THIRD PARTIES AS CONSTRUCTIVE TRUSTEES: SELANGOR REVISITED

By C. B. Cato LL.B. (Hons), B.C L (Oxon.)
Barrister

In this article, the subject of consideration is the liability of third parties as constructive trustees where they have become implicated in transactions carried out in breach of fiduciary duty. Aptly, this area of law has been described by one Chancery judge as one of the most difficult that a court of equity has to deal with.[1] Of central importance here is the case of *Selangor United Rubber Estates Limited* v *Cradock (No.3)*[2] where a bank was held liable as a constructive trustee for participating in a transaction involving a fraudulent acquisition or takeover of the shareholding of a company, Selangor. This controversial ruling of Ungoed-Thomas J. was subsequently followed in similar circumstances by Brightman J. in *Karak Rubber Co. Ltd.* v *Burden (No.2)*[3]. However, the reasoning by which Ungoed-Thomas J. and Brightman J. concluded that the respective banks were liable as constructive trustees has been rejected by the English Court of Appeal in *Belmont Finance Corporation Ltd.* v *Williams Furniture Ltd. (No.2)*[4], a decision which Professor Goode in his *Commercial Law*[5] describes as a case which "has greatly clarified the law"[6]. For reasons which will be advanced here, however, it is submitted that the imposition of constructive trusteeship on the banks was correct, albeit that it was imposed for the wrong reasons. It is submitted that any suggestion, such as is advanced by Professor Goode[7], that the respective banks in *Selangor* and *Karak* ought not to have been liable as constructive trustees for their participation in the fraudulent transfer of their customer's funds, would be inconsistent with authority and wrong in principle.

1 Selangor United Rubber Estates Ltd. v Cradock (No 3)

In this case, the branch of District Bank advanced a large sum of money at the request of a customer, Cradock. The reason that Cradock wished the bank to advance moneys was that he desired to effect the acquisition illegally of the shares of Selangor through an intermediary, the Contaglo Banking and Trading Co. Ltd., "Contaglo". It was Cradock's intention that the shareholding of Selangor would be purchased by using the company's own funds in breach of section 54 of the Companies Act 1948. Cradock told officers of the bank that he might influence the transfer of the Selangor account from its existing bank, National, to District. He asked for a bankers' draft in favour of Contaglo and in exchange promised that the bank would receive a draft to cover the advance.

Subsequently, District Bank complied with Cradock's request but the bank did not receive a draft in exchange. Instead, it received a cheque drawn

[1] Kay J. in *Williams* v *Williams* (1881) 7 Ch.D.437, 442.

[2] [1968] 2 All E.R. 1073.

[3] [1972] 1 W.L.R. 602.

[4] [1980] 1 All E.R. 393. See further [1979] 1 All E.R. 118.

[5] Goode, *Commercial Law* (1982).

[6] Ibid., 514.

[7] Ibid., 515

on the Selangor account, which was duly transferred from the National Bank. This cheque was made out in the name of a third party which had endorsed it in turn to Cradock. Subsequently, this cheque was debited against the company's new account, which had been placed in funds sufficient to meet the cheque. The amount of the cheque was credited to Cradock's account. In this way Contaglo, or effectively Cradock, illegally acquired Selangor by using its own funds for the purpose of acquiring its shares.

Subsequently, Selangor commenced action against, inter alia, Contaglo, Cradock and District Bank to recover the proceeds of the cheque. One of the arguments advanced for Selangor against the bank was that it had participated in Cradock's fraud and hence was liable as a constructive trustee to account for the proceeds of the cheque. This argument was accepted by Ungoed-Thomas J.,[8] who ruled that the bank was liable. Although it was not possessed of an actual appreciation of Cradock's fraud, it was nevertheless negligent in that it had failed to make such inquiries as a prudent banker would have made in those circumstances. In the opinion of Ungoed-Thomas J., knowledge for the purpose of imposing liability as a constructive trustee involved not only actual knowledge, but constructive knowledge as well.

Ungoed-Thomas J. based his reasoning on the famous dictum of Lord Selborne L.C. in *Barnes* v *Addy*[9]. In that case, the issue was whether solicitors who had prepared deeds of appointment and had performed other tasks in relation to a trust fund were liable to account for funds that were misappropriated by one of the trustees. In ruling that the solicitors could not be held liable to account, Lord Selborne L.C. said[10]:

> 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, Lord Selborne continued;[11]

> . strangers are not to be made constructive trustees merely because they act as 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

The rationale for this distinction was expressed by Lord Selborne thus[12]:

> I know not how anyone could, in transactions admitting of doubt as to the view which a court of equity might take of them, safely discharge the office of solicitor, of banker, or of an agent of any sort to trustees.

The ruling of Ungoed-Thomas J. as Professor Goode[13] in his comments on *Selangor* pointed out, understandably caused bankers some concern. Any suggestion that a paying bank without more was liable because it had failed to make inquiries as to the reason for the withdrawal of funds from a customer's

[8] [1972] 1 W.L.R. 602.

[9] (1874) L R 9 Ch. App. 244

[10] Ibid., 251.

[11] Idem.

[12] Ibid , 252.

[13] Supra, p 514, n.5.

account, either at law or in equity, was bound to excite concern. Not only would this be a departure from established authority,[14] but it would also impose an intolerable burden in practice on bankers who not only have to[15] "transact a large amount of business", but also "have very limited time available to them to hold the cheque before deciding whether to honour it . . .".

Selangor was briefly mentioned by the Court of Appeal in a subsequent case, *Carl-Zeiss-Stiftung* v *Herbert Smith and Co. (No.2)*[16]. In that case, the East German Foundation of Carl-Zeiss argued that the assets of the West German Foundation, including its property in England, were held by that foundation in trust for the East German Foundation. The claim brought by the East German Foundation was against the solicitors for the West German Foundation, the argument being that the latter had been put on notice by the pleadings of the East German Foundation in the main action. This, together with other material, it was argued, was sufficient to put the solicitors on notice that the moneys which the solicitors claimed as fees belonged to the East German Foundation. The Court of Appeal ruled that this action must fail, because the defendants had no more than mere knowledge of a claim that the money belonged to the East German Foundation. The ratio of the case is embodied in the statement of Sachs L.J., who said[17]:

> The rule is . . . that no stranger can become a constructive trustee merely because he is aware of a disputed claim, the validity of which he cannot properly assess. Here it has been rightly conceded that no one can foretell the result of the litigation even if the plaintiffs were to prove all the facts they allege.

There was, however, little direct discussion of *Selangor* in the judgment. Indeed, Sachs L.J.[18] expressly refrained from passng comment upon it since at that time the case was proceeding to appeal. However, all three judges in their judgments[19] appeared to hint strongly that an agent ought not to be held liable as a constructive trustee in the absence of fraud. This opinion was most clearly articulated by Sachs L.J. who said of the knowledge required to render a stranger liable for breach of trust[20]:

> . . I am inclined to the view that a further element has to be proved, at any rate, in a case such as the present one That element is one of dishonestly or of consciously acting improperly, as opposed to an innocent failure to make what a court may later decide to have been proper inquiry. That would entail both actual knowledge of the trust's existence and actual knowledge that what is being done is improperly in breach of that trust though, of course, in both cases a person wilfully shutting his eyes to the obvious is in no different position than if he had kept them open.

It was subsequently argued before Brightman J. in *Karak Rubber Co. Ltd.* v *Burden (No.2)*[21] that the concept of constructive notice advanced by Ungoed-

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[14] Idem. See further *Bodenham* v *Hoskins* [1843-60] All E R Rep. 692; *Marfani & Co Ltd.*v *Midland Bank Ltd.* [1968] 2 All E.R. 573.

[15] Idem.

[16] [1969] 2 Ch. 276.

[17] Ibid., 296. Cf. *United States Surgical Corporation* v *Hospital Products International Pty. Ltd.* [1983] 2 N.S.W.L.R. 157 at 252-257 (Overruled by the High Court of Australia on other grounds). Further, see Austin, *"Essays in Equity"* (ed. Finn, 1985) at 236-237

[18] Idem

[19] Ibid., 289-293 (per Dankwerts L J.) 296-300 (Sachs L.J.) 304 (Edmund-Davies L J.).

[20] Ibid., 298.

[21] [1972] 1 W.L.R. 602

Thomas J. in *Selangor* was inconsistent with the opinions of the judges in *Carl-Zeiss-Stiftung* v *Herbert Smith and Co. (No.2).* In a lengthy decision, however, Brightman J., in similar circumstances concluded that there was nothing inconsistent, and that the opinion advanced by Ungoed-Thomas J. in *Selangor* was correct.

The facts of *Karak* were that a bank, Barclays, advanced moneys at the request of a Mr Solomans who operated two accounts at the bank; one a company account named Minories. A scheme to acquire Karak shares was again entered into through the Contaglo Banking & Trading Company Limited. Mr Solomans, who died before the action was tried, intimated to the bank that he had a client who was a man of importance and integrity named Burden. Further, he told the bank that Burden was a chairman of a public company and that the bank might be asked to open a public company account. In exchange for the advance debited to Minories' account which the bank made out in favour of Contaglo's bank, National, the bank received a cheque signed by the incoming directors of Karak, one of whom was Burden. This occurred after the new Karak account had been opened with Barclays, and placed in funds. Barclays credited this cheque to the Minories account. As with *Selangor*, the officers of the bank, who had participated in the fraud, had no actual realisation that fraud was involved. After a lengthy review of the evidence, Brightman J. found that the bank was aware of such facts as would have put a prudent banker on inquiry. Brightman J. said[22]:

> In my judgment, the circumstances were so unusual and out of the ordinary course of banking business, the sum involved so large, and the ground so solid for suspecting that someone was using Karak money to finance the takeover transaction, that a reasonable banker would in the interests of his customer, have made further inquiries before inviting or allowing the customer's signatories to pay over £99,504 of the customer's money to the account of Minories. I do not take the view that a reasonable banker would necessarily have made such inquiries at the board meeting itself. At that stage, Barclays Bank had not become Karak's banker, Karak had no assets with Barclays Bank, and the Karak cheque, though envisaged, had not been drawn. A reasonable banker, possessed of the knowledge of Mr Cooper but, unlike Mr Cooper, approaching the situation in a detached and uncommitted frame of mind, would have put his questions to the signatories when the Karak cheque was actually tendered.

In Australia, the ruling of Ungoed-Thomas J. was further considered by the High Court of Australia in the important case of *Consul Development Pty. Ltd.* v *DPP Estates Pty. Ltd.*[23]. In that case, a solicitor, Walton, as managing director controlled a group of companies engaged in real estate. Walton employed a clerk named Clowes who became the managing director of Consul Developments Pty. Ltd. on the death of his father. One of Walton's companies was DPP Estates Pty. Ltd.. Walton secured the services of a man named Grey to locate suitable properties for the group. Under the terms of his appointment, he agreed not to divulge information concerning the business of the company and undertook not to be involved in real estate except as manager for the companies other than with Walton's consent.

Unknown to Walton, Grey, in breach of his fiduciary duty, entered into several private arrangements with Clowes whereby Consul purchased certain properties in consideration for which Grey secured a commission. However, what was crucial in the opinion of the majority of the High Court of Australia,

[22] Ibid., 630-631.

[23] (1975) 49 A.L.J.R. 74. See Heydon, "Recent Developments in Constructive Trusts" (1977) 51 A.L.J. 635

which reversed a ruling of a majority of the Court of Appeal in favour of DPP Estates Pty. Ltd., was that the trial judge had found that Clowes honestly believed after inquiries of Grey that Walton was not interested in the properties because he could not afford to purchase them. Further, there was evidence that independently of Grey, Clowes knew that the Walton group of companies was in financial difficulties. In rejecting the claim made by DPP Estates Pty. Ltd. that Consul held the properties as constructive trustee, Gibbs J. said[24]:

> . . . on the facts which Clowes believed to exist, Grey was not acting in breach of his fiduciary duty in participating in the purchase of the properties. Therefore, Clowes did not knowingly participate in Grey's breach; he neither actually knew, nor had reason to believe, that Grey was violating his duty, and in the circumstances, an honest and reasonable man would not have thought it necessary to inquire further.

Stephen J. on this point, said[25]:

> The fact was that the Walton group of companies, because of lack of funds, was unable to pay the necessary price for, and hence did not wish to buy, the properties which Grey told him of. If Clowes believed that, as I think must be concluded, then his actions throughout were consistent with ignorance of Grey's fraud, although no doubt inconsistent with any nice appreciation of what was proper in the conduct of an articled clerk; . . .

Of *Selangor*, McTiernan J.,[26] who dissented on the grounds that Clowes' conduct undermined Grey's loyalty, considered that he[27] "would readily accept whatever extension of the (*Barnes* v *Addy*) doctrine, that may be implicit in the decisions of Ungoed-Thomas J. in *Selangor*". Gibbs J. appeared also to lean in favour of *Selangor* which, in his opinion, was distinguishable from *Carl-Zeiss-Stiftung* v *Herbert Smith and Co. (No.2)*[28]; however, he expressed some reservation. He said[29]:

> It may be that it is going too far to say that a stranger will be liable if the circumstances would have put an honest and reasonable man on inquiry, when the stranger's failure to inquire has been innocent and he has not shut his eyes to the obvious. On the other hand, it does not seem to me to be necessary to prove that a stranger who participated in a breach of trust or fiduciary duty with knowledge of all the circumstances did so actually knowing that what he was doing was improper. It would not be just that a person who had full knowledge of all the facts could escape liability because his own moral obtuseness prevented him from recognising an impropriety that would have been apparent to the ordinary man. However, it is unnecessary for me to express any concluded view on these questions, and I assume for the purposes of this case, but without finally deciding, that the formulation of principle on this point in the *Selangor* case was correct.

Stephen J., with whose judgment Barwick, C.J. expressed his agreement, appeared also to question the reasoning of Ungoed-Thomas J. pointing out that[30]:

> . . . the state of the authorities as they existed before *Selangor* did not go so far, at least in cases where the defendant had neither received nor dealt in property impressed with any trust, as to apply to them that species of constructive notice which serves to expose a party to liability because of negligence in failing to make inquiry.

[24] Ibid., 86.

[25] Ibid., 89.

[26] Ibid., 76–80.

[27] Ibid., 80.

[28] [1969] 2 Ch. 276.

[29] Supra, p. 76 n. 23.

[30] Ibid., 91.

Yet Stephen J.'s opinion on what the law should be was also clouded by some doubt, for he added[31]:

> If a defendant knows of facts which themselves would, to a reasonable man, tell of fraud or breach of trust, the case may well be different, as it clearly will be if the defendant has consciously refrained from inquiry for fear lest he learn of fraud. But to go further is, I think, to disregard equity's concern for the state of conscience of the defendant.

2 BELMONT FINANCE CORPORATION LTD v WILLIAMS FURNITURE LTD.[32]

The reasoning of Ungoed-Thomas J. in *Selangor* is, however, inconsistent with the judgment of the Court of Appeal in *Belmont Finance Corporation Ltd.* v *Williams Furniture Ltd.*. In that case, a Mr James controlled two companies, Williams Furniture Ltd. and City, which in turn owned the shares in the plaintiff, Belmont. A Mr Grosscurth and associates owned a company, Maximum. Grosscurth desired to acquire an interest in Belmont and James was keen to secure Grosscurth's services in the field of property development. A scheme was entered into whereby James and Grosscurth agreed that Belmont should purchase Maximum for £500,000. Maximum in turn would then purchase City's shares of Belmont for £489,000. It was found as a fact by the trial judge that James honestly believed that the value of Maximum was appropriately fixed at £500,000 and that to secure Grosscurth's services in this way was a good commercial proposition. Grosscurth had also obtained legal opinion which he furnished to City to the effect that the proposed sale of Maximum to Belmont in this way did not contravene section 54 of the Companies Act 1948, whereby it was unlawful for Belmont to give financial assistance, directly or indirectly, for the purpose of acquiring shares in that company. Subsequently, Belmont went into liquidation and it was discovered that Maximum was grossly overvalued. The liquidator accordingly commenced actions in conspiracy and in equity based on constructive trusteeship against a number of defendants including Williams, City and Grosscurth.

At first instance, before Foster J. the claims failed. Foster J. considered that because the transaction had been entered into at arm's length and because both parties genuinely believed it to be a good commercial proposition, section 54 was not violated. The Court of Appeal, however, found for Belmont both in conspiracy and constructive trusteeship. It was the opinion of the court that the transaction was exceptional and artificial and was not in any sense an ordinary, commercial transaction. Because the arrangement was unlawful and Williams, City and Grosscurth were parties to the illegality, conspiracy was made out. The fact that erroneous legal advice was given did not excuse any of the defendants.

Of the claim relating to constructive trusteeship, the court unanimously found that City was liable as a constructive trustee for the sum of £489,000 being the sum it had received from Grosscurth in consideration for its shares in Belmont. Buckley L.J. said[33]:

> In the present case the payment of the £500,000 by Belmont to Mr Grosscurth, being an unlawful contravention of section 54, was a misapplication of Belmont's money and was in breach of the duties of the directors of Belmont. £489,000 of the £500,000 so misapplied found their way into the hands of City with City's knowledge of the whole circumstances

[31] Idem.

[32] [1980] 1 All E.R. 393.

[33] Ibid., 405.

> of the transaction. It must follow, in my opinion, that City is accountable to Belmont as a constructive trustee of the £489,000 under the first of Lord Selborne L.C.'s two heads.

However, the Court unanimously held that there could be no liability under the second head of *Barnes* v *Addy*. The directors of Belmont were not guilty of fraud. Goff L.J. who had already expressed some doubt about *Selangor* in *Competitive Insurance Co. Ltd.* v *Davies Investments Ltd.*,[34] said[35]:

> This leaves only the second head of constructive trusteeship and in my judgment, that cannot be supported without going behind the judge's finding as to Mr James's genuine belief, which I have already said I am not prepared to do. He may be carried away by his enthusiasm over Mr Grosscurth, but if he genuinely believed that the agreement was a good, commercial proposition for Belmont, he cannot be held to have been fraudulent. If he had been wilfully shutting his eyes to the truth, his belief would not have been genuine.

Belmont, therefore, constitutes a rejection of the reasoning by which Ungoed-Thomas J. found the District Bank liable as a constructive trustee in *Selangor*. Constructive notice is not sufficient to found participation in a breach of trust under the second head of *Barnes* v *Addy*. It is, however, sufficient under the first head. As Buckley L.J. said in *Belmont*[36]:

> So, if the directors of a company in breach of their fiduciary duties misapply the funds of their company so that they come into the hands of some stranger to the trust who receives them with knowledge (actual or constructive) of the breach, he cannot conscientiously retain these funds against the company unless he has some better equity. He becomes a constructive trustee for the company of the misapplied funds.

3 Selangor Reconsidered In The Light Of Belmont

Although *Belmont* refutes the reasoning by which Ungoed-Thomas J. in *Selangor* and Brightman J. in *Karak* found the banks liable as constructive trustees, it is submitted that the banks were rightly held liable as constructive trustees because they came within the first head of Lord Selborne L.C.'s dictum. The banks were more than the mere paying banks Professor Goode,[37] in his *Commercial Law,* appears to suggest. Rather, they had placed themselves in a position where they stood to lose heavily if they did not collect the companies' cheques in order to extinguish the debts created by the advances which had been made at the request of Cradock and Solomans, both of whom had promised that in exchange for assistance, the respective company accounts would be transferred.

Indeed, in *Karak*, Brightman J. hinted at this when he said of counsel for the plaintiff's argument:[38]

> I take this opportunity to record that I asked Mr Edward-Jones whether he based his claim to any extent on the first category of constructive trusteeship, having regard to the fact that the Karak cheque was made payable to Barclays Bank and was endorsed by Barclays Bank and credited to Minories, so that in that sense the trust money passed through the hands of Barclays Bank. Mr Edward-Jones told me that the claim against Barclays Bank in the context of constructive trusteeship was based exclusively on the second category of constructive trusteeship, that is to say, on the *Barnes* v *Addy* formula, where it is fundamental to find existence of a dishonest and fraudulent design on the part of the trustees.

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[34] [1975] 1 W.L.R. 1240 at 1251. See further *Belmont Furniture Ltd.* v *Williams Furniture Ltd. (No.1)* [1979] 1 All E.R. 118 at 136.

[35] Supra, pp. 412-413, n. 32.

[36] Ibid., at 405.

[37] Supra, pp.514–515, n.5.

[38] [1972] 1 W.L.R. 602 at 639. Note also the discussion on this point by Austin in *Essays in Equity*, supra, pp 225–227, n.17.

A number of cases, however, decided prior to *Selangor* would appear to support the argument advanced here that the banks were liable as constructive trustees under the first head of Lord Selborne L.C.'s dictum on the grounds of constructive notice. Of these, the first is *Bodenham* v *Hoskins*,[39] which was relied upon and cited with approval by Ungoed-Thomas J. in *Selangor*.[40] There, Parkes, a solicitor, was the receiver of the rents of an estate. Parkes had a private account with the same bank which was overdrawn. In exchange for the bank permitting him to overdraw his private account, he had informed his bankers that he would introduce the estate's account and business to the bank. Subsequently, he misappropriated estate funds by drawing a cheque on the estate account and applying it to reduce his personal indebtedness to the bank. Although exonerating the bankers of any fraud, the court found them liable to account to the plaintiff for the proceeds of the cheque. Kindersley V.C. said[41]:

> I am constrained to arrive at the conclusion that the bankers, although I must exonerate them from any deliberate intention to commit a fraud, were not only parties to the simple fact of transfer, but were parties to the fraud in question in this sense — that they were aware of the circumstances which made it a fraud in Parkes to make the transfer to his private account, and being cognisant of that throughout, they concur in a transaction the effect of which was that for their own pecuniary benefit an act was done by Parkes which is a fraud upon the plaintiff. According to the plain principles of a court of equity, such an act never can be sustained; a person cannot retain the benefit which he has derived from being a party to such an act with such knowledge of the nature of the act.

Another case which illustrates that a party who receives a pecuniary advantage, or other property in breach of trust, cannot plead his own moral obtuseness in defence if a reasonable man would have been put on inquiry is the decision of the House of Lords in *Reckitt* v *Barnett*.[42] There, a solicitor named Terrington drew a cheque on his principal, Sir Harold Reckitt, to extinguish a personal debt on a motor car which he had purchased from the respondents. This cheque was made payable to the respondents and was signed "Sir Harold J. Reckitt, by Terrington his Attorney". The House of Lords unanimously held that the respondents were liable to the appellants for the value of the cheque. In the opinion of Viscount Dunedin[43]:

> The respondents not having made any inquiry cannot be in a better position than if they had made inquiry. The inquiry would necessarily be whether the drawing and handing over of the cheque on Reckitt's account for a debt of Lord Terrington's was within the power of attorney is clear. It only authorises Lord Terrington to conduct Reckitt's business, not to pay accounts of his own.

Further, there is the famous case of *Nelson* v *Laholt*.[44] There, an executor of an estate over a period of three years cashed a series of cheques on the banking account of his testator's estate in favour of the defendant, who was a bookmaker. The defendant gave value for the cheques, and it was not suggested that he did not receive them in good faith. Denning J. held, however, that the defendant was liable to account to the estate for the proceeds of

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[39] [1843–60] All E.R. Rep. 692.

[40] [1968] 2 All E.R. 1073 at 1097.

[41] Supra, p.697, n 39.

[42] [1929] A.C. 176.

[43] Ibid., 184.

[44] [1948] 1 K.B. 339.

the cheque. Citing as authority *Reckitt* v *Barnett*, Denning J. said of the defendant[45a]:

> He must, I think, be taken to have known what a reasonable man would have known. If, therefore, he knew or is to be taken to have known of the want of authority, as, for instance, if the circumstances were such as to put a reasonable man on inquiry, and he made none, or if he was put off by an answer that would not have satisfied a reasonable man, or in other words, if he was negligent in not perceiving the want of authority, then he is taken to have notice of it.

Applying the reasoning in these cases to *Selangor* and *Karak*, it is accordingly submitted that constructive trusteeship was imposed rightly upon the banks albeit that they were also paying bankers, because they had received cheques which had been misappropriated to reduce the private indebtedness of their customers in circumstances which would have put reasonable bankers on inquiry. Their failure to recognise that the circumstances might involve fraud was no defence because they had received a pecuniary advantage. Since at least *Bodenham* v *Hoskins*, the law has imposed a higher obligation upon those who receive trust property than upon those who honestly but perhaps foolishly become participants in a breach of trust, but who do not receive the property for their own advantage.

Finally, on this analysis, it is submitted that the recent judgment of Peter Gibson J. in *Baden Delvaux and Lecuit* v *Société General*[45b] is open to criticism. In a very lengthy judgment, Peter Gibson J. declined to hold a bank, the Société General, liable to account to beneficiaries defrauded by a transfer of funds from a trust account to the fiduciary. The money was dissipated by the fiduciary for unauthorised purposes. In rejecting the claim that the bank was liable to account, Peter Gibson J. held that the bank did not have either actual or constructive notice of the fraud. Although the bank was put on inquiry, applying an objective standard of reasonableness, Peter Gibson J. considered that a reasonable banker would not have suspected fraud by the answers to its inquiries.

The judgment places considerable emphasis on *Selangor* and *Karak* which were not challenged. It is, however, submitted that the case is readily distinguishable from *Selangor* and *Karak* because the Société General was in the position of a paying bank. It was not receiving trust funds for its own benefit. On this analysis, it was unnecessary for Peter Gibson J. to consider whether the bank had constructive notice in order to impose an account. In the absence of evidence of actual knowledge of the fraud, the Société General, as a paying bank, ought not to have had to account even assuming that the court had found that it had failed to undertake the inquiries of a prudent banker. Such duty of care or inquiry as the bank owed to the plaintiffs by virtue of the fiduciary nature of the account exposed the bank to liability not in equity, but in tort.

4 Conclusions

From the cases, the following principles appear to apply to govern the liability of third parties who become involved in breaches of trust or other fiduciary obligation:

(a) Third parties who receive such property for their own benefit will be liable if they have not pursued inquiries which would be expected of

[45a] Ibid., 343.

[45b] [1983] B.C.L.C. 325.

a reasonable and prudent person in their position. The fact that a third party was not dishonest, but was merely obtuse, will not provide a defence in these circumstances.[46]

(b) Third parties, who receive trust property for their own benefit, are not liable should they make the inquiries which a reasonable and prudent person in their position would have made. It would appear, following *Consul Developments Pty. Ltd.* v *DPP Estates Ltd.*,[47] that a satisfactory answer from the fiduciary will be sufficient, but it is submitted that in general, a prudent third party should endeavour to make inquiries directly of the principal. Answers to inquiries are prima facie to be presumed to be honest,[48] but the circumstances surrounding the transaction may be so suspicious as to rebut this presumption and invite further inquiry.[49]

(c) Third parties, who act solely as agents, should not be liable unless they have participated in the transaction with actual knowledge of the fraud.[50] An agent who wilfully shuts his eyes to the obvious should be in no different position from one who has kept them open.[51] Actual knowledge should be the test of liability, even where the agent receives or has control over trust property, so long as the agent is in possession of the property only in his capacity as an agent. Any loss that the beneficiaries may suffer, because of a failure to perform properly the agency or make such inquiries as a reasonable agent would have made in the circumstances, may give rise to an obligation in tort or upon the contract of agency but not in equity.

(d) Third parties who perform services as agents should not be held liable merely because they have knowledge that property they receive by way of reimbursement for their services in fees is the subject of a disputed claim or doubtful equity.[52] Where the agent has actual knowledge that the property is in fact trust property or wilfully closes his eyes to the obvious[53], he should be held liable as a constructive trustee. However, the agent who has acted honestly should be entitled to rely on his principal's claim to the property and retain the fruits of his labour.

Postscript

Since this article went to print, the decision of the Court of Appeal

[46] *Bodenham* v *Hoskins* (1843-60) All E.R. Rep. 692; *Berwick-upon-Tweed Corporation* v *Murray* (1857) 7 De G.M & E. 499; *Gray* v *Johnston* (1867) L.R. 3 H.L. 1; *Coleman* v *Bucks and Oxon. Union Bank* (1897) 2 Ch. 243; *Reckitt* v *Barnett* [1929] A.C. 176; *Nelson* v *Laholt* [1948] 1 K.B. 339; *Selangor United Rubber Estates Ltd.* v *Cradock (No.3)* (1968) 2 ALL E.R. 1073; *Karak Rubber Co. Ltd.* v *Burden (No.2)* [1972] 1 W.L.R. 602; *Belmont Finance Corporation Ltd.* v *Williams Furniture Ltd. (No.2)* [1980] 1 All E.R. 393

[47] (1975) 49 A.L.J.R. 74.

[48] *Selangor United Rubber Estates Ltd.* v *Cradock (No.3)* [1968] 2 All E.R. 1073; *Baden Delvaux and Lecuit* v *Société General* [1983] B.C.L.C. 325 at 414-416

[49] *Nelson* v *Laholt*, supra; *Karak Rubber Co. Ltd.* v *Burden (No.2)*, supra, at 631.

[50] *Barnes* v *Addy*, Supra; *Williams* v *Williams* (1881)7 Ch. D.437; *Williams-Ashman* v *Price and Williams* [1942] 1 Ch.218; *Belmont Finance Corporation Ltd* v *Williams Furniture Ltd (No.2)*, supra.

[51] *Carl-Zeiss-Stiftung* v *Herbert Smith & Co. (No.2)* [1969] 2 Ch. 276.

[52] Ibid.

[53] *Baden Delvaux and Lecuit* v *Société General* [1983] B.C.L.C. 325 at 407. Also *United States Surgical Corporation* v *Hospital Products International Pty. Ltd.* [1983] 2 N.S.W.L.R. 157 at 255-258.

in *Westpac Banking Corporation* v *Savin* has been reported: [1985] 2 NZLR 41.

This case involved a bank receiving trust funds in reduction of the trustee's private overdrawn account. The Court of Appeal began by noting that a bank is not ordinarily bound to inquire into the sources from which a customer receives money paid into his own account. However, in a case such as this, where the bank was accepting trust money in reduction of the trustee's overdrawn account, the bank could be fixed as a constructive trustee of that money notwithstanding that it had no actual knowledge that the trustee was acting in an unauthorised manner. In such a situation the court held that it was sufficient for the imposition of a constructive trust if the bank's knowledge was such as would have lead a reasonable (or "ordinary", per McMullin J.) person to the belief that the deposit of trust funds was unauthorised.

Sir Clifford Richmond went on, obiter, to consider the position of persons who assist in a fraudulent design on the part of the trustees but are not actually in receipt of the trust property. His Honour favoured the view that actual knowledge of the fraud would be required before a constructive trust could be imposed on such a person, although no final opinion was expressed on the matter.

Significantly, Sir Clifford also indicated that agents in receipt of trust property purely in their capacity as agents are to be regarded as falling in to the category of "knowing assistance" rather than "knowing receipt".

This analysis is substantially in keeping with the arguments put forward by Mr Cato in the article above.

For a more detailed discussion of *Westpac Banking Corporation* v *Savin* see J. Vroegop, [1986] NZLJ 183.

EDITOR