

Recovery of Misappropriated Trust Money From Third Parties: Knowing Receipt and the Law of Restitution

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I Introduction

A strength of the law of restitution is that it provides a means to reconsider existing rights and remedies. One area that restitution lawyers are turning their attention to, is the recovery of one's money from a third party. Two claims in particular - the common law claim of 'money had and received' and the equitable claim of 'knowing receipt', are attracting their attention.

Assume that I steal your money and give it to another - the 'third party'. Through the medium of money had and received you may be able to recover the value of the money from the third party. The knowing receipt claim also facilitates the recovery of money from a third party, but in slightly different circumstances. This is when the 'thief' is a trustee, the money is misappropriated trust money, and the plaintiff is the beneficial owner.

Notwithstanding this general similarity, these claims operate in different ways. The focus of money had and received is on the third party's receipt of the plaintiff's money. The third party's knowledge is relevant only for determining the availability of defences, such as change of position. Subject to defences, a successful claim culminates in an order that the third party repay the value of the plaintiff's money actually received.

Turning to the knowing receipt claim, while there is disagreement as to the state of knowledge that a third party must have, the orthodox view is that knowledge is a prerequisite. The extent of the third party's potential liability is also different. A number of successful claims have resulted in an obligation to repay the value of the trust money so received.¹ But this is the minimum liability; the claim may culminate in the imposition of "the full burdens of trusteeship"² upon the third party and the punitive remedies associated with defaulting trustees.

Restitution lawyers are asking 'why are these claims different?' An answer that Professor Birks has given is, "because of the the immaturity of the law of restitution".³

Underlying this answer is the belief that knowing receipt is a restitutionary claim and that the motivation of the courts is to address the otherwise unjust

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¹ The New Zealand banking cases, such as *Westpac Banking Corporation v Savin* [1985] 2 NZLR 41 (CA), *Lankshear v ANZ Banking Group (New Zealand) Limited* [1993] 1 NZLR 481, *Westpac Banking Corporation v Ansell* (1993) 4 NZBLC 103,259 (CA) and *Anderson v Chilton and Bank of New Zealand* (1993) 4 NZBLC 103,375, are examples.

² *Re Montagu's Settlement Trusts* [1987] 2 WLR 1193 at 1200 per Sir Robert Megarry.

³ Peter Birks "Misdirected funds: restitution from the recipient" [1989] 3 LMCLQ 296 at 296.

enrichment of the knowing recipient.⁴ This belief appears to be the product of three influences. First, the recognition by their Lordships in *Lipkin Gorman v Karpnale Limited*⁵ that when money had and received is employed to recover stolen money from a third party, it is “founded” upon the principle of unjust enrichment.⁶

The second influence is the similarity between money had and received and knowing receipt - both deal with money received by a third party. Indeed, in *El Ajou v Dollar Holdings Plc* Millett J described knowing receipt as “the counterpart in equity of the common law action for money had and received.”⁷

The third influence is the wish of some restitution lawyers to unify common law and equity. Professor Birks has gone so far as to suggest that a belief in this unity is an “article of faith” of restitution lawyers.⁸

Returning to the belief that knowing receipt is restitutionary, the underlying assumption appears to be that if money had and received is restitutionary, so too must knowing receipt be. Proceeding from this assumption, proponents of a restitutionary rationale suggest that the present differences between knowing receipt and money had and received constitute an “indefensible inconsistenc[y]”⁹ which has arisen because, when considering knowing receipt, “neither judges nor jurists have been able to see a clear view of the nature and the rationale of the recipient’s liability”.¹⁰

The application of a restitutionary analysis to knowing receipt is intuitively attractive. Not only does the receipt of the trust money appear to constitute a clear enrichment but the traditional knowledge requirement (what ever that may be) appears to show that it is unjust for the knowing recipient to retain the trust money. Advocates of the restitutionary rationale, however, seek to do more than just bring this claim within a ‘restitution for wrongs’ category; they seek to transform it.

They believe that the present focus on the recipient’s knowledge is misplaced. A restitutionary rationale apparently demands that liability arise from the receipt

⁴ The principal academic proponent for this rationale has been Professor Birks, “Misdirected funds: restitution from the recipient” *Idem*. See also Harpum, “Knowing Assistance and Knowing Receipt” in *The Frontiers of Liability* Vol 1, (1994), ed P Birks at 17-25; Jones ed, *Goff and Jones, The Law of Restitution* (4th ed, 1993) at 673; and Burrows, *The Law of Restitution* (1993) 150-156. New Zealand judicial support for this rationale is provided by Thomas J in *Powell v Thompson* [1991] 1 NZLR 597 at 607; Blanchard J in *Nimmo v Westpac Banking Corporation* [1993] 3 NZLR 218 at 225; and Smellie J in *Equiticorp Industries Group Limited (In Statutory Management) v A-G* (High Court, Auckland, CP No. 2455/89, 12 July 1996) at 245.

⁵ [1991] 1 WLR 10.

⁶ *Ibid* at 27 per Lord Goff.

⁷ [1993] 3 All ER 717 at 736

⁸ Birks, “Civil Wrongs: A New World”, Butterworths Lectures 1990-1991 (1992) at 55.

⁹ Birks “Misdirected funds: restitution from the recipient”, *supra* n3 at 310. As Mr Gardner has observed, a “commendable” aspect of the restitutionary rationale is that “it can claim to handle cases of unjust enrichment of a trust in the same fashion as cases of unjust enrichment at the expense of a straightforward owner of property”. “Knowing Assistance and Knowing Receipt: Taking Stock” (1996) 142 LQR 56, 86.

¹⁰ Birks “Misdirected funds: restitution from the recipient”, *ibid* at 296.

of trust money, not from the recipient's knowledge. The recipient's knowledge would be relevant only for determining the availability of defences, such as change of position. Subject to such defences, the maximum liability would be to repay the value of the trust money received.¹¹

The effect of these changes would be that the knowing receipt claim, as we presently know it, would disappear. Such a transformed claim may be better renamed the 'receipt' claim, for its focus would be upon the receipt of trust money. In essence, the transformed claim would operate in a fashion similar to money had and received.

The remainder of this article will question the application of the restitutionary analysis to knowing receipt. In *Westdeutsche Landesbank Girozentrale v Council of the London Borough of Islington*¹² ("*Westdeutsche*") Lord Goff comments upon a growing tension between restitution lawyers and equity lawyers. As his Lordship observes, the source of this tension is that restitution lawyers perceive that some equitable institutions have the function of reversing unjust enrichment. The same lawyers have then sought to embrace these equitable institutions within the law of restitution, "if necessary moulding them to make them fit for that purpose". This has raised the fears of equity lawyers that, in this moulding process, the underlying equitable principles "may become illegitimately distorted."¹³ It is submitted that a similar process is occurring with knowing receipt.

Knowing receipt and money had and received may be similar in that the plaintiff is seeking to recover money from a third party. Nevertheless, their differences do not constitute an indefensible inconsistency. Rather, they reflect the different focus of each claim. As shall be seen, the primary use of money had and received is against the immediate recipient of one's money. Indeed, cases where it has been successfully used against third parties are rare. In contrast, knowing receipt was specifically designed to provide relief against third parties. Differences between the two claims reflect Equity's desire to protect the otherwise vulnerable equitable interest of the beneficiary while ensuring that inappropriate liability is not imposed upon innocent third parties.

In Parts II and III of this article respectively, I will provide an overview of the claims of money had and received and knowing receipt. My focus will be on the factors that have shaped these claims. Some of these factors are common to both claims, for instance the function of money. Other factors, however, for instance the protection of the trust relationship, are unique to one claim - knowing receipt. This supports my argument that these claims have different functions. I will also explain how the courts of common law and equity have responded in different ways to some of the common policy considerations.

In evaluating the arguments of the advocates for the restitutionary transformation of knowing receipt, a significant factor is that, in response to its concern for innocent third parties, Equity has developed two different ways in which third party liability can be determined. In addition to knowing receipt,

¹¹ See generally Birks, "Misdirected funds: restitution from the recipient", *idem*.

¹² [1996] 2 WLR 802.

¹³ *Ibid* at 810.

Equity has created sophisticated tracing rules and presumptions that are available against innocent third party recipients of trust money. To the extent that these rules and presumptions identify the trust money within the third party's assets, a court can impose an obligation to transfer the identified property back to the trust. This form of redress shall be referred to as the "Tracing process".¹⁴ The significance of the Tracing process is also examined in Part III.

It is because: i) claims against third parties are only a secondary function of money had and received; ii) different policy considerations have affected these two claims; and iii) the respective courts have responded differently to similar policy considerations; that the guidance some seek from money had and received for the transformation of the knowing receipt claim is unwarranted.

II The Claim For Money Had and Received

1 Overview

Money had and received is an unusual claim. It is the common law's 'workhorse' for the recovery of money, available in a large number of seemingly different situations. As the learned authors of *Goff and Jones The Law of Restitution* observe:

[Money had and received lies] to recover money which the plaintiff had paid to the defendant, on the ground that it had been paid under a mistake or compulsion, or for a consideration which had wholly failed. By this action the plaintiff could also recover money which the defendant had received from a third party, as when he was accountable or had attorned to the plaintiff in respect of the money, or the money formed part of the fruits of an office of the plaintiff which the defendant had usurped. The action also lay to recover money which the defendant had acquired from the plaintiff by a tortious act; and, in the very rare cases, where the [third party] defendant had received money which the plaintiff could identify as his own at the time of receipt and for which the defendant had not given consideration, the plaintiff could assert his claim by means of this action.¹⁵

It is the last example with which this article is concerned.

2 Money - items of property, yet, currency

Because money is an integral component of our everyday lives it is easy to overlook two characteristics that are important in understanding the operation of money had and received. First, money, manifested as either bank notes or coins, is an item of property. Indeed, their serial numbers make bank notes unique items of property. I own the \$10.00 bank note, serial number AY072460,

¹⁴ There are two aspects to this process. First, the rules dealing with the preservation of the equitable interest following the transfer of legal title and second, the rules and presumptions designed to identify the equitable interest in new property derived from the original trust property. Some commentators regard these two aspects as comprising different claims. See R P Austin, "Constructive Trusts" from Finn (ed) *Essays in Equity* (1985) at 214-5 and M Cope *Constructive Trusts* (1992) at 380-381.

¹⁵ Jones ed, *Goff and Jones The Law of Restitution*, supra n4 at 3.

which is in my wallet. If I lose this note, or if it is stolen, the finder, or thief, does not become its owner; it is still mine and through an action for conversion¹⁶ or money had and received, I can assert my ownership.¹⁷

Three factors have camouflaged the proprietary nature of money, however. First, except when a particular bank note or coin has its own special value, for instance because of its age or rarity, we value it for the “purchasing power in terms of commodities”¹⁸ that it represents. My aim, upon locating the thief of my \$10.00 bank note, is to recover \$10.00 of currency; it is immaterial whether it is ‘my’ bank note or any other bank notes or coins to the value of \$10.00.

The second factor is money’s status as currency. Money is an exception to the general rule of *nemo dat quod non habet*. The thief cannot acquire legal ownership¹⁹ of the victim’s money, but he or she can confer ownership upon a third party who acquires possession of the money “fairly and honestly upon a valuable and bona fide consideration.”²⁰

The third factor is the way in which the common law sometimes provides relief against infringements of property rights. There is a temptation to associate such relief with the recovery of one’s property *in specie* but often the relief provided by the common law is the award of damages. While the resulting obligation to pay compensation may be vulnerable to the defendant’s insolvency, it survives the loss of the original property.²¹ This attribute is particularly important with money, which, because of its role as a medium of exchange, does not usually remain long in a person’s possession. Indeed, recovery of stolen money would be severely curtailed if it was dependent upon the identification and return of one’s particular bank notes. Since the plaintiff’s aim is to recover a loss of purchasing power, the obligation to pay compensation equivalent to that purchasing power provides full relief.

Money had and received reflects both the proprietary and currency characteristics of money. While the claim’s availability depends upon evidence of the defendant’s receipt of the plaintiff’s money,²² it imposes a ‘strict’ liability to repay its value. As Fox LJ observed in *Agip (Africa) Ltd v Jackson*:

¹⁶ *Miller v Race* (1785) 1 Burr. 452, 457-458 per Lord Mansfield; Jones ed, *Goff and Jones The Law of Restitution*, *ibid* at 78 note 33.

¹⁷ Similar legal reasoning applies to coins, but their fungible nature produces additional evidentiary problems.

¹⁸ *Banco de Portugal v Waterlow & Sons* [1932] AC 452 per Lord Macmillan at 508.

¹⁹ As against other parties, however, the thief may acquire possessory rights.

²⁰ *Miller v Race*, *supra* n16 at 457-8, 401 per Lord Mansfield.

²¹ Sir William Holdsworth suggests that it is because of “their destructible and moveable character”, that the law protects legal interests in chattels through personal remedies. *A History of English Law* (1966 Reprint) volume iv at 413.

²² While it is tempting to equate money with bank notes and coins, the concept of money (*i.e.* purchasing power) extends beyond these traditional manifestations. The cheque provides an early example of the courts’ recognition of other manifestations of money. While a cheque may not enjoy quite the status of a bank note or coin, it performs the similar function of transferring ‘purchasing power’ and, as occurs with bank notes and coins, is valued for the purchasing power that it represents. Confronted with claims of conversion and money had and received with respect to cheques, the courts have awarded ‘damages’ for their ‘face’ value, see *Morrison v London County and Westminster Bank Ltd* [1914] 3 KB 356 (CA). Economic reality suggests that the more

[l]iability depends upon receipt by the defendant of the plaintiff's money and the extent of the liability depends on the amount received. Since liability depends upon the receipt, the fact that a recipient has not retained the asset is irrelevant, ... [nor is] dishonesty or lack of inquiry on the part of the recipient [relevant for the imposition of liability.]²³

Implicit in the reference to the defendant's receipt of the plaintiff's money is the assumption that the circumstances surrounding the defendant's acquisition of the money were such so as to preclude the application of the currency exception to *nemo dat*. Should the third party acquire possession of the plaintiff's money "fairly and honestly upon a valuable and bona fide consideration",²⁴ he or she will have an absolute defence.

3 Claims against Third Parties

Third party recipients of stolen money can be classified into three groups. The first group are those who, because of the operation of the currency exception, are protected against the money had and received claim. An example is the retailer who innocently sells a product to the thief.

The second group is comprised of third parties who do not come within the currency exception because they did not acquire the money "fairly and honestly".²⁵ Members of the third group also are not protected by the currency exception, not because of their knowledge, but because they were donees.

In determining membership of the second group - those who did not acquire the money "fairly and honestly", the issue is whether transferees of money are required, or should be required, to make enquires as to the transferor's title. To fulfil its function as a means of exchange, money must be able to circulate freely. It would cease to do so if transferees who had given value, feared the subsequent imposition of personal liability to repay its value. Significantly, this fear was a factor in making currency an exception to the *nemo dat* rule.²⁶

This policy consideration suggests that in arm's length transactions the courts should not impose a general obligation upon the transferee to make enquires nor, in the absence of a reckless disregard for the rights of others, impute knowledge to the defendant.²⁷ Membership of this group, therefore, would appear to be confined to those third parties who knew that the money did not belong to the transferor.

modern forms of withdrawals from a bank account, for instance through the medium of an automatic teller machine or electronic funds transfer, be treated in a similar fashion.

²³ [1992] 4 All ER 451 at 463.

²⁴ *Miller v Race*, supra n16 at 457-8, 401 per Lord Mansfield.

²⁵ *Idem*.

²⁶ *Idem*.

²⁷ A recent case where money was recovered from a vendor of property is *Police v Hutana* [1995] DCR 914. The money, some \$4,000, represented proceeds from a bank robbery. While it had been conceded that Hutana had acquired the money as consideration for the sale of her car, the Court held that the currency exception to *nemo dat* did not apply. Crucial to this conclusion was the Court's willingness to infer that Hutana

The third group is composed of donees. Given the suggested restricted membership of the last group, donees should comprise the majority of third parties potentially facing liability pursuant to money had and received. But is the imposition of liability to repay the value of money innocently received, regardless of whether that money has been dissipated, appropriate? Prior to the recognition of a change of position defence such liability may have been perceived as inappropriate.

Indeed, successful claims against third parties have been “very rare”.²⁸ A reason for this has been the evidentiary difficulties confronting the plaintiff. Not only does the plaintiff have to show that his or her money was received by an intermediary (for instance a thief) but that the intermediary transferred the same money to the third party.

One solution to such difficulties is the utilisation of tracing rules and presumptions. When compared to equity’s “modern doctrine” of tracing,²⁹ however, the common law has traditionally taken a conservative approach to tracing.³⁰ The admixture of the plaintiff’s money with money of another, for example, has been regarded as precluding the ability to trace it. At one time it was even thought that the common law was unable to follow money out of a bank account in which it had been the only money deposited, a conservatism that was laid to rest by the Court of Appeal in *Re Diplock*.³¹ It is submitted that this conservatism reflects the collective wisdom of the nineteenth century

knew the money represented the proceeds of a crime. A significant factor underlying this inference was the apparent relationship of the purchaser to Hutana; while Hutana would not name the purchaser - she feared reprisals - she “acknowledge[d]” that he had criminal convictions and “did not dispute” that he was related to the father of her children. For that reason the Court considered that the transaction was “in a very broad sense, an inter-family one and not at arm’s length between strangers” (at 917). Additional factors included the fact that the money was in the form of large denomination notes and that Hutana did not bank the money for some four months.

²⁸ Jones ed, *Goff and Jones The Law of Restitution*, supra n4 at 3. A case in which the evidentiary problems were overcome is *Clarke v Shee and Johnston* (1774) 1 Cowp 197; 98 ER 1041. The intermediary was the plaintiff’s clerk. In the course of his employment he received money on behalf of the plaintiff. Instead of accounting for this money, the clerk used it to purchase lottery tickets from the defendants (the third party). As this transaction contravened the Lottery Act 1772, the ‘value’ given by the defendant for this money was not regarded as constituting consideration. The Court concluded that “the money and notes which [the clerk] paid to the defendants [were] the identical notes and money of the plaintiff” (1774) 1 Cowp 197; 98 ER 1041 at 200; 1043 per Lord Mansfield.

²⁹ *In Re Hallett’s Estate* (1879) 13 Ch D 696 (CA) at 708 per Jessel MR.

³⁰ *Taylor v Plumer* (1815) 3 M & S 562; 105 ER 721 at 575; 726 per Lord Ellenborough CJ is regarded as establishing the power of common law courts to trace money. One interpretation of this case is that the Court seeking the power to trace money simply adopted the then tracing rules of Equity, see SR Scott, “The Recovery of Money - Recognising the Potential of the Claim for Money Had and Received” (1994) 8 OLR 239 at 256-8. But see Lionel D Smith, “Tracing in *Taylor v Plumer*: Equity in the Court of King’s Bench” [1995] LMCLQ 240 for the argument that the defendant’s case “was based on the assertion of equitable proprietary rights in the proceeds of a disposition by a faithless fiduciary” at 268.

³¹ [1948] 1 Ch 465 at 519.

common law judges that the imposition of strict liability upon third parties (the majority of whom, one suspects, would be innocent of any wrongdoing) to pay the value of money received, is inappropriate.

This collective wisdom may underlie an observation of Millett J in *Agip (Africa) Ltd v Jackson*.³² At issue was whether the common law could trace money that had been transferred electronically. In concluding that it could not, Millett J considered that the common law "can only follow a physical asset, such as a cheque or its proceeds, from one person to another."³³ Professor Birks suggested that this limitation, "is barely intelligible except as part of a[n] ... attack on the strict common law liability."³⁴

The fear of imposing absolute liability on innocent recipients is further apparent from the attempt of Millett J to limit the significance of the decision of the Court of Appeal in *Banque Belge Pour L'Etranger v Hambrouck*.³⁵ He suggested:

[That case] is no authority for the proposition that [money had and received] lies against a subsequent transferee who has parted with the money, and I doubt that it does. At this remove the action begins to take on the aspect of a proprietary claim rather than the enforcement of a personal right to account. Should it be sought to impose personal liability on a person who has parted with the money, recourse can be made to equity, which has developed appropriate principles by which such liability can be determined. The alternative is to expose an innocent transferee who has dissipated the money to a claim at law where none would exist in equity and to make that liability depend on the fortuitous circumstances that the money had not been mixed with other money prior to its receipt by him.³⁶

Since Millett J delivered his judgment in *Agip*, the fear of imposing strict liability upon innocent third parties has been addressed with the recognition, by the House of Lords in *Lipkin Gorman v Karpnale Limited*,³⁷ that a change of position defence may be available to a third party recipient of another's money. Indeed, a motivation for their Lordships' acceptance of a restitutionary rationale for money had and received may have been the ability which this rationale provided to 'graft' a change of position defence on to the claim. While liability still arises from the receipt of the plaintiff's money, this defence enables the courts to give relief to an innocent defendant, "whose position has so changed that it would be inequitable in all the circumstances to require him to make restitution, or

³² Supra n23.

³³ Ibid at 398. His Honour reiterated this view in *El Ajou v Dollar Land Holdings plc*, supra n7 at 733-734.

³⁴ Birks, "Misdirected Funds: restitution from the recipient", supra n3 at 340.

³⁵ [1921] 1 KB 321. In that case the rogue, one Hambrouck, defrauded his employer of a number of cheques which he paid into his own bank account in which, in substance, no other funds had been paid. From the proceeds Hambrouck paid money to his mistress who in turn deposited them in her own bank account into which only these monies were deposited. On discovering the fraud the employer's bank successfully recovered the funds which remained in the mistress's bank account.

³⁶ Supra n23 at 400.

³⁷ Supra n5. See also s 94B Judicature Act 1908 (NZ) for a statutory change of position defence.

alternatively to make restitution in full."³⁸

The significance of the change of position defence for claims against third parties is that courts may now be more willing to find that a third party has received the plaintiff's money. As Lord Goff observes in *Lipkin Gorman v Karpnale Limited*, "the recognition of ... [the change of position] defence ... enable[s] a more generous approach to be taken to the recognition of the right to restitution [i.e. the imposition of liability]."³⁹ The application of this more generous approach to the imposition of liability is displayed in that case.

The intermediary, a partner in the plaintiff firm, had used funds from the plaintiff's client account to finance his gambling. The third party was the gambling club. A difficulty confronting the plaintiff's claim, however, was that upon the withdrawal of the money, the intermediary became its legal owner.⁴⁰ But, if the money legally belonged to the intermediary, how could it also legally 'belong' to the plaintiff so as to provide the necessary foundation for the claim? Lord Goff considered that the plaintiff did not have to show that the money was its legal property. This requirement was only "a general rule".⁴¹ Rather, relief would be available if the plaintiff could establish a basis on which it was entitled to the money. Here that basis was the original *chose in action* between the plaintiff and its bank.⁴² Lipkin Gorman could trace their interest in the *chose in action* into some sort of interest in the money which at that stage legally belonged to the plaintiff and which he then 'gave' to the defendant club.⁴³ Of further interest is the acceptance by the parties and the Court of factual evidence indicating that the intermediary must have used funds from the client account to finance his gambling.

4 Summary

The two dominant characteristics of money had and received are its focus on the receipt of another's money and, irrespective of the third party's innocence, the imposition of liability to repay the value of that money. Collectively these characteristics reflect the proprietary attributes of money, its role as currency, and the evidentiary problems associated with attempting to identify specific dealings with money.

The operation of this claim against third parties is tempered, however, by three general factors, namely, the existence of the currency exception to *nemo dat*, the restriction of liability to the amount received,⁴⁴ and the common law's conservatism about tracing. It is submitted that these factors reflect a concern

³⁸ Ibid at 34 per Lord Goff.

³⁹ Ibid at 35 per Lord Goff.

⁴⁰ In reaching this conclusion Lord Goff applied two earlier decisions of the Privy Council: *Union Bank of Australia Ltd v McClintock* [1922] 1 AC 240 and *Commercial Banking Co of Sydney Ltd v Mann* [1961] AC 1.

⁴¹ Supra n5 at 27.

⁴² Ibid at 29.

⁴³ A recent case displaying a similar judicial approach in focusing upon the "reality" of the situation is *Agip (Africa) Ltd v Jackson*, supra n23: See also *Reid v Rigby & Co* [1894] 2 QB 40.

⁴⁴ The ability to trace into substitute products as displayed in *Taylor v Plumer* supra n30

about the imposition of liability upon innocent third parties. Indeed, it is only with the recognition of the change of position defence and an associated apparent willingness to develop a more generous approach to tracing money, that this claim may provide an effective means of recourse against third parties.

III The Recovery of Trust Money

1 *The Significance of the Trust Relationship*

The equitable claim of knowing receipt also provides relief against a third party recipient of another's money, but it operates differently to that of money had and received. As noted earlier, notwithstanding disagreement as to the state of knowledge required of the third party, the orthodox view is that knowledge is a prerequisite. The claim may also culminate in the imposition of punitive remedies. But do these differences constitute an "indefensible inconsistenc[y]" as some suggest?⁴⁵ It is submitted that the differences are quite defensible. They are attributable to the trust relationship and the court's balancing of their concern for innocent third parties with the need to protect the interests of Equity's "darling"⁴⁶ - the beneficiary.

The significance attached by Equity to the trust relationship is displayed by both the extensive duties required of trustees and the punitive remedies imposed upon trustees who fail to satisfy them. Consider the remedies that are available against a trustee who misappropriates trust property. Just as a legal owner of money has a remedy against the thief, the beneficiary has a remedy against the dishonest trustee. The beneficiary's remedies, however, are not limited to recovering the value of the stolen money. Rather, through the application of the accounting remedy, he or she can deprive the trustee of any profit derived through the use of that money. The beneficiary also enjoys sophisticated tracing rules and presumptions pursuant to which it may be possible for him or her to trace the trust money into a new asset and assert either equitable ownership or an equitable charge over that asset.

This response is attributable to the fact that the trustee, unlike the thief, acquired the money on the basis that he or she would advance the interests of the beneficiary. While the settlor may accept (or be deemed to have accepted) the risk that the trust money may be stolen by a stranger,⁴⁷ he or she is not regarded as accepting the risk that the trustee will steal the money.⁴⁸

suggests that the plaintiff may be able to trace his or her money into an appreciating asset.

⁴⁵ Birks "Misdirected funds: restitution from the recipient", supra n3 at 310.

⁴⁶ Finn, "The Liability of Third Parties for Knowing Receipt or Assistance" in Waters ed, *Equity, Fiduciaries and Trusts* (1993) 195 at 197.

⁴⁷ In which case the trustee, as the legal owner, has remedies against the thief and the failure to exercise them may constitute a breach of trust.

⁴⁸ Professor Finn suggests that third party receipt of trust money in situations in which there is no breach of trust (e.g. a bank combining a trust account with that of a trustee) is "generically distinct" from the situation where the money was transferred in breach of trust. See "The Liability of Third Parties for Knowing Receipt or Assistance", supra n46 at 209.

In developing remedies against the trustee that confer preferential recovery and deprive the trustee of any personal profit, the courts have utilised the flexible nature of the beneficiary's interest in the trust. For some purposes the beneficiary's equitable interest can be equated with ownership of specific items of property. For other purposes, the interest becomes one of ownership of a fund, the composite parts of which are always changing. Utilising the fiction that the dishonest trustee is really honest, the misappropriation of trust money, and its employment in the acquisition of some other asset, can be transformed into a mere alteration in the composition of the trust fund.⁴⁹

2 *The Creation of Rights of Property against Third Parties - The Tracing process*

Equity's protection of the trust does not stop with the development of extensive remedies against the trustee. There are also extensive remedies available against third parties. As Lord Parker observed in *Sinclair v Brougham*:

Starting from a personal equity, based on the consideration that it would be unconscionable for any one who could not plead purchase for value without notice to retain an advantage derived from the misapplication of trust money, it ended, as was so often the case, in creating what were in effect rights or property, though not recognised as such by the common law.⁵⁰

Regarded by some as an application of the law of priorities,⁵¹ the Tracing process facilitates the survival of an existing equitable interest following the transfer of legal title to another.⁵² The starting point is the trustee's ability (as the legal owner) to transfer legal title to a third party. Assuming that the transfer is in breach of trust, the issue becomes whether the third party acquires legal title subject to the existing equitable interest. The general response is that the transfer of legal title is insufficient to destroy the equitable interest. Unless the transfer is to a *bona fide* purchaser for value without notice of the existing equitable

⁴⁹ *Re Hallett's Estate*, supra n29 at 709.

⁵⁰ [1914] AC 398 at 441-442.

⁵¹ Austin, "Constructive Trusts", supra n14 at 214-5; *Cope Constructive Trusts*, supra n14 at 380-1.

⁵² As Sir Frederick Jordan observed:

"If a person has acquired a legal title to property, a Court of Equity will not compel him to hold it for the benefit of another who in fact has a prior equitable interest in it, unless the person who acquired the legal title did so in such circumstances that he cannot in good conscience hold it, except subject to the equitable interest. Hence a purchaser who acquires the legal title for value, and without notice of any equitable interests, is entitled to hold it free from any such interests, if they in fact exist *Pearce v Bulteel* [1916] 2 Ch 544. But property the legal title to which has been acquired voluntarily must be held subject to all existing equitable interests, ie interests in the property concerned *Reeves v Poole* [1914] 2 KB 284; and even a purchaser for value takes subject to all equitable interests of which he had notice: *Lewin* 14th ed p 748; *Craddock Bros v Hunt* [1923] 2 Ch 136 at 158-9."

This observation is reproduced in Meagher Gummow and Lehane, *Equity Doctrines & Remedies* (3rd ed 1992) at 250.

interest, the transferee's legal title is subject to that interest.⁵³

*Sinclair v Brougham*⁵⁴ confirms the application of the Tracing process to trust money. It is significant that the Tracing process, at least as it applies against a volunteer who does not have notice of the equitable interest,⁵⁵ does not result in the imposition of liability to pay for the value of the trust money received. It is only to the extent that the trust money remains identified that the third party becomes under an obligation to restore it.⁵⁶

It was against this general background that Lord Selbourne made his observation in *Barnes v Addy*⁵⁷ as to the situations in which a third party can become personally liable to repay the value of the trust money received (but no longer identifiable).

3 Knowing receipt, *Barnes v Addy* style

According to Lord Selbourne LC:

Those who create a trust clothe the trustee with a legal power and control over the trust property, imposing on him a corresponding responsibility. That responsibility may no doubt be extended in equity to others who are not properly trustees, if they are found either making themselves trustees *de son tort*, or actually participating in any fraudulent conduct of the trustee to the injury of the *cestui que trust*. But, on the other hand, strangers are not to be made constructive trustees merely because they act as the agents of trustees in transactions within their legal powers, transactions, perhaps of which a Court of Equity may disapprove, unless those agents receive and become chargeable with some part of the trust property, or unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees.⁵⁸

⁵³ Underlying this response is Equity's maxim that where there is equal equity the law must prevail. As explained in AE Randall *Storey on Equity* 3rd ed (1920) at 36, para 64c:

"[i]f the defendant has a claim to the passive protection of a court of equity, and his claim is equal to the claim which the plaintiff has to call for the active aid of the court, in such a case the court will do simply nothing, and he who has the legal estate will prevail."

⁵⁴ *Supra* n50. See also *Re Diplock*, *supra* n31 at 536-537.

⁵⁵ Views differ as to the position of third parties with notice of the equitable interest. Some believe that in the absence of their knowledge of the breach of trust, such parties attract the same liability as the innocent volunteer. Others, however, believe that the knowing receipt claim encompasses third parties with notice of the equitable interest.

⁵⁶ *Sinclair v Brougham*, *supra* n50 at 442-3. See also *In re Montagu's Settlement Trusts*, *supra* n2 at 1203 and *El Ajou v Dollar Land Holdings Plc*, *supra* n7 for recent confirmation of the Tracing process. The ability to trace the trust money into substitute assets means that if the defendant has used the trust money (and only that money) to acquire another asset which has subsequently appreciated in value, the Tracing process may result in recovery in excess of the original trust money received and preferential recovery should the defendant be insolvent. It may be argued that "justice between the parties" (*O'Sullivan v Management Agency and Music Ltd* [1985] Ch 428 at 468 per Fox LJ) demands that the third party should have a claim for an allowance to reflect his or her skill and labour in preserving the trust property and/or increasing its value.

⁵⁷ (1874) LR 9 Ch App 244.

⁵⁸ *Ibid* at 251-2. While Lord Selbourne was directing his observation as to the liability of

Prior to his judicial appointment, Professor Finn noted that Lord Selbourne's observation has one important "virtue" - "[i]ts unequivocal affirmation that the third party's liability [for knowing receipt] was grounded in participation in a wrong."⁵⁹ Indeed, a close reading of Lord Selbourne's observation reveals that he was considering the situations in which the "responsibility" imposed upon a trustee is to "be extended in equity to others who are not properly trustees."⁶⁰ Not only does the third party who "receives trust property with notice that it is trust property which is being transferred in breach of trust" take that property subject to an equity in favour of the beneficiaries but he or she is subjected to "the full burden of trusteeship".⁶¹

The result is that in addition to becoming personally liable to repay the value of the trust money so received, the knowing recipient becomes potentially subject to the duties and obligations imposed upon an express trustee.⁶² Further, just as tracing rules and presumptions can be employed against the express trustee, they can be employed against the knowing recipient. If the plaintiff can trace the trust money into a more valuable asset, a constructive trust or equitable lien will be imposed over that asset. The knowing recipient's personal liability to repay the value of the trust money so received therefore constitutes the minimum level of liability. For the purpose of this article, the term 'constructive trustee' will be used to refer to the situation in which the court imposes the full burden of trusteeship upon the third party. Because of the severity of the associated duties and obligations, some commentators, for instance Mr Harpum, suggest that they should not be "lightly imposed" upon a third party.⁶³

4 Differences between knowing receipt and the Tracing process

Until recently Lord Selbourne's observation from *Barnes v Addy*⁶⁴ has been regarded as constituting the definitive analysis of third party or 'stranger'

agents, his views concerning knowing receipt and knowing assistance have become regarded as being of general application.

⁵⁹ Finn, "The Liability of Third Parties for Knowing Receipt or Assistance", supra n46 at 205.

⁶⁰ Supra n57 at 251.

⁶¹ *Re Montagu's Settlement Trusts*, supra n2 at 1198 and 1200 respectively per Sir Robert Megarry V-C. Knowing receipt is also available against a third party who "acquires [the requisite knowledge] subsequent to such receipt and then deals with the property in a manner inconsistent with the trust." The claim also applies against trust money in the third party's possession at the time he or she acquires the requisite knowledge. *Karak Rubber Co. Ltd v Burden (No 2)* [1972] 1 WLR 602 at 632-633 per Brightman J, *Re Montagu's Settlement Trusts*, supra at 1198, and *Westdeutsche*, supra n12 at 830.

⁶² As Professor Cope observes, the third party's "in personam liability for a breach of trust is the same as an express trustee, that is the [third party], like a trustee, is liable to place the trust in the same position as it would have been if no breach had been committed and matters such as causation, foreseeability and remoteness are usually irrelevant in the calculation of the loss." Cope, *Constructive Trusts*, supra n14 at 360-361. See also Harpum, "The Stranger as Constructive Trustee" (1986) 102 LQR 114 at 119.

⁶³ *Ibid* at 120.

⁶⁴ Supra n57.

liability.⁶⁵ Indeed, for some, the existence of the Tracing process may come as a surprise. Knowing receipt has gained such prominence that it is easy to assume that it provides the sole form of redress against a third party recipient of misappropriated trust money.

The preceding section, however, has discussed and examined the existence of the Tracing process.⁶⁶ For those who remain unsure about the independence of the Tracing process, observations of Lord Browne-Wilkinson in *Westdeutsche*⁶⁷ should clarify the position. There it was unsuccessfully argued that the ability to enforce an equitable interest against the legal owner of the property was dependent upon the legal owner being a trustee. His Lordship observed:

[It was] contended that where *under a pre-existing trust*, B is entitled to an equitable interest in trust property, if the trust property comes into the hands of a third party, X (not being a purchaser for value of the legal interest without notice), B is entitled to enforce his equitable interest against the property in the hands of X because X is a trustee for B. In my view the third party, X, is not necessarily a trustee for B: B's equitable right is enforceable against the property in just the same way as any other specifically enforceable equitable right can be enforced against a third party. Even if the third party, X, is not aware that what he has received is trust property B is entitled to assert his title in that property. If X has the necessary degree of knowledge, X may himself become a constructive trustee for B on the basis of knowing receipt. ... *In re Diplock, Diplock v Wintle* [1948] Ch 465, 478; *In re Montagu's Settlement* [1987] Ch 264. Therefore, 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.⁶⁸

This observation makes a number of important points. Prominent among them is Lord Browne-Wilkinson's confirmation that an equitable interest may be enforced against a third party quite independently of the knowing receipt claim. Significantly, his Lordship also confirms that to become subject to a knowing receipt claim, the third party must have "the necessary degree of knowledge", and, that knowing receipt culminates in the third party becoming a constructive trustee.

A key to understanding the inter-relationship of the Tracing process and knowing receipt is to realise the different remedies that they may occasion. As noted earlier, following an application of the Tracing process the liability of the third party is limited to restoring identified trust property. Knowing receipt, however, may culminate in a punitive remedy. A source of confusion, however, has been the use of the constructive trust in conjunction with the Tracing process.⁶⁹

⁶⁵ As Professor Austin has noted, Lord Selbourne's "direct and forceful style, and [his] status ... have ensured ... [the] pre-eminence [of his observation] in all subsequent pronouncements on this subject." Austin, "Constructive Trusts", supra n14 at 201.

⁶⁶ Recent judicial recognition of the existence of these two remedies and their different natures is provided by *Re Montagu's Settlement Trusts*, supra n2 and *Polly Peck International plc v Nadir (No 2)* [1992] 4 All ER 769.

⁶⁷ Supra n12.

⁶⁸ Ibid at 830. (His Honour's emphasis.)

⁶⁹ JE Martin, *Hanbury and Maudsley's Modern Equity* (14th ed., 1993) at 71 includes this situation within the categories of constructive trusts.

Not surprisingly, such use supports an assumption that the third party becomes a constructive trustee, and, as such, becomes subject to the fiduciary obligations associated with trustees and knowing recipients.

The fallacy of this assumption was revealed by Millett J in *Lonhro Plc v Fayed (No 2)*⁷⁰ and should be laid to rest by an other observation of Lord Browne-Wilkinson in *Westdeutsche*. His Lordship reminded lawyers that:

[t]here are many cases where B enjoys rights which, in equity, are enforceable against the legal owner, A, without A being a trustee. ... Even in cases where the whole beneficial interest is vested in B [the beneficial owner] and the bare legal interest is in A, A is not necessarily a trustee.⁷¹

As noted above, his Lordship also confirmed that in the context of a successful Tracing process the third party is not a trustee.⁷²

A further key to understanding the inter-relationship of the Tracing process and knowing receipt is to follow the application of their different tracing rules and presumptions. A good starting point is the rules and presumptions applied against an express trustee. They are more onerous than those applied in the Tracing process against third parties. An example is the response to the situation where trust money, in conjunction with other money, has been used to purchase a depreciating asset. As against the trustee, the beneficiary can assert a charge and thereby recover the trust money in priority to the trustee. Such preferential treatment, however, may be unavailable against the third party. As Lord Parker explained in *Sinclair v Brougham*:

Suppose ... that the fiduciary agent parts with the money to a third party who cannot plead purchase for value without notice, and that the third party invests it with money of his own in the purchase of property. If the third party had notice that the money was held in a fiduciary capacity, he would be in exactly the same position as the fiduciary agent, and could not, therefore, assert any interest in the property until the money misapplied had been refunded. But if he had no such notice this would not be the case. There would on his part be no misconduct at all.⁷³

⁷⁰ [1992] 1 WLR 1 at 12. See also *Henderson v Merrett Syndicates Ltd* [1994] 3 WLR 761 (HL) at 799 per Lord Browne-Wilkinson.

⁷¹ *Supra* n12 at 830.

⁷² The significance of *Westdeutsche*, *supra* n12, for this debate is displayed in *Equiticorp Industries Group Limited (In Statutory Management) v A-G*, *supra* n4. While Smellie J expressed his personal view that “unjust enrichment is the foundation for recipient liability” (at 245) and that there is an “attractive logic” to the strict liability proposition (at 254), he saw no warrant to depart from the views of Lord Browne-Wilkinson as expressed in *Westdeutsche*.

⁷³ *Sinclair v Brougham*, *supra* n50 at 442-443 per Lord Parker. See also *Re Diplock*, *supra* n31 at 524 but this should be compared with the views of Millett J in *Boscawen v Bajwa* [1995] 4 All ER 769 at 779. A high point of the lenient approach conferred upon third parties is the conclusion in *Re Diplock* at 546-7 that the Court could not identify trust money spent in alterations to the third party’s hospital.

5 *One more source of confusion*

As noted earlier, the distinction between the Tracing process and knowing receipt has been blurred by the use of the constructive trust in conjunction with the Tracing process and the resulting assumption of the imposition of a trusteeship. With *Westdeutsche* this particular source of confusion has been addressed. Unfortunately, one major source of potential confusion remains. It involves the scope of the overlap between the Tracing process and the knowing receipt claim. An overlap arises because a knowing recipient cannot be a bona fide purchaser for value without notice of the equitable interest.

But does the converse apply, is everyone who cannot plead bona fide purchase for value without notice a knowing recipient? If so, the Tracing process would merge within the ambit of the knowing receipt claim. Such a merger may support the arguments advanced by advocates of a restitutionary transformation of knowing receipt. Unfortunately for these advocates, the converse situation does not apply. As long as a knowledge component remains a requirement of knowing receipt, that claim cannot operate against third parties who have no knowledge whatsoever of the trust or its breach. But such third parties, at least those who are volunteers, come within the operation of the Tracing process and therefore, to the extent that the trust money can be identified, come under an obligation to restore it.

While volunteers without notice constitute the core area for the operation of the Tracing process, there is disagreement about the situation when the third party, whether he or she is a volunteer or a purchaser, had notice of the equitable interest. The disagreement is over whether such 'notice' can constitute 'knowledge' for the purposes of knowing receipt. If so, the result is to draw a general distinction between volunteers without notice (who are subject to the Tracing process) and all other third parties who cannot plead bona fide purchaser for value without notice. This latter group would face liability as knowing recipients.

While this disagreement may not appear to be directly relevant to the issue of whether knowing receipt should be transformed into a restitutionary claim, it plays an important role, albeit a hidden one. In essence, the disagreement centres upon whether knowing receipt should be a response to dishonest conduct or negligent conduct.⁷⁴ The concept of notice, or at least its wider aspects, is directed to the latter.

⁷⁴ *Baden Delvaux and Le Cuit v Societe Gen. de Commerce SA* [1992] 4 All ER 161. At 235-6 Peter Gibson J suggested that knowledge can comprise any one of the following five different mental states:

"(i) actual knowledge; (ii) wilfully shutting one's eyes to the obvious; (iii) wilfully and recklessly failing to make such inquiries as an honest and reasonable man would make; (iv) knowledge of circumstances which would indicate the facts to an honest and reasonable man; (v) knowledge of circumstances which would put an honest and reasonable man on inquiry."

The dispute between supporters of the dishonesty and negligence sub-rationales pertains to whether the knowing receipt claim should be available against third parties having either category (iv) or (v) knowledge. For an overview of the English cases see Oakley, "Liability of a Stranger as a Constructive Trustee" in Cope Ed, *Equity Issues and Trends* (1995) at 62.

'Notice' provided the means by which Equity could regulate transactions involving the transfer of legal interests so as to provide protection for the otherwise vulnerable equitable interest. This was achieved by imposing a standard of care upon intending transferees to investigate the transferor's title so as to ascertain whether it was subject to an equitable interest. The high point of this requirement of investigation was reached with transactions involving land.

Not only did the purchaser of land have notice of facts within his or her actual knowledge but he or she was deemed to have constructive notice of "facts or deductions which a party is deemed to have acquired by reason of his knowledge or actual knowledge of other facts".⁷⁵ In addition, the purchaser was deemed to have 'imputed' notice of facts or deductions which his or her agent, for instance a solicitor, had "either received or should have received had [that agent] made proper inquiries, whether the notice is communicated by [that agent] to his principal or not."⁷⁶ As Fry J observed, to satisfy Equity, the purchaser was required to show that "he took all reasonable care and made inquiry, and that, having taken that care and made inquiry, he received no notice of the trust which affected the property."⁷⁷

Guided by *Westpac Banking Corporation v Savin*, supra n1, the New Zealand courts, when considering the liability of banks using deposited funds to reduce their client's indebtedness to them, appear to accept that, subject to "appropriate caution" with respect to category (v) knowledge, all five categories of the *Baden* test are appropriate (see *Lankshear v ANZ Banking Group (New Zealand) Limited*, *Westpac Banking Corporation v Ancell*, and *Anderson v Chilton and Bank of New Zealand*, supra n1, *Marr v Arabco Traders Ltd* (1987) 1 NZBLC 102,732 at 759.). In the banking cases a common theme has been the bank's level of involvement in its customer's business affairs and knowledge derived through regular monitoring of the accounts. These cases should not be regarded as constituting judicial acceptance of negligence as the requisite standard. As Smellie J recently observed in *Equiticorp Industries Group Limited (In Statutory Management) v A-G*, supra n 4 at 242, "[a]ll the endorsements were *obiter*. Clearly then, in New Zealand, as in England and elsewhere, the debate is not yet over."

⁷⁵ Randall, *Story on Equity*, supra n52 at 163. While it is tempting to equate a failure to inquire when put on notice with common law negligence, Mr Harpum has observed that the required degree of culpability is higher than that associated with negligence. "The Stranger as Constructive Trustee", supra n62 at 124.

⁷⁶ Meagher, Gummow & Lehane, *Equity Doctrines & Remedies*, supra n52 at 252.

⁷⁷ *Re Morgan* (1881) 18 ChD 93 at 102. An expansive view of what constitutes 'notice' (in particular the concept of constructive notice) may be justified when the purchase involves land but, as Mr Harpum has observed, this approach does not reflect either the usual standard of a purchaser's inquiry when the subject matter of the purchase is not land, or the level of inquiry that the courts have required in this situation. *Manchester Trust v Furness*: [1895] 2 QB 539, 545 (CA) is authority that constructive notice (and presumably imputed notice) does not apply in commercial situations. While this relaxation has received general acceptance by the courts, some differences in its implementation have emerged. Some judges have equated 'notice' with actual knowledge. *Eagle Trust Plc v SBC Securities Ltd* [1993] 1 WLR 484 at 506-8 per Vinelott J; *Cowan de Groot Properties Ltd v Eagle Trust Plc* [1992] 4 All ER 700 at 759-60 per Knox J. Other judges have advanced a negligence focus - suggesting that in the commercial context the reasonable person may take less trouble in making enquires as to the vendor's title. *El Ajou v Dollar Land Holdings Plc* supra n7 at 739 per Millett J; and

Notice of an equitable interest, however, does not preclude a purchaser from acquiring the legal title free from that interest. Until the 1860s the 'overreaching' process could operate to protect a purchaser who had notice. In the context of the sale of trust property, the overreaching process operated as follows. If the sale was within the trustee's powers and the purchaser could show that the purchase money was applied pursuant to the trust, or that he or she was discharged from having to show that it had been so applied, the equitable interest in that trust property was deemed to have transferred to the purchase money. When it is the 'purchaser' who is acquiring trust money, the process operates to transfer the equitable interest from that money to the property given by the purchaser in exchange for the money.

While the overreaching process appears to operate as a defence, it presupposes an obligation upon a purchaser who has notice to see to the application of the property transferred to the trustee.⁷⁸ Compliance with this obligation may provide protection, but failure to do so resulted in the imposition of liability to make good any loss arising from the trustee's subsequent misappropriation of the purchase money.⁷⁹ Subject to many limitations and qualifications, this obligation ceased with various statutes enabling trustees to give receipts thereby protecting the purchaser from any subsequent misappropriation of which he or she was unaware.⁸⁰

Notwithstanding this statutory relaxation of the notice doctrine, a purchaser with notice of an existing equitable interest continues to assume the risk that the trustee is acting in breach of trust. In this situation, to be fully protected the purchaser must ensure that the property can be discharged from the equitable interest and that this has occurred.⁸¹ Failure to do so means that the equitable interest remains.

Returning to the knowing receipt claim, the issue is whether a failure adequately to investigate the title of a transferor of money, or to see to the application of the property given in consideration for that money, should give rise to liability as a knowing recipient.⁸²

Macmillan Inc v Bishopsgate Investment Trust Plc [1995] 1 WLR 978 at 1000-1 per Millett J.

⁷⁸ Randall, *Storey on Equity*, supra n53 at paras 1124-1135a provides an overview.

⁷⁹ Brown, *Snell's Principles of Equity* (7th ed, 1884) at 105.

⁸⁰ Lord St. Leonards' Act 1859 (22 & 23 Vict., c. 35, s 23); Lord Cranworth's Act 1860 (23 & 24 Vict., c 145, s 29); Conveyancing Act 1881 (44 & 45 Vict., c 41, s 36. For the present New Zealand section see s 19 Trustee Act 1956.

⁸¹ In *Jared v Clements*, [1903] 1 Ch 428 (CA) for instance, the purchaser knew that the land which he was buying was subject to an equitable mortgage and required that it be discharged. On settlement he received from the vendor's solicitor (who also acted for the mortgagee) the deed of mortgage together with what purported to be a receipt signed by the mortgagee. The receipt turned out to be a forgery and the members of the Court of Appeal unanimously held that the purchaser's legal title was subject to the equitable mortgage. As Collins MR observed at 431, "if the purchaser chooses to complete without ascertaining for himself whether the charge has been paid off, he does so at his own risk."

⁸² Some believe that the Tracing process and knowing receipt claim are aimed at different mischiefs with the result that 'notice' and 'knowledge' respectively are different concepts. *Re Montagu's Settlement Trusts*, supra n2 at 1200 and 1204 per Sir Robert

For the purpose of the wider issue of whether knowing receipt should be transformed into a restitutionary claim, this disagreement is important. The equation of knowledge with notice does not directly undermine the proposition that knowing receipt is a punitive remedy based upon the third party's knowledge. Nevertheless, enlarging knowing receipt so that it encompasses negligent behaviour severs the symmetry between the Tracing process and knowing receipt claim, and the remedies that they give rise to.⁸³

Consider the situation where a failure adequately to investigate the title of a transferor of money or to see to the application of the property given in consideration for that money is not equated with knowledge for the purpose of the knowing receipt claim. The result is that the third party who knows of the breach of trust is treated more harshly than the third party who just had notice of the existence of the equitable interest. Put simply, while the third party with notice may have been careless, he or she (unlike the knowing recipient) has not been guilty of "conscious impropriety"⁸⁴.

The result of extending knowing receipt to encompass negligent behaviour is to impose the punitive remedies associated with a constructive trusteeship upon a third party who has notice of the existence of the equitable interest (or should have been aware of it, if he or she had not negligently failed to draw the appropriate inference). But is such liability appropriate?

Many would think not and, to accommodate this reaction, an immediate response is to draw back from imposing a constructive trusteeship upon the 'innocent' third party in favour of personal liability to repay the sum received. It is in this regard that the New Zealand banking cases noted earlier are of interest. While the courts have held that the banks were knowing recipients, the liability imposed upon them was just to repay the value of the trust money that they received.⁸⁵

But even this level of liability may be regarded as being inappropriate for a third party who, while "act[ing] honestly ... fail[ed] to draw the obvious inference by reason of his inexperience or because he was unusually or unreasonably

Megarry VC, *Eagle Trust plc v SBC Securities Ltd*, supra n77 at 497 per Vinelott J.

The principal English judicial proponent of a negligence focus is Millett J, see *El Ajou v Dollar Land Holdings*, supra n7 and *Boscawen v Bajwa*, supra n73 at 779. In *El Ajou*, his Honour went so far as to observe that he could not see "how it would be possible to develop any logical and coherent system of restitution if there were different requirements in respect of knowledge for the common law claim for money had and received, the personal claim for an account in equity against a knowing recipient and the equitable proprietary claim [ie the Tracing process]" (at 730). See also *Cigna Life Insurance New Zealand Limited v Westpac Securities Limited* [1996] 1 NZLR 80 in which Greig J suggested that dishonesty is not an essential requirement of knowing receipt.

⁸³ Support for a distinction between careless and dishonest third parties is provided by *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 3 All ER 97. While this case concerned the knowing assistance claim, a claim which has also attracted considerable disagreement over the nature of the knowledge required to establish liability, the equation of knowledge with dishonesty would appear to apply equally to knowing receipt.

⁸⁴ *Ibid* at 106 per Lord Nicholls

⁸⁵ *Supra* n1.

trusting, or for some other reason".⁸⁶ Does the utilisation of a change of position defence then follow? If such developments occur the features that presently distinguish knowing receipt from money had and received cease to exist.

Such concerns must raise the question, 'is the equation of notice with knowledge and the introduction of a negligence standard an interim fall back position for supporters of a restitutionary based transformation of knowing receipt?' Judicial support for the negligence approach is provided by Millett J.⁸⁷ But is he being influenced by his belief (as contained in his extra-judicial writings⁸⁸) that knowing receipt would be better served by a restitutionary rationale? As Mr Gardner has observed, his Honour's advancement of the notice (or negligence) requirement may have been so as to take "him closer to his preferred position than knowledge would have done."⁸⁹

The equation of negligent behaviour with the knowledge required to establish liability for knowing receipt raises other matters of concern. It further blurs the dividing line between knowing receipt and the Tracing process. In addition, it also brings the creation of a new hybrid claim imposing personal liability for the value of trust money received upon third parties who cannot plead *bona fide* purchaser for value without notice that much closer. This will include purchasers and volunteers who, while not dishonest, are deemed to have notice because of their negligence in not checking the transferor's title. From here it is only a short step to the application of a restitutionary rationale.

IV Conclusion

In some situations the principle of unjust enrichment provides an attractive and persuasive rationale for judicial intervention. Notwithstanding its inherent attractiveness, the principle of unjust enrichment does not provide the rationale for knowing receipt. The very existence of the Tracing process must make one question the restitutionary rationale and the associated transformation that some seek to impose upon knowing receipt. Insofar as the trust money can be identified within the third party's assets and the third party is not a *bona fide* purchaser for value without notice, the Tracing process ensures that the third party recognises the plaintiff's equitable ownership. In this respect the Tracing process may be regarded as intuitively applying embryonic restitutionary principles. To the extent that the third party remains unjustly enriched by the plaintiff's property, he or she must restore it.

The function of the knowing receipt claim, however, is different to that of the Tracing process. While some courts appear to have watered down the consequences of a successful knowing receipt claim by ordering the recovery of just the value of the money originally received, it is submitted that the dominant characteristic displayed by this claim is the constructive trusteeship that it may culminate in. This is just one of the many situations in which the principle of unjust enrichment comes into contact with other rationales, for instance a judicial

⁸⁶ *Eagle Trust plc v SBC Securities Ltd*, supra n77 at 497 per Vinelott J.

⁸⁷ *El Ajou v Dollar Land Holdings*, supra n7; *Boscawen v Bajwa*, supra n73 at 779.

⁸⁸ Millett, "Tracing the proceeds of Fraud" (1991) 107 LQR 71.

⁸⁹ Gardner, "Knowing Assistance and Knowing Receipt: Taking Stock", supra n9 at 87.

policy of protecting the trust relationship while recognising the potential impact upon third parties. In such circumstances the issue is which rationale is to be dominant. Commenting on the developing law of restitution Professor Sutton has observed:

This is a law of complex undercurrents; its vitality is far from completely expressed by saying that in all cases that it 'depends' upon a principle of unjust enrichment or is expressive of some generalised right to restitution, as distinct from rights given under the law of contract, property or torts. The policies applicable to the prior relationship between the parties (whether as persons who have made a contract, or contending claimants to property, or confider and confidant) will often determine the outcome.⁹⁰

It is submitted that this observation accurately captures the situation. Equity has developed a hierarchy of remedies for the recovery of misappropriated trust money from a third party. At one extreme there is the innocent voluntary recipient. The court's recognition of that party's innocence is reflected by the imposition of liability, pursuant to the Tracing process, to return the trust money that remains identifiable. At the other extreme is the third party who knew that the transfer to him or her was in breach of trust. In this situation the court's reprehension of the third party's conduct is reflected in the imposition of liability for the value of the trust money received and the ability to impose the full burdens of trusteeship. In the middle ground is the *bona fide* purchaser who, while not having knowledge of the breach of trust, had notice of the pre-existing equitable interest. Unlike the knowing third party, the *bona fide* purchaser with notice has not been dishonest. He or she should just have made more enquires before acquiring the money or should, at least, have more fully appreciated the significance of the information that he or she possessed. Reflecting the *bona fide* purchaser's innocence, he or she is treated in the same way as the innocent voluntary recipient.

While to a degree the principle of unjust enrichment can be perceived operating within the knowing receipt claim, it is submitted that it does not provide its *raison d'être*.

⁹⁰ RJ Sutton, "Book Review, The Law of Restitution. Third Edition" [1987] CLJ 509 at 513.