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd.*[40] In that case, Hansen J accepted that one could justify different tests for accessory and recipient liability because they responded to different kinds of claim. Accessory liability was the equitable response to a wrong committed by the accessory, whereas recipient liability was a restitutionary response to the unjust enrichment of the recipient at the expense of the trust beneficiary.[41] However, while this reasoning may account for a difference between the tests for liability, it does not explain the particular test adopted for recipient liability. As Hansen J himself acknowledged, the unjust enrichment analysis warrants a different test in which liability is strict and knowledge is irrelevant, except for defences.[42] It is also evident that the unjust enrichment analysis played no explicit part in the cases upon which Hansen J relied as the sources of the test of constructive knowledge.[43] As a result, one is left without guidance from *Koorootang* on the rationale for the test.

It might appear that by rejecting the need for dishonesty and accepting the sufficiency of constructive knowledge, Anderson J was simply reverting to the position reached in *Ninety Five*. That interpretation, it is suggested, is unconvincing. The adoption of the language of knowledge, rather than notice, and the rejection of the sufficiency of the fifth category of knowledge, are inconsistent with the premise in *Ninety Five* that personal liability flows from the fact that the recipient had previously held the trust property on constructive trust. There is nothing in the test

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the decisions where the fifth degree of knowledge was regarded as sufficient: cf *Agip (Africa) Ltd v Jackson* [1991] Ch 547, Fox LJ 567; *El Ajou v Dollar Land Holdings* [1993] 3 All ER 717, 739-740; *Westpac Banking Corp v Savin* [1985] 2 NZLR 41, Richardson J 53, McMullin J 60; *Citadel General Assurance Co v Lloyds Bank (Canada)* [1997] 3 SCR 805.

39. This finding was confirmed on appeal by the Full Court, which therefore did not need to address the question of the test for recipient liability: see *Hancock v Porteous* supra n 36.
40. Supra n 4.
41. Ibid, 105. This analysis and its implications are discussed in more detail below: see infra pp 215-216.
42. Ibid, 100.
43. *Belmont Finance Corp v Williams Furniture (No 2)* supra n 15; *Rolled Steel Products Ltd v British Steel Corp* supra n 17; *DPC Estates v Grey and Consul Development* supra n 17, Jacobs J 459; *Consul Develoment v DPC Estates* supra n 6, Stephen J 410; *Ninety Five* supra n 14; *Westpac Banking Corp v Savin* supra n 38.

adopted in *Hancock* that is directed to determining whether the recipient ever held the property on trust.

It is perhaps more plausible to regard the *Hancock* test as a broadening of the reasoning in *Re Montagu* to encompass a wider range of circumstances in which the recipient's conduct can be said to have been sufficiently discreditable or unconscionable to warrant equitable intervention. That, however, does not explain why conduct falling short of dishonesty might suffice for recipient liability but not for accessory liability.[44] Ultimately, one is left without a satisfactory explanation for this test of recipient liability, beyond the lingering influence of earlier authorities such as *Ninety Five*, that were based upon a different model of recipient liability.

(iii) Rationalising the tests: liability for wrongful participation

In our view, it is legitimate to impose the full personal liabilities of a trustee on a recipient where the receipt can be characterised as an equitable wrong of participation in a breach of trust. This is possible if it is recognised that participation in a breach of trust can take various forms, such as inducing or procuring the breach, assisting in its perpetration or completing the breach by receiving the property.[45] Participation, in any of these forms, interferes in the proper relationship between trustee and beneficiary and can be regarded as an equitable wrong, broadly analogous to the tort of interference with contractual relations.[46] Where this interference is sufficiently culpable, the third party can be made liable in the same measure as the trustee who has committed the breach, since both contribute to the beneficiary's loss. The trustee is prima facie liable even if unaware that the action constitutes a breach,[47] but that strict approach is defensible on the ground that an express trustee has knowingly accepted the office. By contrast, the third party recipient's culpability should depend, in principle, on its knowledge of the breach, as such knowledge provides an opportunity to withdraw from the participation. However, actual knowledge should not be essential. Most obviously, a defendant should not be advantaged by its own dishonesty. Accordingly, a defendant should be treated as if it had actual knowledge if it failed to recognise or to enquire into

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44. Had Anderson J accepted the first four degrees of knowledge as sufficient for accessory liability, as suggested in *Consul Development v DPC Estates* supra n 6 and *Equiticorp Finance v Bank of New Zealand* supra n 38, 104, he might have maintained a common test for recipient and accessory liability. However, his Honour preferred to follow the 'objective dishonesty' test for accessory liability established in *Royal Brunei Airlines v Tan* supra n 4.
45. P Finn 'The Liability of Third Parties for Knowing Receipt or Assistance' in D Waters (ed) *Equity, Fiduciaries and Trusts* (Ontario: Carswell, 1993) 195.
46. *Royal Brunei Airlines v Tan* supra n 4, 387; *Dubai Aluminium Co Ltd v Salaam* [1999] 1 Lloyd's Rep 415, 451, 470 (reversed on appeal on other grounds [2000] EWJ 1947).
47. *National Trustees Co (Australasia) v General Finance Co (Australasia)* [1905] AC 373.

what an honest person in the circumstances would have perceived or investigated. It is more contentious whether a negligent defendant is sufficiently culpable. However, if it is thought appropriate in Australia to extend liability to accessories who have not been dishonest,[48] a similar extension would be warranted for recipients.

Although this approach may offer a more satisfactory explanation for imposing on a recipient liabilities that are commensurate with those of a defaulting express trustee, it offers remedies beyond that which a plaintiff usually seeks. It is rare to find a reported 'knowing receipt' case where the plaintiff has sought to impose on the recipient the burdens of trusteeship in the form of a liability to make good losses incurred by the trust or an account of profits from use of the trust property. Instead, the plaintiff generally seeks only the value of the assets received.[49] While this may be the same amount as the loss to the trust, it need not be so. Suppose an express trustee, in breach of trust, transferred shares to R at a time when the shares were valued at $1 000 and R sold them for that price. Suppose also that those shares are now worth $5 000. The express trustee would be liable to pay $5 000 to make good the loss caused by the breach of trust. Similarly, R could be made liable for that sum if a knowing participant in the breach. However, if the beneficiary were to seek only to make R liable for $1 000, the value of the shares received, there would be no need to establish that R was culpable as a participant for the loss, provided an alternative basis for liability could be established. It is here that the third view of liability becomes significant.

3. Strict liability

This view posits that the recipient is liable to make restitution of the value of the property received, in that the recipient has been unjustly enriched at the beneficiary's expense. The recipient is enriched whether or not it knew the property was transferred in breach of trust. Accordingly, the recipient's liability is strict, in that it is based simply upon receipt and not upon knowledge. Knowledge, or notice, is only relevant to defences such as change of position or bona fide purchase for value.

In no Western Australian case has it been suggested that the recipient could be made personally liable simply on the basis of receipt of the trust funds. It has been accepted that it is necessary to show that the defendant had some form of knowledge or notice that the funds had been transferred in breach of trust. Indeed,

48. *Consul Development v DPC Estates* supra n 6; *Equiticorp Finance v Bank of New Zealand* supra n 38, Kirby P 104.

49. In *Lord v Spinelly* supra n 30, the husband was liable for the depreciation in the value of the assets purchased by the wife with trust money, but this was equivalent to making the husband liable for the value of the assets as at the time of receipt.

in *Hancock v Porteous*,[50] Anderson J specifically excluded the possibility of liability arising in a case where the defendant received the trust property without knowledge of any kind that the property had been misapplied by the trustee.

This cursory rejection of the possibility of strict liability was somewhat surprising, given Anderson J's reliance upon the decision in *Koorootang*.[51] In that case, discussed briefly above, Hansen J conducted an extensive review of the principles and precedents in this area. His Honour concluded that there is 'considerable persuasion'[52] in the view that recipient liability is restitution-based and that the knowledge of the defendant should not be an element in the cause of action. In other words, recipient liability 'should be strict but subject to defences of bona fide purchase and change of position'.[53] Ultimately, Hansen J did not decide the case on this basis. The plaintiff had argued and proved that the defendant had constructive knowledge of the breach of trust, which Hansen J held was sufficient, if not necessary, to establish liability.

There is much to commend an approach whereby the recipient is liable for the value of the misappropriated property it receives unless it can establish a defence of change of position or bona fide purchase. In simple terms, it seems right that if the recipient has retained the benefit of an unauthorised transfer of another's property, that benefit should be restored to the other. In the example given above, if R still has the proceeds of the sale of the shares, or their traceable product, a proprietary remedy would be available. If R has spent the money on ordinary living expenses without obtaining a traceable asset, a proprietary remedy would no longer be available. Even so, R would effectively be better off through saving $1,000 that would otherwise have been drawn from other sources to pay for the ordinary expenses. A personal liability to pay the beneficiary the value of the property received would prevent R from obtaining a windfall through the fortuitous circumstance that the trust funds, rather than other assets, were used to pay for the ordinary expenses.[54]

A general rule of strict personal liability for unauthorised recipients of trust property would enhance consistency in the availability of equitable personal and proprietary remedies, in that both could be applied against a volunteer recipient without notice or knowledge. It would also accord with the position at common law

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50. Supra n 36, 149. Similarly, in *Linton v Telnet Pty Ltd* [1999] 30 ACSR 465, the NSW Court of Appeal proceeded on the basis that a recipient could not be liable in the absence of proof of some form of knowledge of the breach of fiduciary duty.
51. [1998] 3 VR 16.
52. Ibid, 100.
53. Ibid, 105.
54. D Nicholls 'Knowing Receipt: The Need for a New Landmark' in WR Cornish et al (eds) *Restitution: Past, Present and Future* (Oxford: Hart, 1998) 231, 237.

where the recipient of misapplied property is strictly liable to the legal owner.[55] If a trustee sues, perhaps at the instigation of a beneficiary,[56] to recover a mistaken payment of trust money, the knowledge of the recipient is irrelevant at common law except in relation to possible defences.[57] If equity adopted a strict liability approach to recipient liability, the position would be the same if the beneficiary proceeded to recover the payment directly from the recipient.

The recognition of strict liability for the value received would not preclude the retention of an alternative basis of liability for knowing participation in a breach by way of receipt of the trust property.[58] The recipient's knowing participation in the breach would warrant the imposition of the more onerous liabilities imposed on defaulting trustees, such as compensation for losses and accounting for profits. In practice, most plaintiffs would be likely to opt for the unjust enrichment claim with its corresponding restitutionary remedy.

Two principal obstacles stand in the way of the adoption of this strict liability approach. The first is that there is only slight authority to support it and much that is inconsistent with it, if not directly, then by implication. In supporting the case for strict personal liability in equity, Professor Birks[59] has relied on the House of Lords decision in *Ministry of Health v Simpson.*[60] In that final episode of the Diplock litigation,[61] the House of Lords established that persons entitled to be paid from a deceased estate, whether as creditors, beneficiaries or next of kin on an intestacy, could bring a personal claim directly against those to whom the estate had been wrongly distributed.[62] The liability of the recipients was strict. It did not depend on

55. The recipient of a mistaken payment is liable regardless of whether it realised the payment was made under mistake. Similarly, liability for conversion of another's property is strict.
56. The beneficiary can compel the trustee to pursue available remedies to recover trust property: see *Re Robinson* [1911] 1 Ch 502, 507-508.
57. Eg in *Gertsch v Atsas* supra n 12, the administrator of a deceased estate sued to recover moneys paid out of the estate by a person purporting to act as executor under a forged will. The moneys were recoverable by the administrator under a claim for money had and received. The knowledge of the recipients was relevant only to the defence of change of position, which succeeded in part.
58. P Birks 'Property and Unjust Enrichment: Categorical Truths' [1997] NZ Law Review 623, 653.
59. Birks supra n 3; P Birks 'Trusts in the Recovery of Misapplied Assets: Tracing, Trusts and Restitution' in E McKendrick (ed) *Commercial Aspects of Trusts and Fiduciary Obligations* (Oxford: OUP, 1992) 149.
60. [1951] AC 251.
61. The relevant provision in the will of Caleb Diplock had been held invalid in *Chichester Diocesan Fund and Board of Finance (Inc) v Simpson* [1944] AC 341. In *Re Diplock* supra n 8 the Court of Appeal settled the question of the proprietary remedies available to the next of kin against the charities to whom the estate had been wrongly, but innocently, distributed. *Ministry of Health v Simpson* was concerned only with those aspects of *Re Diplock* that dealt with the personal liability of the charities.
62. In fact, the recipients were required to pay to the judicial trustee to distribute to all the next of kin, but the precedents on which the court relied indicate that where all persons entitled are before the court, the court can order the recipients to pay the plaintiffs directly.

proof that they knew or ought to have known that they were not entitled to the property. However, it only arose after all claims against the executors had been exhausted.

The House of Lords reserved the question whether this principle applied outside the context of the administration of deceased estates.[63] The decision in *Re Montagu*[64] proceeded on the assumption that it did not. Birks, however, has argued that it is illogical to limit the principle in this way. In his view, there is no reason in principle for thinking that the 'common justice'[65] of a court should be available only in the context of deceased estates. The 'evil of allowing one man to retain what is really and legally applicable to the payment of another man'[66] might equally arise from a misapplication of property subject to an express inter vivos trust, or a resulting or constructive trust, and would warrant an equivalent response. The point seems to have been taken in several cases[67] where courts have accepted, in principle, that strict personal liability can be imposed on a recipient of property transferred in breach of any trust.

More broadly, there are signs of a growing judicial recognition that a restitutionary analysis of recipient liability is appropriate and that it requires the law to develop a rule of strict liability in equity, tempered by a defence of change of position. For example, in *El Ajou v Dollar Land Holdings*,[68] Millett J accepted the view that recipient liability was based on a restitutionary claim, although he did not adopt a strict liability test. Extra-judicially, Lord Millett has endorsed a test of strict liability for volunteer recipients.[69] In *Royal Brunei Airlines Sdn Bhd v Tan*,[70] Lord Nicholls supported the view that the liability is restitution-based, in contrast to accessory liability, which he regarded as fault-based. He too has developed his views extra-judicially, advancing a powerful case for strict liability for all recipients.[71]

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63. *Ministry of Health v Simpson* supra n 60, 266.
64. Supra n 5. The assumption is supported by Harpum supra n 16, 22-23. See also SJ Whittaker 'An Historical Perspective to the "Special Equitable Action" in *Re Diplock*' (1983) 4 Journ Leg Hist 3.
65. *Noel v Robinson* (1682) 1 Vern 90, Lord Nottingham 93.
66. *Harrison v Kirk* [1904] AC 1, Lord Davey 7.
67. *GL Baker Ltd v Medway Building and Supplies Ltd* [1958] 1 WLR 1216, 1220; *Eddis v Chichester Constable* [1969] 1 WLR 385, 391; *Re J Leslie Engineers Co Ltd (in liq)* [1976] 1 WLR 292, 299; *Butler v Broadhead* [1975] Ch 97, 107-108; *Ron Kingham Real Estate Pty Ltd v Edgar* [1999] 2 Qd R 439, Davies JA 440. See also *Hagan v Waterhouse* (1991) 34 NSWLR 308, 369-370.
68. Supra n 38. To similar effect, see *R v Equiticorp Industries Group Ltd* [1996] 3 NZLR 586, 604.
69. Millett supra n 20.
70. Supra n 4, 386. In *Hancock v Porteous* supra n 36, Anderson J relied on the conclusions in *Royal Brunei Airlines v Tan* regarding accessory liability, but made no reference to the views expressed by Lord Nicholls as to recipient liability.
71. Nicholls supra n 54, 231.

In Australia, the only explicit judicial support is to be found in the judgment of Hansen J in *Koorootang*, where it was clearly obiter. In *Macquarie Bank Ltd v Sixty-Fourth Throne Pty Ltd*,[72] the Victorian Court of Appeal at least acknowledged the argument for strict liability, although it did not need to resolve the debate. Thus, while the strict liability approach is far from established in Australia, it is clear that it cannot be ignored.

The second objection to the unjust enrichment analysis concerns the proper classification of the relevant cause of action in recipient liability cases. The argument is that where, after receipt, the plaintiff retains the equitable interest in the asset, there is no relevant 'enrichment of the defendant at the plaintiff's expense' and so the action cannot be based on unjust enrichment. Instead, the receipt of property in which the plaintiff retains an equitable proprietary interest should be regarded as a wrong, for which the recipient is personally liable.[73] By analogy with the common law proprietary torts,[74] personal liability for this equitable 'proprietary wrong' should be strict.

The significance of this problem of classification lies not with the issue of strict liability, which arises under both the unjust enrichment and the 'proprietary wrong' approaches. Rather, it lies in other consequences that might depend upon classification of the relevant cause of action. The first is that if the measure of recipient liability is analogous to that for proprietary torts, then liability may extend beyond the amount initially received to include consequential gains[75] or losses.[76] If so, then in practice the liability of a recipient, however innocent, would be similar to that of a defaulting express trustee. The second main consequence relates to the availability of defences. In particular, it is said that the change of position defence is exclusive to the law of unjust enrichment and, accordingly, does not apply to claims arising out of torts or equitable wrongs.[77]

This objection, and its corresponding consequences, might be met in various ways. First, it has been argued that it is sufficient to establish a claim in unjust enrichment that the recipient obtained a benefit in a factual sense, even if it did not obtain beneficial title.[78] The second response may be to question whether the

72. [1998] 3 VR 133, Tadgell JA 157, with whom Winneke P agreed.
73. W Swadling 'Some Lessons from the Law of Torts' in Birks supra n 16, 41.
74. Trespass, conversion and, in Western Australia, detinue.
75. By way of restitution for wrongs.
76. Again by analogy with the tort of conversion.
77. Swadling supra n 73, 47, notes that change of position has never been a defence to the tort of conversion. In *Lipkin Gorman v Karpnale* supra n 33, 580, Lord Goff expressly stated that the defence is not available to a 'wrongdoer'. On the significance of fault on the part of the recipient, see R Nolan 'Change of Position' in P Birks (ed) *Laundering and Tracing* (Oxford: OUP, 1995) 135, 151-158.
78. Birks supra n 58, 654.

common law and equity protect (or should protect) proprietary interests in the same way. Strict personal liability may be necessary under the common law proprietary torts because there is no other means by which the common law protects property rights, whereas other means are available in equity. Hence, the direct analogy with the proprietary torts may simply be inappropriate. In any event, it can be questioned whether it would be right to follow the common law example and deny a defence of change of position where the claim is brought for commission of an equitable proprietary wrong.[79]

Whether an unjust enrichment or proprietary wrong analysis is adopted, it seems inevitable that plaintiffs will invoke strict liability at least as an alternative to the traditional 'knowing receipt' claims. Courts throughout Australia and elsewhere will need to consider arguments for and against its adoption of the kind made above.[80] In Western Australia, the debate should also take into account the fact that strict liability already exists under section 65 of the Trustees Act 1962 (WA). It is necessary, therefore, to examine the extent of that liability and its implications for liability under the general law.

STATUTORY LIABILITY: TRUSTEES ACT 1962

1. Outline of section 65

In essence, section 65 provides a remedy for those entitled to receive trust property in circumstances where the trustee has distributed the property to someone else. The remedy takes the form of an order that the person who has received the property pay a sum not exceeding the value of the asset received. Liability is strict in the sense that it is imposed whether or not the recipient knew or ought to have known of the plaintiff's interest in the property. However, a defence is available where the defendant has so altered its position in reliance on having an indefeasible interest in the assets received that it would be inequitable to grant relief in whole or in part.

A major difficulty lies in determining the range of cases to which section 65 applies. It was introduced as part of a scheme designed to enable executors and trustees to distribute deceased estates and trust property[81] as soon as possible, without having to wait for all possible claims to the property to materialise.[82] Trustees

79. Nicholls supra n 54, 237-238.
80. In *Sixty-Fourth Throne Pty Ltd v Macquarie Bank Ltd* M101/1997, the High Court was invited to review the law regarding 'knowing receipt.' The court refused leave to appeal.
81. For convenience, in the remaining discussion of s 65 reference is made only to trustees and trust property.
82. WA Law Reform Committee *Report on the Law of Trusts* (Perth, 1961). Similar reforms, in more limited terms, appear in the Trusts Act 1973 (Qld) s109 and Administration Act 1969 (NZ) s49.

who followed specified procedures for identifying creditors or beneficiaries would be protected against latent claims that emerged after the distribution, while the late claimants would have recourse against the recipients of the property. However, while the principal concern may have been to ensure the availability of a remedy for claimants who were prejudiced by a distribution for which the trustee enjoyed statutory protection,[83] it is clear that the section goes beyond cases where the trustee has acted properly. As section 65(7) makes evident,[84] it also operates in cases where the trustee may still be liable to the claimant as a result of a wrongful distribution. What is not clear is whether this includes all misapplications of property by trustees or other fiduciaries.

Resolution of that issue will have a major bearing on the debate about recipient liability in Western Australia. Given a broad application, the section would make redundant the argument for strict liability under the general law. However, even if applied more narrowly, the very existence of the statutory regime may support the adoption of analogous strict liability in equity. Moreover, two aspects of the statutory regime, namely the defence of change of position and the order for exhausting remedies, apply whenever a trustee has made a distribution of trust property, regardless of whether a remedy is sought under section 65 or in equity or otherwise. It is necessary, therefore, to examine the scope and operation of the section in more detail.

2. The plaintiffs

The remedy is available to plaintiffs in three classes of claims:

(1) an application under the Inheritance (Family and Dependants Provision) Act 1972 (WA) (the 'Inheritance Act');
(2) a claim to which section 63 of the Trustees Act applies; and
(3) a claim by a person to be a beneficiary under the will, or to be entitled on the intestacy, of a deceased person, or to be beneficially interested under a trust.

Under the Inheritance Act, a court may order that provision be made out of the deceased estate for specified persons[85] for whom inadequate provision had been made by will or the intestacy laws.[86] In the usual case, the personal representative will then distribute the estate as if the order formed a codicil to the will or an amendment to the intestacy law.[87] However, where some or all of the deceased estate has already

83. WALRC, ibid, 27.
84. S 65(7)(b) provides that a person shall not exercise any remedy that may be available to him against the trustee in consequence of the making of the distribution until he has exhausted all other remedies available to him. See infra pp 228-229.
85. S 7.
86. S 6.
87. S 10.

been distributed among the persons otherwise entitled under the will or intestacy, the court may make orders under section 65 of the Trustees Act against the recipients in favour of the persons for whom provision should have been made. It appears that the prior distribution to those entitled under the will or intestacy rules may or may not have involved actionable fault on the part of the personal representative. Whereas the Inheritance Act specifically excludes liability for a distribution made without notice of any actual or intended application under that Act,[88] a personal representative would generally[89] be at fault for distributing the estate without regard to a known pending or intended claim under the Act.

Section 63 of the Trustees Act applies to claims by creditors[90] against a deceased estate or trust property or claims against the trustee personally, in respect of which the trustee is entitled to reimbursement out of the estate or trust property.[91] The section allows a trustee to require, by advertisement, that creditors with such claims notify the trustee. Thereafter, a trustee that distributes the relevant property will not be liable to any creditors that have not given notice of their claims. Of course, a trustee that does not advertise at all for creditors, advertises in a way that fails to meet the requirements of section 63, or distributes the property without regard to the claims of creditors that have given notice, may still be liable to the creditors thereby prejudiced. However, whether the trustee is liable or not, the creditors may pursue a claim under section 65 against those to whom the trust property was distributed.

The third category of claim under section 65 is where a person claims to be entitled under a will or intestacy, or to be beneficially entitled under a trust. A trustee that has distributed the property to someone else may or may not have committed a breach of trust for which the trustee would be liable to the person entitled to the property. Normally, a trustee commits a breach of trust by appointing trust property to the wrong person, even if the appointment was made in good faith and on legal advice.[92] However, the trustee may have acted with the authority of a court order[93]

88. S 20(1).
89. There are exceptions to this proposition: s 11(1) of the Act specifically exempts the personal representative from liability in cases where distribution to dependant beneficiaries is immediately necessary, and other exceptions can probably be made out: see AF Dickey *Family Provision after Death* (Sydney: Law Book Co, 1992) 178-179.
90. Claims under the Inheritance Act and those claiming to be entitled under the will or trust or by virtue of intestacy law are specifically excluded by s 63(10).
91. S 63(9). The trustee is entitled to be reimbursed out of the trust fund for all expenses properly incurred in the execution of the trust: see *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360, 371. The trustee may also be entitled to an indemnity from the beneficiaries, where there is insufficient trust property: see *Hardoon v Belilios* supra n 21. See further *Ron Kingham Real Estate v Edgar* supra n 67.
92. *National Trustees Co v General Finance Co* supra n 47.
93. Eg under Trustees Act s 66.

or in circumstances where the trustee's breach would be excused by a court.[94] Again, the claimant may seek a remedy under section 65 against the recipient, whether or not the trustee might also be liable.

3. The defendants

Liability under section 65 may be imposed upon a person to whom assets were distributed by the trustee[95] (a 'primary recipient') or any person who received from a primary recipient any interest in any assets distributed by the trustee (a 'secondary recipient').[96] However, such an order is not available against a secondary recipient who received the interest in good faith and for valuable consideration.

4. The remedy

The court may order the recipient to pay to the claimant a sum not exceeding the value of the interest or assets received. In most cases, this will simply be the amount of money received and would seem to exclude an award of interest. If the assets are non-monetary, it is unclear at what time the assets or interest should be valued. The natural sense of the section would suggest that the defendant would be liable for the value of the assets at the time they were received.[97] However, it is arguable that if the recipient has since sold the assets, the court should accept the sale price as the value of the assets; and, if the recipient still holds the assets, their value might be assessed as at the time of judgment. In this way, the recipient would be protected from a fall in the value of the assets, without having to resort to a change of position defence. It would also prevent the recipient from obtaining a windfall through the appreciation of the asset.[98]

5. Distribution

Importantly, the statutory regime only applies where the trustee has *distributed* trust assets.[99] What is meant by 'distributed' or the cognate expression 'made a distribution'? In the context of a provision relating to trusts and deceased estates, 'distribution' obviously includes the transfer of property to the persons entitled

94. Under Trustees Act s 75.
95. S 65(3)(a).
96. S 65(3)(b). It is unclear whether an action is available against a secondary recipient under *Ministry of Health v Simpson* supra n 60: see R Goff & G Jones *The Law of Restitution* 5th edn (London: Sweet & Maxwell, 1998) 703.
97. The New Zealand equivalent specifies that the value is at the date of distribution: Administration Act 1969 (NZ) s 49.
98. This objective is consistent with s 65(7) which prevents the recipient from obtaining a windfall. See infra pp 228-230.
99. S 65(1).

under the trust, will or intestacy.[100] Section 8 of the Inheritance Act confirms this sense when it provides that:

> The court may make an order under section 65 of the Trustees Act 1962 ... where the estate of the deceased ... has been distributed *among the persons entitled under the will or intestacy.*

'Distribution' should not, however, be confined to appointments to persons with existing, although defeasible, entitlements. It should at least include a transfer of property to those who merely *appear to be entitled.* The word is used in this sense, for example, in section 132(1) of the Adoption Act 1994 (WA) which provides that:

> A trustee ... may ... distribute property to or among the persons *appearing to be entitled* to the property without having ascertained whether or not an adoption order has been made which may affect a person's entitlement to an interest in the property.

On this interpretation, section 65 would also be available where the plaintiff successfully disputes the apparent claim of the recipient and establishes a better claim to the property. For example, the next of kin may succeed in a claim to be entitled to part of a deceased estate on account of the invalidity of the relevant provisions of the deceased's will.[101] In such cases, the beneficiaries named in the will are in effect strangers to the deceased estate. Nevertheless, they would be liable under section 65 if the executors had already transferred the property to them: it would have been a distribution to persons appearing from the will to be entitled to the property.

It is arguable that 'distribution' may also extend to cases where the trustee appoints trust property to persons with no apparent eligibility or entitlement to receive it. Suppose a will directs that the testator's property be divided among his sons, but the executor divides the property among the testator's sons and daughters, or even among the daughters alone. In either case, there would clearly be a wrongful distribution, but one could still properly describe it as a distribution. This suggests that the term 'distribution' simply refers to the process of handing over or transferring the trust property and makes no assumption as to whether the trustee has acted properly in doing so. In the words of Swinfen Eady J: 'To distribute means to pay over.'[102] Consequently, the statutory regime would apply even against a stranger to

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100. See eg Administration and Probate Act 1929 (ACT) s 5: '"Distribute" means to pay, deliver, or divide the estate or property referred to, to or among the person or persons entitled under any intestacy or under any will.'
101. As in *Chichester Diocesan Fund v Simpson* supra n 61.
102. *Scrimgeour v Mackinlay* (1911) 56 Sol J 142.

whom the trustee made a gift in deliberate breach of trust.[103]

However, a transfer by a trustee for valuable consideration would not be described as a distribution since bounty, rather than bargain, is essential to the meaning of 'distribution' in this context. A trustee that properly invests trust moneys in an asset does not 'distribute' the trust fund to the vendor of the asset. Similarly, a trustee that fraudulently cashes cheques drawn on a trust account and then uses the cash for its own purposes[104] would not be described as having made a distribution to the person cashing the cheques. This distinction helps to explain why there is no exclusion under section 65(3)(a) of primary recipients who have received assets in good faith and for valuable consideration: they could not be liable under the section simply because they are not persons to whom assets were 'distributed'. By contrast, an exception is made for bona fide purchasers for value under section 65(3)(b), as that subsection deals with secondary recipients who are not the persons to whom a distribution was made.

6. Application of section 65 beyond express trusts and deceased estates

It is important to decide the extent to which section 65 can be applied beyond cases involving express trustees and personal representatives. 'Knowing receipt' claims have often arisen in relation to misappropriations by company directors or other fiduciaries, and the question arises whether the strict liability arising under section 65 is available in these contexts.

(i) Directors

It is common to refer to company directors as trustees of company assets under their control.[105] Further, the general law treats a misuse of company funds by a director as a breach of trust for the purposes of imposing personal liability on a recipient or accessory under the rule in *Barnes v Addy*.[106] However, it is doubtful that section 65 can be extended to any distribution of company funds contrary to the director's fiduciary duties. In *Metcalf v Permanent Building Society*,[107] the Full

103. It is unclear whether the personal remedy in *Ministry of Health v Simpson* supra n 60 would be available if an executor gave estate assets to a stranger in deliberate disregard of the will or intestacy rules. The House of Lords only addressed the case of a good faith distribution to persons apparently entitled under the will.
104. As in *Nelson v Larholt* [1948] 1 KB 339.
105. See eg *Great Eastern Railway Company v Turner* (1872) LR 8 Ch App 149, Lord Selborne LC 152; *Re Forest of Dean Coal Mining Company* (1878) LR 10 Ch D 450, Lord Jessel MR 453; *Mulkana Corporation NL (in liq) v Bank of NSW* (1983) 8 ACLR 278, 283-285.
106. As in *Ninety Five* and *Hancock v Porteous*, discussed supra pp 209, 213.
107. (1993) 10 WAR 145.

Court of the Supreme Court of Western Australia held that directors, whether of a building society or of a company, were not to be regarded by virtue of their office as trustees for the purposes of the Trustees Act:

> [The definition of 'trust' in section 6] refers to a trustee as known to the law; a person in whom property is vested subject to the beneficial interest of a cestui que trust and the duties imposed on the trustee which arise out of that relationship. Those duties and obligations are greater than those imposed by the law upon a mere fiduciary. The circumstances in which the court will grant a remedy against a trustee will not necessarily be the same as those in which a remedy will be available against a fiduciary.... [The appellants argue] that the position of a director may in some respects be equated with that of a trustee. For the purpose of a statutory definition in the Trustees Act, that does not make it so.[108]

The court concluded that a director was unable to rely on the protection afforded to trustees by section 75 of the Trustees Act. Although it is possible for the terms 'trust' and 'trustee' to have different meanings within the same Act,[109] the reasoning in *Metcalf* suggests that a director, or any other fiduciary in whom property is not vested, would equally be unable to invoke the protection for trustees in section 65(7). More broadly, it suggests that those with claims to company funds could not proceed against recipients under section 65 since there will have been no distribution by a trustee.[110]

(ii) Trustees in bankruptcy and liquidators

Trustees in bankruptcy and liquidators do have property vested in them and are subject to duties similar to those of trustees. However, they are not strictly trustees for the creditors or contributories[111] and are unlikely to be regarded as trustees for the purposes of the Trustees Act on the approach taken in *Metcalf*. In any event, section 65 would not apply in favour of a creditor who failed to prove a debt before the distribution was made by the trustee in bankruptcy or liquidator. A claim under section 65 is excluded if there is anything in any Act to prevent a distribution from being disturbed,[112] and section 144 of the Bankruptcy Act 1966 (Cth) clearly contains such a provision:

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108. Ibid, Murray J 167, with whom Rowland and Seaman JJ agreed. See also *Jalmoon Pty Ltd (in liq) v Bow* [1997] 2 Qd R 62, Pincus JA and Helman J 72-73: 'Relief under [the equivalent Queensland] provision ... is not available to a mere fiduciary, not being a trustee within the definition in ... the Act.'
109. The definition in s 6 applies unless the context requires otherwise.
110. On this view, s 65 could not have been applicable in *Ninety Five* or in *Hancock v Porteous*.
111. *Knowles v Scott* [1891] 1 Ch 717.
112. S 65(1).

> A creditor who has not proved his or her debt before the declaration of a dividend is entitled to be paid, out of any available money for the time being in the hands of the trustee, dividends that he or she has failed to receive before that money is applied to the payment of a future dividend, but he or she is not entitled to disturb the distribution of a dividend declared before he or she proved his or her debt.

Similarly, in the case of a company liquidation, the Corporations Law provides for the exclusion from the distribution of creditors who fail to prove their debts before the distribution.[113]

(iii) Resulting and constructive trustees

Since the term 'trust' in section 65 extends to implied and constructive trusts, unless the context otherwise requires,[114] a claim to be beneficially entitled under a resulting or constructive trust would appear to fall within the third category of permissible claimants under section 65. If the person holding property on the resulting or constructive trust has disposed of it, other than for valuable consideration, it might be said that the property had been distributed by a trustee, so that the recipient would prima facie be liable under section 65. Hence, notwithstanding *Metcalf*, if a fiduciary obtained title to property in circumstances where equity would impose a proprietary constructive trust[115] and then gave it away, the recipient could be liable under section 65. Indeed, if a thief holds stolen property on constructive trust for its true owner,[116] a claim might be available under section 65 against the recipient of the stolen property. It may be, however, that this argument extends the use of the term 'distribute' too far, removing from it the sense of a trustee at least purporting to exercise a dispositive power derived from the office of trustee. Accordingly, it is more likely that the section would be confined in its operation to express trustees and personal representatives.

7. The order for making claims

Section 65 does more than provide a remedy for the plaintiff. It creates an important protection for the trustee who has made the distribution, by imposing an order for pursuing remedies under which any action against the trustee is made a

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113. Corporations Law s 485. In *Butler v Broadhead* supra n 67, 109, the court relied on a similar provision, the Companies (Winding up) Rules 1949 (UK) r 106, to refuse a late claim by a creditor against the contributories of a liquidated company to whom the surplus assets had been distributed.
114. Trustees Act s 6(1).
115. Eg in *A-G (Hong Kong) v Reid* [1994] 1 AC 324.
116. *Black v S Freedman & Co* (1910) 12 CLR 105, O'Connor J 110.

last resort.[117] Section 65(7) makes it clear that the plaintiff is not required to exercise any rights and remedies against the trustee before pursuing other remedies. Indeed, the plaintiff may not exercise any remedy against the trustee in consequence of making the distribution until all other available remedies have been exhausted. The other remedies would obviously include a proprietary remedy against the primary recipient or some other person into whose hands the property can be traced and a personal remedy against primary or secondary recipients under section 65. Further, it would apparently include a personal remedy against any person liable as an accessory to the breach. It would make no difference that the trustee was equally complicit in a fraudulent distribution; the remedy against the accessory would need to be exhausted first.

Importantly, this new order for exhaustion of remedies is not only mandatory in cases where the plaintiff seeks or would have a remedy under section 65. It is the rule for all actions arising from a distribution by a trustee of trust assets. Hence, if removal from office is regarded as a remedy against a defaulting trustee, then the plaintiff cannot seek even that redress until all remedies available against other parties have been exhausted.

The most obvious impact of this provision is that it reverses the rule in *Ministry of Health v Simpson*. In that case, the next of kin's personal claim[118] against the wrongly paid recipients was conditional on the prior exhausting of all remedies against the executors. This did not require pursuing the executors to judgment. Rather, a settlement was reached under which a small part of the wrongly distributed estate was recovered from the executors and the recipients were responsible for the rest. The rule raised the prospect of the recipients retaining a windfall, to the extent of recovery against the executors, whenever the executors were also unable to recover from the recipients, such as where they had paid under a mistake of law.

The section also affects the choice of remedies otherwise available outside the context of deceased estates. Equity has generally allowed beneficiaries who suffer loss several options. They could pursue available remedies directly against recipients or other third parties involved in the breach, or they could recover from the defaulting trustees, leaving the trustees to pursue the recipients or other third parties. Alternatively, the beneficiaries could proceed concurrently against the trustees, recipients and other third parties. In such a case, the court might designate the order in which liability would arise. For example, in *Eaves v Hickson*,[119] trustees were induced to distribute property to five children, who would have been eligible only if

117. It is this aspect of the section that explains the inclusion of s 65 within Part VI of the Trustees Act, headed 'Indemnities and Protection of Trustees, etc.'

118. Exhaustion of remedies against the executors is not a prerequisite for the proprietary remedy available against the recipients: *Hagan v Waterhouse* supra n 67, 370.

119. (1861) 30 Beav 136.

legitimate, on the strength of a forged document that falsely indicated their legitimacy. The document had been forged and tendered by the children's father. Sir John Romilly MR ruled that the children were each liable to repay the sums they had received; that the father was liable to pay so much of the trust fund as was not recovered from the children; and that the trustees were liable for any deficiency not recovered from the other defendants. The apparent policy was, first, to prevent the children from obtaining a windfall; and, thereafter, to attribute responsibility for any remaining loss according to the culpabililty of those responsible. The fraudulent father was thus liable ahead of the duped trustees. While section 65(7) does not prescribe an order for exhausting remedies as between recipients and other third parties who may have been involved in the breach, nor affect the order in which their liability might be designated, it does require that the remedies against the trustee be placed last in the line.

In our view, the provision provides excessive protection to trustees. It appears to have two objectives. First, it seeks to prevent a recipient retaining a windfall gain at the expense of the trustee. Secondly, it confines the liability of trustees to losses that are irrecoverable from other parties. We believe the first objective is better met by ensuring that the trustee is able to recover from the recipients in all appropriate cases. Removal of obstacles such as the bar on recovery for distributions made under mistake of law[120] has aided that cause. So far as the second objective is concerned, section 65(7) protects even a dishonest or grossly negligent trustee. If the trustees in *Eaves v Hickson* had been aware that the document was a forgery, it is doubtful that their liability would have been postponed to that of the father. Yet under section 65(7), even the dishonest trustee obtains protection, so that remedies against an accessory must be exhausted first. We think it would be preferable simply to eliminate any requirement for exhaustion of remedies.[121]

8. The significance of section 65 to recipient liability under the general law

The most obvious impact of section 65 on recipient liability is that some of the cases decided under the general law in other jurisdictions would be decided differently in Western Australia. For example, *Re Montagu's Settlement Trusts*[122] involved the

120. Property Law Act 1969 (WA) s124.

121. As provided for in Administration Act 1969 (NZ) s50. Under Trusts Act 1973 (Qld) s109(2), a court has power to dispense with the requirement to first exhaust the remedies against the trustee. In *Ron Kingham Real Estate v Edgar* supra n 67, it was not necessary to exercise the power, as any action against the insolvent trustee would have been fruitless.

122. Supra n 5.

wrongful distribution of chattels from an inter vivos trust. The recipient was excused from liability because he had acted innocently in taking the chattels to which he was not entitled. He either never knew, or else had forgotten, the precise terms of the trust, and was under no obligation to make inquiries as to his entitlement. Had the case been governed by section 65, the recipient's innocence would have been no defence to a claim for the value of the chattels he received.[123]

Section 65 also affects the debate about recipient liability under the general law in that it overcomes the objection that strict liability must be confined to the context of the administration of deceased estates. Indeed, the equal treatment in section 65 of claims arising under estates and those under inter vivos trusts confirms the view that, on the merits, if not the authorities, there is no reason to distinguish between them.

The section also demonstrates how strict liability for the value of property received can co-exist with the more stringent requirements and more onerous remedies that seem to apply to a wrongful participant in a breach of trust.[124] It gives the plaintiff a choice whether to seek payment of the value of property received or to pursue the potentially wider remedies available against a dishonest recipient under the general law. In either event, the plaintiff is subject to the restrictions on exhausting remedies and the statutory defence of change of position. The section also manages to impose personal liability without resorting to the language of constructive trusts.

Opinions may differ as to whether section 65 constitutes a reason for or against developing the general law to impose strict liability in receipt cases falling outside the statutory regime. If the *Metcalf* reasoning confines section 65 to cases of trusts in the strict sense, the different treatment of trustees as compared to other fiduciaries might warrant corresponding differences between recipients. Against that, it can be argued that no such distinction between recipients is currently made in the context of the *Barnes v Addy* rules nor in the availability of equitable proprietary remedies. Historically, equity has simply extended the remedies available against those who receive property misapplied by trustees to those who receive from other fiduciaries. Hence, if the legislature has seen fit to impose strict liability upon recipients from trustees, the courts might follow that lead and extend that liability to recipients from other fiduciaries. This would not necessarily require an extension to other fiduciaries of the statutory rule for the exhaustion of remedies: consistently with *Metcalf*, this protection might be confined to trustees in the strict sense.

123. It is not clear from the facts whether the recipient would have been able to establish a defence of change of position under s 65(8) or limitation under s 65(5) and (6).

124. In *Re Diplock* supra n 8, the Court of Appeal acknowledged the possibility of a similar two-tier liability, with a higher level of liability for knowing recipients.

CONCLUSION

Although the precise scope and operation of section 65 of the Trustees Act remains to be settled, it is clear that it establishes in Western Australia a regime of strict personal liability for recipients of misapplied trust funds in a substantial range of cases. It is arguable that in this jurisdiction the existence of the statutory regime enhances the arguments advanced elsewhere for recognising a wider equitable cause of action in which a recipient of misapplied trust property is strictly liable for the value received, subject to defences of change of position and bona fide purchase. Even so, knowledge on the part of a recipient may continue to be relevant, not only to defences, but also in establishing a separate cause of action with a more onerous measure of liability. Where the recipient has acted with sufficient cognisance of the breach of trust that its behaviour can be characterised as dishonest, it is appropriate to impose the full measure of personal liability to which the defaulting trustee and other dishonest participants in the breach are liable.