# Solicitors: honest partners and constructive trusteeship

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*Does a solicitor who misappropriates a trust fund in breach of trust render his partners, who have no actual knowledge of the events, liable to account to the beneficiaries for the loss of the fund? This is the question addressed by David Patterson in this article.*

## I. INTRODUCTION

In *Blyth* v. *Fladgate*,[1] decided in 1891, it was held that a solicitor who had dealt with a trust fund in breach of trust rendered all his partners liable as constructive trustees. In *Mara* v. *Browne*[2] in 1896 three judges of the Court of Appeal expressed the opinion, obiter, that even if one partner was held liable as constructive trustee for his dealings with a trust fund, the other members of the partnership would not be liable if they were without actual knowledge of the misapplication. There was no further judicial statement on this question for over eighty years, until the decision of Vinelott J. in *Re Bell's Indenture, Hickley* v. *Bell*[3] in 1979. Vinelott J., applying the dicta in *Mara,* decided that a partner, who was liable as a constructive trustee for misapplication of a trust fund, did not render his innocent partners liable either as constructive trustees or under sections 10 and 11 of the Partnership Act 1890 (U.K.). *Re Bell* is of interest for two main reasons. First, it has resolved an apparent conflict between two cases decided over eighty years ago, and is therefore of interest as to the manner of that resolution. Secondly, the decision itself is of interest as a matter of substantive law.

This article attempts two tasks. First, it is proposed to examine the authoritative basis of the decision itself. Secondly, the decision will be examined in the context of constructive trusts imposed on transferees and agents.

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1 [1891] 1 Ch. 337.
2 [1896] 1 Ch. 199.
3 [1980] 1 W.L.R. 1217.

## II. CONSTRUCTIVE TRUSTS — AN OVERVIEW

Four types of trust exist[4] — the express trust, the resulting trust, the implied trust, and the constructive trust. The express trust arises where the settlor by express statement intentionally creates a relationship of trustee and beneficiary. The implied trust and resulting trust both occur where the settlor carries out some other transaction from which the court infers the relationship of trustee and beneficiary. The settlor makes no express statement of intention, but the settlor's intention is inferred from the circumstances. A constructive trust arises where the court imposes on certain persons a relationship of trustee and beneficiary as the result of their conduct or knowledge. This relationship arises totally independently of the intention of any of the parties.[5]

Since the constructive trust is imposed by the court, the vital task is to define the circumstances in which the court will impose the trust. Definition of these circumstances has been carried out by a process of separation and development of categories of liability, rather than by a statement of general principle. One of these categories results in a constructive trust being imposed on a stranger — that is, a transferee or agent — who has dealt with or received property which has come into his hands as the result of a breach of fiduciary duty by another. *Re Bell* falls into this category.

Definition of the detail of the categories of constructive trust has presented some problems. In order to introduce the type of question that will be discussed later in this paper, it is proposed to outline one of the problems that has been encountered in the imposition of constructive trusts on transferees or agents. The problem has arisen as to the degree of knowledge of the original wrongdoing and/or existence of a trust that is required by the stranger to the trust fund, before a constructive trust can be imposed on him. Must the stranger actually have known that he was receiving or dealing with trust property in breach of trust? Or is it sufficient that he should have known, or could have discovered the breach had he acted in a reasonable manner? This question, among others, will be discussed in the context of the three cases of *Blyth, Mara,* and *Re Bell.*

## III. THE AUTHORITATIVE BASIS OF THE DECISION IN *RE BELL*

*Mara* v. *Browne, Blyth* v. *Fladgate,* and *Re Bell* all involved solicitors who, without their partners' actual knowledge, dealt with a trust fund in a manner which turned out to be a breach of trust. In each case the beneficiaries of the express trust brought an action against the solicitors, seeking to make them and their partners liable for the loss of the trust fund. In *Blyth* the wrongdoing partner and the other partners, who had no actual knowledge of what had been done, were all held liable as constructive trustees. In *Re Bell* the wrongdoing partner

4 There are some difficulties with this assertion. It may be better to view the resulting and implied trusts as synonymous (see A. J. Oakley *Constructive Trusts* (Sweet and Maxwell, London, 1978) 9). It may also be that secret trusts are best treated as a separate type. These problems are not destructive of the present classification as this is used purely to introduce the body of law that is to be discussed.

5 For the source of this discussion see A. J. Oakley op.cit. 8-9.

was liable as a constructive trustee, but his partner was not so liable. In *Mara* neither the partner who dealt with the fund, nor the innocent partner was held liable as a constructive trustee. How, then, can these cases be reconciled? It will be necessary first to describe in detail what happened in each case.

### *A. Detailed Examination of the Three Cases*

#### 1. *Blyth* v. *Fladgate* 1891

Under a marriage settlement in 1855 between Mr. and Mrs. B, the three trustees were to invest the trust fund in real securities and to pay the income to Mrs. B during her life. While G, the last surviving trustee, was alive he authorised payment of the trust fund to Fladgates, a firm of solicitors. On G's instruction Fladgates invested the money in Exchequer bills, depositing the bills in Fladgates' name at their bank. G died in June 1883. Subsequently Mr. B wanted to find a suitable investment for the trust fund. He saw S, a partner in Fladgates. S, who acted for the firm throughout,[6] pointed out that there were no trustees of the settlement. Three new trustees, including S himself, were proposed, but because of a delay they were not appointed until April 1884. Before this the Exchequer bills were sold by order of the firm and the proceeds banked at their bankers. Then, in March 1884, S advised and executed an investment of the trust fund in favour of the proposed trustees (who, with S and Mr. B, had approved the investment). The advance was imprudent. The investment proved to be an insufficient security, and thus it was held that a breach of trust was committed.

Shortly after this transaction the trustees were appointed. In *Blyth* v. *Smith,*[7] which was decided in 1888, the trustees were held jointly and severally liable to make good the loss sustained because they had, by never repudiating the investment, effectively sanctioned an investment that could not be made by duly constituted trustees. Some £9,600 had been lost. In an attempt to recover fully that amount, the beneficiaries of the express trust brought an action claiming that the partners of S were also liable for the loss of the trust fund. It was admitted that: (i) all the partners actually knew that, having had custody of the Exchequer bills, the partnership had sold them and retained the proceeds in the partnership's bank account; (ii) all the partners knew, or were affected with knowledge, that the bills were subject to the trusts of the settlement.

The partners of S were held liable as constructive trustees, even though they had no actual knowledge of S's activities with regard to the fund. In reaching his decision, Stirling J. made statements that give the impression that liability was imposed on them on the principle that the knowledge of one partner must be imputed to the other member of a partnership:[8]

> . . . the knowledge so acquired by [S] must, as it seems to me, be imputed to the other partners, whose agent he was, for the purpose of dealing with this trust fund under their

6 The firm receiving payment for his services.
7 1888 unreported.
8 Supra n.1, 352.

> control. I think, therefore, that the other partners must be taken to have had notice that the security was not of a character suitable for the investment of trust funds, and was one which the trustees of the settlement could not properly sanction as an investment of the funds in the custody of the firm. The partners were consequently implicated in the breach of trust which was committed.

However, these comments should be read in the light of the facts of the case and the manner in which the problem was introduced by Stirling J.:[9]

> The funds . . . came into the custody and under the control of the firm with notice of the trusts upon which they were held; and as against the Plaintiffs in *Blyth* v. *Fladgate*, it lay with the firm to discharge themselves by shewing that the funds were duly applied in accordance with the trusts.

Interpreting the case on this statement, the partnership undertook a duty by receiving the trust fund at a time when there were no trustees. To discharge themselves, the honest partners needed to show that the funds were applied in accordance with the terms of the trust. This they could not do because of the investments made by S, and all members of the partnership were liable as constructive trustees.

2. *Mara* v. *Browne* 1896

Mrs. M was the life tenant under a marriage settlement made on her marriage to HR. It was discovered that J, one of the trustees of the trust fund, had misapplied that fund. His co-trustee was W, who had not been active in the management of trust affairs. In January 1884 Mr. and Mrs. HR, who had power to appoint the trustees, appointed AR in place of W. However, AR and W did not execute this deed. J remained trustee on the understanding that, when he had made good the deficiencies in the assets, he would be replaced by Miss. MR. The deficiencies were made good and by deed of 9 May 1884 she was reappointed trustee to act with AR. However, between January 1884 and 9 May 1884 J paid the trust money into a joint account for himself and AR, from which payments were made to HB. HB was a solicitor, who advised investments of the trust fund. Once that advice had been considered and approved by AR and Mr. and Mrs. HR, HB would make the investment. J knew that investments were being made with the money, but was not consulted about the actual investments made.

Some of the investments were imprudent and made in breach of trust. Mrs. M sought to make liable as constructive trustees HB, who had advised and made the investments, and AB, his partner in the solicitors' firm, who knew nothing of what had happened. It was accepted that any possible liability of HB for negligence in advice given was, by the time the action was brought, barred by the Statute of Limitations.

It was not contended that HB was guilty of any fraudulent or dishonest conduct to the injury of the beneficiaries.[10] Having admitted this it became necessary to admit that, if the deed appointing AR and Miss MR trustees had been executed in January 1884, then HB could not be liable as he would have been acting merely

9 Ibid. 351.

10 Per Smith L.J., supra n.2, 209. See also A. L. Smith L.J., supra n.2, 212; and Rigby L.J., supra n.2, 214.

within his capacity as the solicitor of the trustees. However the plaintiff argued that until 9 May AR was at most a trustee de son tort, an intermeddler, as he was not validly appointed a trustee. J and W were the existing trustees and neither was authorising HB to act for him. As HB had no principals, the plaintiff argued, he must be held to be a principal himself and therefore liable as a trustee de son tort.

The defendant argued that when HB made the investment he acted only as agent and with the authority of the then existing trustees, J and AR, and so was not liable as a constructive trustee.[11] Since HB was not a constructive trustee it followed that AB could not be. An alternative argument was that even if HB was a constructive trustee, AB, although a partner of HB, was not as he knew nothing of what happened.

North J.[12] held that the deed of January 1884 was never acted upon and was abandoned, incomplete. He held HB liable as a constructive trustee — he was an agent in possession of trust funds who, without the consent of duly appointed trustees, misapplied the trust fund. North J. also held that AB was liable — the receipt of money by a partner in the course of business is a receipt by the firm and thus all the partners were liable. Whether AB was liable as a constructive trustee or under partnership law was irrelevant, in North J.'s opinion, for liability was to the same extent in either case.

The appeal was allowed. The Court of Appeal took a different view of the facts. Lord Herschell, A. L. Smith L.J., and Rigby L.J. all held that AR was a validly appointed express trustee under the appointment of January 1884. On this view of the facts it was clear that HB received the money from duly appointed trustees for application upon specific investments and he so applied the money. He acted only in his capacity as solicitor and so could not be liable as a constructive trustee.

An issue on alternative facts was argued strongly before the court: if AR had not been validly appointed as a trustee, but by his actions became a trustee de son tort as an intermeddler, would this affect the liability of the solicitor HB? North J. at trial had accepted that this would render HB liable. The Court of Appeal, having decided that AR was validly appointed, was not obliged to consider this question and two of the judges did not. Lord Hershell, obiter, expressed the opinion that even if the trustee, under whose instructions the solicitor worked, was invalidly appointed, the solicitor would not be liable as a constructive trustee, so long as he acted honestly in the course of his agency.

If HB was not liable as constructive trustee it was clear that AB, his innocent partner, was not liable also. However, the three judges in the Court of Appeal expressed the opinion that, even if HB was liable as constructive trustee, AB, as an innocent partner, would not also be liable because[13]

11 Citing as authority *Barnes* v. *Addy* (1874) L.R. 9 Ch. App. 244.

12 [1895] 2 Ch. 69.

13 Per Lord Herschell, supra n.2, 208.

it is not within the scope of the implied authority of a partner in such a business that he should so act as to make himself a constructive trustee, and thereby subject his partner to the same liability.

3. *Re Bell's Indenture, Hickley* v. *Bell* 1980

By a marriage settlement, the settlor settled property on himself for life and, by his will, he devised that property to his son, A, for life with various remainders over. In 1940 A and his mother, the settlor's widow, became the only trustees of the trusts created by the will and between then and 1947 they dissipated the whole trust fund in breach of trust. H, a partner in the firm of solicitors acting for the trustees, knew of these misapplications and in some cases actively assisted in them. H knew that payments, that he made to A and his mother from the trust fund held by the solicitors' firm, were misappropriated by them as trustees of the fund. Although moneys received and paid in breach of trust passed through the firm's client account in the name of the trustees, H's partner had no actual knowledge of the breaches of trust and acted reasonably throughout.

A died in 1959 and the life interest passed to his mother and, on her death, to other members of the family. The plaintiffs, who had contingent interests under the will trusts, made inquiries and in 1967 discovered what had happened. Proceedings were brought against H, the executors of the estate of H's partner, and the executrix of A's estate claiming the replacement of the various sums and assets dissipated in breach of trust. It was conceded that:

(i) A was liable as a trustee for breaches of trust;
(ii) H was liable as a constructive trustee in so far as he assisted in the breaches of trust.

Questions arose as to the actual amount of liability, but these are of no concern here. The issue of concern here was whether H's partner was liable either as a constructive trustee, or alternatively under the principle embodied in sections 10 and 11 of the Partnership Act 1890 (U.K.).

The plaintiffs argued that *Blyth* supported the proposition that, where a partner is conducting the business of the partnerhip, the knowledge of that partner with regard to that business must be imputed to the other members of the partnership. Thus whenever trust moneys are received by a firm of solicitors and are paid out for a purpose which one of the partners knows to be a breach of trust, all the partners are liable to make good the breach of trust, under either a constructive trust or alternatively sections 10 and 11 of the Partnership Act (U.K.). The defendant, the executor of the estate of H's partner, argued that H alone was the wrongdoer. H's partner had acted honestly throughout, and had done everything he could reasonably have been expected to do, and therefore should not be liable.

The claim against H's partner was dismissed. Vinelott J. distinguished *Blyth* and applied obiter in *Mara,* accepting the principle that "a solicitor has the implied authority of his partners to receive trust moneys as agent of the trustees but does not have any implied authority to constitute himself a constructive trustee."[14]

14 Supra n.3, 1230.

*B. The Three Cases Distinguished*

1. *Mara* and *Blyth*

One significant difference between *Blyth* and *Mara* is the respective state of knowledge of the partners conducting the transactions involved. In *Blyth* S, knowing that he was dealing with a trust fund, had actual knowledge that the investments were in breach of trust.[15] In *Mara* however, although there was a suggestion that HB might well have been guilty of some negligence,[16] it was conceded that HB had no actual knowledge that his investment of the trust money was a breach of trust.[17] It is clear that if HB had known he was participating in a breach of trust he would have been liable as a constructive trustee. By conceding that HB did not knowingly assist in a breach of trust, the plaintiff was forced to contend that HB was liable because, acting as a principal, he was an intermeddler in the affairs of the trust. This argument failed when HB established that he acted under instructions from duly appointed trustees and the action against him was dismissed. This difference in the facts is crucial in explaining why HB in *Mara* was not a constructive trustee and S in *Blyth* was, but it does not explain the difference in liability of the innocent partners in the two cases.

As regards the liability of the partners not directly involved in the transactions, it could be claimed[18] that the two cases are inconsistent because *Blyth* states that notice to one partner is to be imputed to the others, while the obiter comment of all three members of the Court of Appeal in *Mara*[19] states that it is not. As indicated earlier, in *Blyth* Stirling J. does make statements that appear to support the proposition that the knowledge of one partner that makes him a constructive trustee is to be imputed to the other partners, who must be taken to have had knowledge equivalent to that of the wrongdoing partner. This knowledge then renders the innocent partners liable as constructive trustees.[20] It is submitted, as was pointed out by Vinelott J. in *Re Bell*,[21] that these statements must be read in the light of the special facts of *Blyth*. In *Blyth* the partnership, having sold the Exchequer bills, took receipt of the trust fund at a time when there were no trustees. In doing so, the partnership came under a duty and to discharge themselves the partners had to show that the funds were applied in accordance with the terms of the trust. It is in this context that the statement is made that the knowledge of one partner is to be imputed to the others. It is submitted that the true import of these words is that

15 Stirling J. states, supra n.1, 352, that the knowledge imputed to the partners (and hence the actual knowledge of S) was that: (i) the security was of an unsuitable character for trust funds; and (ii) the investment was not one that the trustees of the settlement could properly sanction. He then states that a breach of trust was committed. From these statements it is concluded that S know that investments made were in breach of trust.

16 Per Lord Hershell, supra n.2, 205. There certainly was no finding of negligence for constructive notice purposes.

17 Per Smith L.J., supra n.2, 209.

18 This seems to be the view of Paul Matthews "Intermeddlers as Constructive Trustees" (1981) 131 N.L.J. 243.

19 And for that matter the decision in *Re Bell*.

20 Supra n.8.

21 Supra n.3, 1228.

the knowledge of the trust and actions in breach of trust of one partner were such as to breach the duty imposed on the partnership and render the whole partnership liable. If this is correct, the decision can then be distinguished from *Mara*.

The fundamental difference in fact between *Blyth* and *Mara* is that the solicitors' firm in *Blyth* received and dealt with the trust fund at a time when there were no trustees, whereas in *Mara* it was found that the solicitor, HB, acted throughout on instructions from duly appointed trustees. In *Blyth* by selling the Exchequer bills and taking receipt of the trust fund at a time when there were no trustees, the partnership became constructive trustees of the fund. As such the partnership came under a duty to ensure that the trust fund was applied in accordance with the terms of the trusts of which they were aware.[22] In *Mara* by receiving the fund on instructions from duly appointed trustees, HB acted merely as solicitor and no constructive trust could be imposed on him at this stage. In *Blyth* Fladgates could not claim that, in receiving and dealing with the fund, they acted as agents of trustees as there were no trustees at the time.

The differing points in time at which constructive trusts can arise are perhaps best explained by reference to the two types of constructive trusts referred to in *Selangor United Rubber Estates Ltd.* v. *Cradock (No. 3)*[23] and adopted by Goff J. in *Competitive Insurance Co.* v. *Davies Investments*.[24] The two types of constructive trust are: (i) where the defendant has already become a constructive trustee before the acts or omissions complained of; and (ii) where the very act or omission which gives rise to liability is that which creates the constructive trusteeship. *Blyth* falls in the first category. By selling the Exchequer bills and receiving the proceeds at a time when there were no trustees, the partnership intermeddled in the trust affairs. At that time they became constructive trustees subject to certain obligations. The further act[25] that brought about the partnership's particular liability for breach of trust only occurred after the creation of the constructive trust. However *Mara* and, as will be seen, *Re Bell* are in the second category of case where the very act or omission which gives rise to liability is that which causes the constructive trusteeship. In *Mara* no constructive trust could arise on receipt of the fund because at this stage HB was acting as the agent of trustees. If HB had then decided to misapply the fund in breach of trust, he would be rendered liable by a constructive trust arising instantaneously with the act giving rise to liability.

Ignoring for the moment any difference between the two cases in the manner in which the implied authority of a partner is assessed,[26] the difference between the liability of S's partners in *Blyth* and AB in *Mara* revolves around the difference between the two categories of constructive trust outlined by Goff J. in *Competitive Insurance*. In *Blyth* as all the partners were constructive trustees on receipt of the

22 Per Stirling J. supra n.1, 351: "[A]ll the partners knew, or were affected with the knowledge that those bills formed part of the funds subject to the trusts of the settlement."
23 [1968] 1 W.L.R. 1555, 1579.
24 [1975] 1 W.L.R. 1240, 1247.
25 This act being the investment in breach of trust.
26 For a discussion of this see part III B. 2.

trust fund, when one partner, acting as agent of the partnership in administering the trust fund, made investments in breach of trust all the partners automatically became jointly and severally liable for that breach of trust. The basis of liability is analogous to the situation where an express trustee, by acting in breach of trust, renders his co-trustees jointly and severally liable. Here liability is imposed because the passive trustee is himself said to be in some way guilty of an act or a default prejudicial to the trust. An example of such liability would be the case where one trustee, $T_1$, leaves a matter in the hands of his co-trustee, $T_2$, without inquiry. $T_1$ is jointly and severally liable with $T_2$ for any breach of trust brought about by $T_2$.[27] In *Blyth,* after the creation of the constructive trust, one of the constructive trustees made an investment in breach of trust, while acting as the representative of the other constructive trustees and without inquiry from them about his activities. On this interpretation, it is submitted that the decision in *Blyth* is correct.

In *Mara* as HB was held not liable as constructive trustee it was clear that AB was not liable. But assume for the moment that in *Mara* HB had been held liable as constructive trustee on the grounds, for instance, of intermeddling in the application of the trust funds without the authority of the trustees.[28] Even on this assumption, no constructive trust could be imposed on the whole firm prior to the act that brought about the liability of HB. A constructive trust could be imposed on HB as a result of his receipt of the trust fund from AR (an intermeddler) or as a result of his investment of the trust fund in breach of trust. In either case the constructive trust imposed on HB would only arise as a result of the activity that brought about the claim against him. If the court found that, by his dealings with the trust fund, HB was liable as a constructive trustee, the question as to the liability of AB could not be settled automatically on the basis of AB's existing status as a constructive trustee, as it could be in *Blyth*. The question of the liability of AB would have to be looked at separately in the light of the position of that partner himself.

## 2. *Re Bell* and the jig-saw

In *Re Bell,* as in *Blyth,* the trust fund was received into the client's account of the firm, whereas in *Mara* the money was received into the private account of one of the partners. In *Mara* it was not argued that receipt of the fund into the private account of HB meant that HB was acting in his private capacity and so could not possibly render AB liable. It seems to have been assumed that HB was in fact acting in his capacity as a solicitor of the firm. For this reason it is suggested that Vinelott J. was correct when he stated that this difference in the facts between

27 Nathan and Marshall *Cases and Commentary on the Law of Trusts* (7 ed, Stevens, London, 1980) 664-6. Cases cited as authority for this proposition are, inter alia *Chambers* v. *Minchin* (1802) 7 Ves. 186; *Shipbrook* v. *Hinchinbrook* (1810) 16 Ves. 477.

28 Although there were trustees of the fund, AR who approved his actions was not one of them. This also assumes that because AR was not validly appointed a trustee but was an intermeddler that HB would be rendered liable. However note that in *Mara* Lord Herschell, obiter, expressed an opinion to the contrary — supra n.2, 207.

*Re Bell* and *Mara* was irrelevant for the purpose of distinguishing the two cases on their facts.[29]

In *Re Bell* H actually knew of and in some cases actively assisted in the dishonest design of the trustees and clearly was liable as a constructive trustee. This was similar to *Blyth* where the wrongdoing solicitor actually knew that he was applying trust funds in an investment improper for those funds. The different result as to the liability of the active partner was reached in *Mara* simply because there HB had no actual knowledge that the investments he was making were in breach of trust.

In *Re Bell,* as in *Mara,* the trust fund was received on instructions from trustees. *Re Bell* was treated as a case, not of knowing receipt and dealing with property in breach of trust, but of knowing assistance by H in a dishonest design on the part of the trustees. In *Re Bell* there is thus no question of the entire firm becoming constructive trustees from the outlet as the result of a positive assumption of trusteeship as in *Blyth.*

Without considering for the moment any liability of the honest partners founded on their own act or omission, let us consider liability of the honest partners that is parasitic on the liability of the wrongdoing partner. On this basis the honest partners are rendered liable as a direct result of the activities of the wrongdoing partner. In this manner the honest partners could be liable either (i) as constructive trustees themselves, or (ii) as partners of the person liable as a constructive trustee under the Partnership Act 1890 (U.K.).[30] The question then becomes — to what extent, if any, should the partnership be liable for the acts of a wrongdoing partner?

The general argument for holding honest partners liable as constructive trustees is that, when the wrongdoing partner receives the trust fund, he receives it as agent of the partnership and holds himself out as representing the partnership in that matter, so that there is actually a receipt by the partnership. Thus if the funds were knowingly[31] received or misappropriated by the wrongdoing partner in breach of trust, the partnership would be liable as a constructive trustee if it could be said that there was a receipt or misappropriation by the partnership. To satisfy this last step it must be possible to say that, in receiving or dealing with the trust fund in a wrongful manner, the partner was acting within the ordinary course of business of the partnership and within the scope of his apparent authority.

Holding the honest partner liable under sections 10 and 11 of the Partnership Act 1890 (U.K.)[32] involves very similar considerations of what is in the scope of the partner's authority and what is in the ordinary course of business of the

29 However the account into which the money was received must play a role in determining whether the partner was acting in the course of business of the firm and whether there was a receipt by the firm. For instance if the partner receives the trust money into his private account, this may enable the court to find that he was not acting in the course of business of the partnership. It will, of course, not be conclusive.

30 In New Zealand the Partnership Act 1908.

31 The state of knowledge required is discussed later.

32 In New Zealand ss.13 and 14 of the Partnership Act 1908.

partnership. Indeed North J. in *Mara* thought that the test of liability was the same under both. Having decided that everything HB did was on behalf of the business and within the scope of his authority, he added:[33]

> With respect to AB, it is hardly worth while to consider whether he is constructively a trustee or not; for, assuming him not to be a trustee, even to the extent of the money actually received by the firm, still he is by the law of partnership liable exactly to the same extent that his partner HB is, and they must stand or fall together.

The Court of Appeal in *Mara* and Vinelott J. in *Re Bell* rejected the claim against the passive partners in those two cases on the following principle as stated by Vinelott J. in *Re Bell:* "[A] solicitor has the implied authority of his partners to receive trust moneys as agent of the trustees but does not have any implied authority to constitute himself a constructive trustee."[34] This presumably was thought in both cases to be enough to dismiss any possible liability of the passive partners, either as constructive trustees or under partnership law. *Blyth* stands consistent with this test, for in *Blyth* S did not make his partners liable because he acted so as to make himself a constructive trustee. The whole firm were constructive trustees and then acting within the scope of his authority S breached that trust.

But, coming to the more important point, if the test in *Re Bell* is correct then it is difficult to see how a partnership could ever be liable for the partner who has "constitute[d] himself a constructive trustee".[35] There would never be implied authority for a partner to make himself a constructive trustee, as constructive trusteeship is not contemplated by either the firm or the wrongdoing partner. The constructive trust arises regardless of the intention of anybody — it is imposed by the court as the result of certain conduct or knowledge on the part of people. In this kind of situation the solicitor will always accept the money as *agent* of the trustees and it is only later that the court imposes a constructive trust on him.

To state simply that a partner never has the implied authority of the partnership to constitute himself a constructive trustee is to preclude an examination of the facts of the case. Surely it is more logical to seek to discover exactly what the partner did, to decide whether this was within the scope of his implied authority, and then to impose liability if those acts were within that scope. Stirling J. in *Blyth* and North J. in *Mara* both concentrate on the actions of the wrongdoing partner. In *Mara* North J. took into account that in the ordinary court of business this partnership had power to receive and invest funds in such a manner, that the trust funds went through the partnership's client account, and that the partnership received payment for the services of the partner in the transaction. In *Blyth* S, as a member of the partnership, was asked to advise whether a security was a safe one for trustees and then to make the investment — a matter which according to Stirling J. fell "within the scope of a solicitor's ordinary duties",[36] and also a

33 Supra n.12, 94.
34 Supra n.3, 1230.
35 Supra n.14.
36 Supra n.1, 352.

matter for which the partnership received payment. The principle adopted in *Re Bell* and *Mara* defies the purpose of constructive trusts from the outset by precluding an examination of the facts of the case. Furthermore, such an approach is not accepted in the general law of principal and agent. It is not sufficient to say that, in an area where an agent has authority to act for his principal, he does not have authority to act negligently or fraudulently. Generally in the law of principal and agent the position is that "an act of an agent within the scope of his actual or apparent authority does not cease to bind his principal merely because the agent was acting fraudulently and in furtherance of his own interests."[37]

The obiter statements of the Court of Appeal in *Mara* and the statement of Vinelott J. in *Re Bell* in form appear to be propositions of law. An analysis on first principles as to whether the extent of "implied authority", for the purpose of imposing a constructive trust, is a question of fact or of law has been beyond the scope of this article. It is submitted that in the area of constructive trusts, as in the law of partnership and the general law of principal and agent, the scope of a person's "implied authority" for the purpose of founding liability of his partner is a question of fact.[38]

Examining the facts of *Re Bell* on this basis it is difficult to see, given the admitted liability of H as constructive trustee, why H's partner was not also liable. The trust fund was held in the firm's client account. H, who was the representative of the firm for dealing with this particular client, paid out the trust fund to the trustees at their request. This type of activity seems to be clearly within the scope of his authority from the partnership. The fact that, while acting within the scope of his authority as a partner and holding himself out to be a partner, a person acts fraudulently and knowingly assists in a breach of trust, does not, it is submitted, take that person outside the sphere for which the firm is responsible, and thus does not absolve the partnership from liability.

### 3. *Liability under the Partnership Act 1890 (U.K.) in Re Bell*

In partnership law any basis for imposing liability on the innocent partners of a firm, as the result of the wrongdoing partner's acts, is to be found in sections

37 *Bowstead on Agency* (14 ed, Sweet and Maxwell, London, 1976) Art. 77, 230. Actual authority in the quotation has been defined earlier in the text to mean express actual authority and implied actual authority. But note that where the act done by the agent falls entirely outside the scope of his authority, the principal will not be responsible.

38 *Otago Aero Club (Inc.)* v. *Stevenson Ltd.* [1957] N.Z.L.R. 471 is an example of a case in the field of master and servant relationships where the scope of ostensible authority of the servant was determined as a question of fact. Furthermore, it is implicit in the analysis of implied authority conducted in *Bowstead on Agency,* op.cit that implied authority is a question of fact. Having considered a number of specific circumstances in which authority is generally implied it is then stated that every agent has in addition "such authority as is to be inferred from the conduct of the parties and the circumstances of the case" (Art. 32, p. 93). For a more detailed discussion of whether the scope of the course of a servant's employment is a question of fact or of law see P. S. Atiyah *Vicarious Liability in the Law of Torts* (Butterworths, London, 1967).

10 and 11 of the Partnership Act 1890 (U.K.). Section 10[39] refers to general torts, while section 11 refers to specific torts in the nature of fraudulent misappropriations. As *Blyth, Mara,* and *Re Bell* all deal with fraudulent misappropriations of property, the specific nature of section 11 is more apposite here. Section 11 reads:

> In the following cases; namely — (a) where one partner acting within the scope of his apparent authority receives the money or property of a third person and misapplies it; and (b) where a firm in the course of its business receives money or property of a third person, and the money or property so received is misapplied by one or more of the partners while it is in the custody of the firm; the firm is liable to make good the loss.

It is difficult to understand why this section has been given such little weight in argument and in the judgments in the three cases. No reference was made to the sections either in argument or in the judgments in both *Blyth* and *Mara.*[40] In *Re Bell* it was argued that liability of the innocent partners arose either under the Partnership Act or under a constructive trust. Vinelott J. conducted no analysis of the sections but presumably, by stating that a partner has no implied authority of the firm to make himself a constructive trustee, believed he had disposed of the argument based on partnership law as well.

By section 11(a) where one partner acting within the scope of his apparent authority obtains money and misapplies it, the firm appears to be prima facie liable. The question that arises is whether the receipt of the property by the individual partner was within the scope of his apparent authority so as to be a receipt by the firm.[41] Section 11(a) deals with the situation where there is some doubt as to whether there was ever a receipt of the fund by the firm. In *Re Bell,* although the exact knowledge of H's partner as to the receipt of the fund is not made clear, the case seems to assume that the trust fund was received by the firm and that the only complaint occurred subsequently, as a result of the misapplication by H. For this reason *Re Bell* seems to fall under section 11(b), which deals with a misapplication by one partner after a receipt by the firm.[42] It requires that a firm "in the course of its business" has received money or property of a third person. This was clearly the case in *Re Bell* where the firm received a trust fund from trustees in the course of its business. For liability of the whole firm the section then only requires that one of the partners misapply the money while it is in the custody

39 Section 10 reads as follows: "Where, by any wrongful act or omission of any partner acting in the ordinary course of business of the firm, or with the authority of his co-partners, loss or injury is caused to any person not being a partner in the firm, or any penalty incurred, the firm is liable therefore to the same extent as the partner so acting or omitting to act."

40 North J. in *Mara* does mention the sections in passing — supra n.12, 86.

41 The term "apparent authority" is based on the doctrine of estoppel. Included within the authority that a partner has is the situation where a firm has allowed a person to "appear" to have more authority than he possessed in fact.

42 Alternatively it is submitted that liability can be founded under s.11(a) in that H was acting within the scope of his implied authority in receiving and dealing with the fund. The argument is the same as that made for imposing liability on H's partner as constructive trustee because H was acting within the implied authority of the firm.

of the firm. *Re Bell* seems to fall squarely within section 11(b) of the Partnership Act[43] and it is submitted that H's partner should have been rendered liable.[44]

It has been suggested[45] that the reason why the passive partner is not liable as a result of the acts of the wrongdoing partner might well be the operation of section 13 of the Partnership Act 1890.[46] Section 13 is as follows:

> If a partner being a trustee improperly employs trust property in the business or on the account of the partnership no other partner is liable for the trust property to the person beneficially interested therein, provided (1) this section shall not affect any liability incurred by any partner by reason of his having notice of a breach of trust . . . .

An initial question arises as to whether "trustee" in the section includes a constructive trustee. It is arguable that section 13 does not extend to constructive trustees. Section 13 requires that "a partner being a trustee improperly employs trust property". To be covered by the section it would appear that the partner would need to be a trustee before he improperly employs the trust property. However, in a case such as *Re Bell* it is only the improper employment of the trust property that makes the active partner a constructive trustee. For this reason section 13 would appear to be inapplicable.

Even accepting that a constructive trustee falls within "trustee" in section 13, it should be noted that the section does not affect "any liability incurred by any partner by reason of his having notice of a breach of trust". There is a strong argument that, even if section 13 is otherwise applicable, it would not alter the extent of a partnership's liability for the activities of a wrongdoing partner, as it begs the question as to whether the innocent partners can be taken to have "notice" of the wrongdoing partner's activities.[47]

It is further submitted that section 13 is of no application in *Re Bell* because in that case the wrongdoing partner at no stage employed the trust property "in the business or on the account of the partnership". Section 13 exists to deal with the situation where partner, who is an express trustee, without the knowledge of his co-partners, brings the trust fund into the business and uses it for business purposes. The constructive trust on H arose as a result of his dealings with the trust fund after receipt by the firm. From the time the constructive trust first arose and subsequently, rather than employing the trust property in the business, H paid the fund out of the business. Therefore it is submitted that H's partner should have been held liable under section 11(b) of the Partnership Act 1890 (U.K.)

43 The applicability of this branch of partnership law can be seen in *Ex parte Biddulph* (1849) 3 De G. and Sm. 587 where trust money in the hands of a firm of bankers was drawn out and misapplied by one of the firm, and it was held that all the partners were liable to make it good.

44 By s.12 of the Partnership Act 1890 (U.K.). For a similar analysis of s.11(b) see Atiyah, op.cit. 120-1.

45 A. J. Oakley, op.cit 32-3. No case has, however, mentioned this section.

46 Section 16 of the New Zealand Act.

47 Supra n.45, 83.

*C. Summary*

It is submitted, in the light of the foregoing analysis, that *Re Bell* was wrongly decided. The analysis establishes that H's partner should have been liable for the losses either as a constructive trustee or under section 11(b) of the Partnership Act 1890. It must be stressed that the proposed liability of H's partner as a constructive trustee is not based on any actual or constructive knowledge of a breach of trust. As is argued in Part IV, liability as a constructive trustee in the "knowing receipt or dealing" and "knowing assistance" categories should only be based on actual knowledge of a breach of trust. H's partner did not have actual knowledge and therefore could not be liable in this manner. The proposed liability of H's partner has a different base. H was liable as a constructive trustee because he knowingly assisted in a breach of trust. Because H was at the time acting within the scope of his implied authority, his liability had the consequence of rendering the entire partnership liable as constructive trustees.

As a matter of policy a principle of insurance might be used to justify conceptually the result that has been argued for. The wrongdoing agent will ordinarily be a member of a company or a partnership. This idea of insurance is that the company or partnership, being a collection of people, is better able to provide for the loss than the victim. They may be able to provide for such loss either by insurance or by inclusion of an amount when calculating charges to be made for services. The loss should be borne by those best able to bear it.

## IV. THE DECISION IN *RE BELL* IN THE CONTEXT OF THE LAW OF CONSTRUCTIVE TRUSTS IMPOSED ON STRANGERS

*A. Classification of Constructive Trusts Imposed on Strangers*

The textbooks[48] categorize constructive trusts imposed on strangers, that is transferees or agents, into three classes: positive assumption of trusteeship; strangers knowingly receiving or dealing with trust propertly; strangers knowingly assisting in a dishonest design.

1. *Positive assumption of trusteeship*

The manner in which liability as a constructive trustee arises in this category was defined by A. L. Smith L.J. in *Mara* v. *Browne*:[49]

> . . . if one, not being a trustee and not having authority from a trustee, takes upon himself to intermeddle with trust matters or to do acts characteristic of the office of trustee, he may thereby make himself what is called in law a trustee of his own wrong — i.e. a trustee de son tort, or, as it is also termed, a constructive trustee.

48 For categorisations used by various text writers see: Nathan and Marshall, op.cit; Pettit *Equity and the Law of Trusts* (4 ed, Butterworths, London, 1979); Underhill *Law of Trustees* (13 ed, Butterworths, London, 1979); Hanbury and Maudsley *Modern Equity* (11 ed, Stevens and Sons Ltd, London, 1981).

49 Supra n.2, 209.

As by definition the constructive trust is imposed as a result of a positive assumption of trusteeship there must be actual knowledge of the existence of the trust and conscious performance of acts in the course of management of the trust fund. As well, the constructive trust is imposed from the initial assumption of trusteeship while the act bringing about the claim for liability may well occur much later.[50] In *Blyth,* by assuming control of the trust fund with knowledge that there were no existing trustees, the partnership became subject to a constructive trust of this type.

2. *Strangers knowingly receiving or dealing with trust property*

It is widely accepted by text writers[51] that a person is a constructive trustee in the following situations under this category — (a) if, though not nominated as a trustee, he has received trust property with actual, constructive or imputed notice[52] that it is trust property transferred in breach of trust; or (b) if (not being a bona fide purchaser for value without notice and not protected by the provisions of the Law of Property Act 1925 (U.K.)[53]) he acquires notice subsequent to such receipt, and then deals with the property in a manner inconsistent with the trust.

3. *Knowing assistance in a dishonest design*

Where a person assists with knowledge in a dishonest and fraudulent design on the part of the trustees, that person may be treated as a constructive trustee primarily for the purpose of being subjected to a purely personal liability to account.

There has been much disagreement as to the measure of knowledge required in this category before the constructive trust can be imposed on the defendant. In *Selangor United Rubber Estates* v. *Cradock (No. 2)*[54] the District Bank acting as agent had, without being aware of the fact, enabled the first defendant unlawfully to buy the plaintiff company with its own money. Ungoed-Thomas J. in the High Court held the bank liable as constructive trustee because its employees should have known, even though they did not in fact know, that they were assisting in a fraudulent and dishonest design on the part of trustees.[55] In *Karak Rubber Co.* v. *Burden (No. 2),*[56] on almost identical facts as the *Selangor* case, Brightman J.

50 See Ungoed-Thomas J. in *Selangor United Rubber Estates* v. *Cradock (No. 3)* supra n.23.

51 Support for these two branches is to be found in *Karak Rubber Co. Ltd.* v. *Burden (No. 2)* [1972] 1 All E.R. 1210, 1234. Although only enunciated in one case this division has found widespread support amongst textwriters — see Hanbury and Maudsley, supra n. 48, 315; Nathan and Marshall supra n.27, 412; Underhill, supra n.48, 331; Pettit, supra n.48, 129.

52 Constructive knowledge as being sufficient for liability in this category is supported by the texts and some case law — see *Karak Rubber Co. Ltd.* supra n.51; *Nelson* v. *Larholt* [1948] 1 K.B. 339; *Belmont Finance* v. *Williams Furniture Ltd.* (No. 2) [1980] 1 All E.R. 393. In Part IV B. 3 it is argued that actual knowledge should be required before a constructive trust is imposed in this category.

53 See the Property Law Act 1952 (N.Z.).

54 Supra n.23.

55 The directors of the company being in the same position as trustees.

56 Supra n.51.

applied that same test of constructive knowledge in imposing a constructive trust on Barclays Bank. The bank's employees had no actual knowledge that they were assisting in a fraudulent and dishonest design. However dicta of the Court of Appeal in *Carl-Zeiss Stiftung* v. *Herbert Smith (No. 2)*,[57] a decision of Goff J. in *Competitive Insurance Co.* v. *Davies Investments*[58] and dicta of Goff L.J. and Buckley L.J. in *Belmont Finance Corp.* v. *Williams Furniture Ltd.*[59] have indicated that constructive knowledge will not suffice for the imposition of a constructive trust in this category. On this view the defendant must be shown to have assisted with actual or "Nelsonian" knowledge — i.e. actually to have known of the dishonesty or to have wilfully shut his eyes to the dishonesty. Because of this conflict of authority, the law on this point remains uncertain.

### *B. The Classification Discussed in Relation to Re Bell*

#### 1. *The position of agents of trustees*

An agent of trustees would appear to be in the same position as the stranger in the tests laid down in the categories outlined above. In dealing with the agent of trustees the warnings of Lord Selborne in *Barnes* v. *Addy*[60] and Bennett J. in *Williams-Ashman* v. *Price and Williams*[61] should be borne in mind. Lord Selborne stated that:[62]

> . . . 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 . . . . If those principles were disregarded, I know not how any one 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 agent of any sort to trustees. But, on the other hand, if persons dealing honestly as agents are at liberty to rely on the legal power of the trustees, and are not to have the character of trustees constructively imposed upon them, then the transactions of mankind can safely be carried through . . . .

Furthermore as regards agents in receipt of trust property Bennett J. in *Williams-Ashman* said:[63]

> . . . an agent in possession of money which he knows to be trust money, so long as he acts honestly, is not accountable to the beneficiaries interested in the trust money unless he intermeddles in the trust by doing acts characteristic of a trustee and outside the duties of an agent.

On this authority an agent dealing with trust property who acts honestly in the course of his agency cannot be made subject to a constructive trust.[64] The policy reason for this, according to Lord Selborne, is so that trust business may safely be conducted by professional men. *Selangor* and *Karak Rubber Co.* do not stand

57 [1969] 2 Ch. 276.
58 [1975] 1 W.L.R. 1240.
59 [1978] 3 W.L.R. 712.
60 Supra n.11.
61 [1942] 1 Ch. 219.
62 Supra n.11, 251-2.
63 Supra n.61, 228.
64 In *Selangor* supra n.23, 1581 Ungoed-Thomas J. states that *Barnes* v. *Addy* is not conclusive on the measure of knowledge required. But in the quote from Lord Selborne's judgment (supra n.62) use of words "persons dealing *honestly* as agents" seems to make clear that constructive knowledge is insufficient.

consistently with this authority, and indeed undermine the policy concept behind the exclusion of honest agents from the burdens of constructive trusteeship.

### 2. *Re Bell — which category?; does it matter?*

Having described the categories under which strangers have been liable as constructive trustees, it is necessary to consider under which category H was held liable in *Re Bell*. Vinelott J. stated:[65]

> It is admitted . . . that in as much as he assisted with knowledge in the misappropriation of trust moneys held in the trustees' client account with the firm, [H] is liable as a constructive trustee.

The case seems to proceed on the assumption that the receipt of the trust fund by the firm was not in breach of trust. H then knowingly assisted in a dishonest design on the part of the trustees and so was liable as a constructive trustee. However, on the facts of the case this does not appear to be strictly correct. The amount of £38,260 which was received by the partnership between August 1940 and February 1947, included sums "from the sale or realization of trust investments, including a farm known as Churchill Farm and of an item of Jewellery".[66] This sale of Churchill Farm was found to be in breach of trust. The farm had been sold by the trustees of the marriage settlement to the trustees of the voluntary settlement. The sale was shown, by a letter given in evidence, to be to raise money for distribution to A and his mother. The court accepted that as the sale was to facilitate a breach of trust, the sale itself was a breach of trust. Thus at least this part of the fund received by the firm was received in breach of trust.[67] It may well be that liability of H as constructive trustee, at least as to this part of the fund, should have been founded on the "knowing receipt or dealing category".

This distinction would not effect the liability of H's partner where that liability is argued to be parasitic on the liability of H, but it would be significant if it is argued that liability of the honest partner is independent of the liability of the wrongdoing partner. This argument must be considered as Vinelott J. in *Re Bell* rejected any liability of H's partner that was parasitic on the liability of H. If liability of the honest partner it to be founded on some act or omission of the honest partner himself, the question then becomes what must be done by him to found liability?

In *Re Bell* Vinelott J. emphasised that H's partner had acted not only honestly, but also as a reasonable solicitor in his position ought to have acted. The latter finding suggests that Vinelott J. might well have been prepared to hold H's partner

65 Supra n.3, 1224.

66 Ibid. 1223.

67 H had actual knowledge of the breach of trust as shown by a letter from H to A's mother referred to in the judgment (supra n.3, 1231 (c)). The constructive trust thus arose on H from the receipt of the proceeds of sale. It can be argued that he was acting within his implied authority in receiving the money on behalf of a client. If this is so then the whole firm became constructive trustees of the proceeds of sale from the time of receipt of that money. By analogy with *Blyth* it can be argued that when H misapplied that money in breach of trust the whole firm became automatically liable to account for the proceeds of sale.

liable as a constructive trustee if he had constructive knowledge of the dishonest and fraudulent design. However, if the facts of a case place it into the category of "knowing assistance in a dishonest and fraudulent design,"[68] then it would appear that actual knowledge is needed before there can be liability.[69] Since honest partners by definition do not have actual knowledge of any fraudulent and dishonest design, liability as constructive trustees of the honest partners of the firm cannot occur independently of the liability of the wrongdoing partner.

However, if the facts place the case in the category of "knowing receipt or dealing" it would appear that constructive knowledge is sufficient to make one a constructive trustee. If that is so, then liability of the honest partners of the firm as constructive trustees could occur without arising automatically from the wrongdoing partner's liability, but rather by some act or omission of the honest partner himself. Knowledge in this category would include actual and constructive knowledge. Thus, although the honest partner clearly has no actual knowledge of the receipt in breach of trust, he may have constructive knowledge because there was something that he should have done, but did not, that would have given him actual knowledge of the receipt in breach of trust.

In *Re Bell* it was accepted that H's partner acted throughout honestly and reasonably. Thus, in that case, no difference in liability could have arisen because of a difference in the standard of knowledge required in the "knowing receipt or dealing" and "knowing assistance" categories. However, the point still remains that, where the honest partner is negligent in not making inquiries and so is held to have constructive notice, he will be liable independently of the liability of the wrongdoing partner, so long as the activities that have occurred fall into the "knowing receipt or dealing" category and not the "knowing assistance" category.[70]

3. *The "knowing receipt or dealing" and "knowing assistance" categories — should there be a difference in the test of knowledge?*

If the "knowing receipt or dealing" and "knowing assistance" categories are to apply different tests of knowledge, the question then becomes whether there is any factual difference between the two categories to justify such a difference. In the "knowing receipt or dealing" category it is clear that the stranger must have received the property. It would appear possible to assist in a dishonest and fraudulent design without ever actually receiving the trust property involved. However, in every reported case which can be categorised as in the "knowing assistance" category, the stranger or agent has actually received the trust fund at some stage.[71] So this cannot be a relevant distinction for the purpose of explaining the difference in the measure of knowledge required between the two categories.

68 As it was with at least part of the fund in *Re Bell*.

69 There is some uncertainty in the law on this point.

70 Dicta in *Carl-Zeiss Stiftung*, supra n.57, suggest that actual knowledge is needed for both categories. As a statement of what the law currently is this seems untenable bearing in mind the decision in *Belmont Finance Corp.* v. *Williams Furniture Ltd. (No. 2)*, supra n.52.

71 If the trust is of a proprietary nature, there would be a major conceptual difficulty in imposing a constructive trust on someone who had not received the trust property.

Another possible distinction is that in the "knowing receipt or dealing" category it is necessary still to possess the trust fund (either actually or in a traceable form) before liability as a constructive trustee can be imposed, whereas in the "knowing assistance" category the stranger will have disposed of the trust property if he had ever had it. This would accord with the view that the "knowing receipt or dealing" category is a traditional type of constructive trust in the form of a proprietary institution, whereas in the "knowing assistance" category the defendant is termed a constructive trustee purely as a prerequisite for subjecting him to a personal liability to account.[72] However the "knowing receipt or dealing" category includes the person who, not being a bona fide purchaser for value without notice, acquires notice of the breach of trust subsequent to receipt and then deals with the property in a manner inconsistent with the trust. This seems to contemplate imposition of a constructive trust in this category on a person who no longer has the trust fund. Furthermore *Lee* v. *Sankey*[73] is a case often stated as falling into the category of "knowing receipt or dealing", yet in that case the person upon whom the constructive trust was imposed no longer had the trust fund. Solicitors were employed by two trustees to receive proceeds of sale. Without authority they paid over the proceeds to only one of the trustees, when it should have been paid to both. This trustee misappropriated the money and the solicitors were held liable to the beneficiaries.

Having argued that it is not acceptable to distinguish the two categories merely by the presence or absence of property, an example is given here of difficulties in categorization, as a result of application of this test. An agent receives trust property in breach of trust. He has constructive, but not actual, notice of the breach of trust. He then assists in a disposal of the trust property to the trustee in breach of trust in circumstances in which he did not actually know that he was assisting in a breach of trust but should have known. Is it to be said that as the agent fortuitously disposed of the property he is not in the "knowing receipt or dealing" category, and that because he had no actual knowledge he could not be liable in the "knowing assistance" category?

A third possible distinction is that the "knowing receipt or dealing" category requires that the trust property initially be received by the stranger in breach of trust, whereas the "knowing assistance" category covers the situation where the stranger, while not having received the property in breach of trust, subsequently deals with it by knowingly assisting in a dishonest and fraudulent design. If this is the only real difference between the two categories then it is difficult to see why a person, who receives property in breach of trust and then disposes of it by assisting in a dishonest design is subject to liability on a different basis of knowledge from the person who having received the property in accordance with the trust then disposes of that property by assisting in a dishonest and fraudulent design. As in both instances the claim is for property that has been wrongfully disposed of, the manner of receipt of that property should obviously be irrelevant to the basis of liability as constructive trustees. The relevant factor is the knowledge that the

72 See Hanbury and Maudsley, supra n.48, 314.
73 (1873) L.R. 15 Eq. 204.

defendant had of the breach of trust committed in disposing of the property — and the test should be the same in either case.

To find a satisfactory basis for distinguishing the "knowing receipt or dealing" and "knowing assistance" categories proves to be very difficult. If the test of knowledge required for liability is the same in both categories, then such difficulties as to rigid classification become less important and such technicalities do not determine the basis on which liability is imposed. Dicta of Brightman J. in *Karak Rubber*[74] support the contention that constructive notice is sufficient to impose a constructive trust in the "knowing receipt or dealing" category. Similarly the case of *Belmont Finance Ltd.* v. *Williams Furniture (No. 2)*[75] proceeded on the basis that in the "knowing receipt" category it was necessary to prove that the defendants received the trust moneys knowing, or in circumstances in which they ought to have known, that it was in breach of trust. However it is submitted, in line with comments made by A. J. Oakley,[76] that a stranger who receives property in breach of an express trust with constructive, but not actual, knowledge of the breach of that trust should not have the burden of constructive trusteeship imposed on him. To impose a constructive trust actual knowledge should be required whether the claim is made for (i) knowing receipt of property in breach of trust; or (ii) dealing with property in a manner inconsistent with trusts of which knowledge is gained subsequently to the receipt of the property (not being a bona fide purchaser for value without notice); or (iii) knowing assistance in a fraudulent and dishonest design on the part of the trustees. Such an approach would be consistent with a number of authorities[77] preceding the *Selangor* case. It would also maintain the policy goal of Lord Selborne in *Barnes* v. *Addy*. By limiting the liability of strangers as constructive trustees to those people who have actual knowledge of a breach of trust, transferees and agents who deal with trust property honestly need have no fear, and "the transactions of mankind can safely be carried through".[78]

If this proposition is accepted then, regardless of the so-called categories that have been considered, the position is as follows:

(i) When trust property is transferred in breach of trust to a person with actual knowledge of the breach of trust, then that person will be bound by the equitable interest of the beneficiaries and, as he has actual knowlodge, he will hold the property as constructive trustee. If he disposes of that property then he will be personally liable to account, in the same manner as any express trustee who dissipates the trust fund in breach of trust. However, if the beneficiaries have no chance of satisfaction against the constructive trustee personally, then an equitable tracing claim might still lie against a third party possessing the property.

74 Supra n.51, 1234. *Nelson* v. *Larholt,* supra n.52, is also said to support the same proposition.

75 Supra n.52.

76 *Constructive Trusts* supra n.4, 70-2.

77 *Barnes* v. *Addy* supra n.11; *Williams* v. *Williams* (1881) 17 Ch. D. 437; *Re Blundell* (1888) 40 Ch. D. 370; *Williams-Ashman* v. *Price* and *Williams* supra n.61.

78 Per Lord Selborne, supra n.62.

(ii) An innocent volunteer[79] who receives trust property in breach of trust is not a constructive trustee of the property, but while he holds the property those beneficially interested under the express trust can recover the property by an equitable tracing claim. If the innocent volunteer disposes of the trust property in its original form, the proceeds of disposal can be traced in equity, even into a mixed fund. However, if the trust property and its proceeds have been disposed of so that no equitable tracing claim can be maintained, the innocent volunteer, as he is not a constructive trustee, is under no personal liability to account.[80]

(iii) In a similar manner to (ii), where a person receives trust property in breach of trust with constructive, but not actual, knowledge of that breach, he will be bound by the equitable interest in the property of the beneficiaries of the express trust. This is under the general principle that only a bona fide purchaser for value without notice takes free of any prior equitable interest. The transferee while he had the property or the proceeds will be liable to an equitable tracing claim. However if he has disposed of the property, so that it is no longer in a traceable form, the equitable tracing claim will fail, and, as it is submitted that he was never a constructive trustee, he does not come under any liability to account.[81]

*C. Summary*

In view of the prior analysis, it is submitted that actual knowledge of a breach of trust is necessary before a transferee of trust property or an agent receiving or dealing with trust property can be made subject to a constructive trust. In *Re Bell* H had actual knowledge that he was assisting in a fraudulent and dishonest design, and so was properly subjected to a constructive trust. The trust fund and its proceeds having been disposed of, H was personally liable to account to the beneficiaries for the loss.[82] H's partners could not be liable as constructive trustees under either the "knowing receipt or dealing" or "knowing assistance" categories, as they had no actual knowledge of the breach of trust. However, in Part III of this article it was argued that H's partners were liable for the actions of H either as constructive trustees or under the Partnership Act 1890 (U.K.), because H was acting within the scope of his implied authority from the partnership. This

79 I.e. a transferee without value and without notice.

80 *Re Diplock* [1948] Ch. 465.

81 See A. J. Oakley "The Prerequisites of an Equitable Tracing Claim" (1975) 28 Current Legal Problems 64. Any n ed for a fiduciary relationship or constructive trust before an equitable tracing claim may be founded is refuted. By use of the authorities of *Sinclair* v. *Brougham* [1914] A.C. 398; *Banque Belge pour l'Etranger* v.*Hambrouck* [1921] 1 K.B. 321 Oakley establishes that ". . . the only prerequisite of an equitable tracing claim is an equitable proprietary interest in the property in question . . . . A fiduciary relationship, in the sense of an obligation to exhibit an especial duty of good faith, does not of itself create any right in a party to that relationship to trace property either at law or in equity — such a right only arises where a proprietary interest is found to exist in the party seeking to trace." (p. 82).

82 As to the proceeds of the farm the constructive trusteeship of H should have been founded in the "'knowing receipt or dealing" category. However, if the test of knowledge is the same 'n both categories, then the strict categorization becomes irrelevant.

liability is not dependent on any type of knowledge of the partners, and so stands consistently with the proposition that actual knowledge of a breach of trust is required before a constructive trust can be imposed under the "knowing receipt or dealing" and "knowing assistance" categories.

## V. CONCLUSION

Two tasks have been attempted in this article: (1) a consideration of the authoritative basis of *Re Bell;* (2) an examination of the decision in the context of constructive trusts imposed on strangers and agents.

(1) It is submitted that *Re Bell* is, in principle, consistent with *Blyth* v. *Fladgate* and *Mara* v. *Browne*. However the level at which the test of "implied authority" is used in *Re Bell* does cause some difficulty. To state that a partner never has the implied authority of the partnership to constitute himself a constructive trustee is to preclude an examination of the facts of the case. On examination of the facts and application of the "implied authority" test to the circumstances, it is suggested that H's partner should have been held liable.

(2) Placing *Re Bell* in the context of constructive trusts imposed on strangers and agents demonstrates the inconsistencies in the categorisation and measure of liability of constructive trusts in this area. It is submitted that, whether the facts of a case place it within the so-called "knowing receipt or dealing" category or within the "knowing assistance" category, actual knowledge of a breach of trust must exist before a constructive trust is imposed.

The inconsistencies in categorisation found in (2) are perhaps indicative of a more general problem in the area of constructive trusts. The law of constructive trusts has been developed by separation and definition of categories. If such a process is to be continued it must be ensured that there is consistency between and within categories.

Lord Denning M.R. has suggested that there is now a new type of constructive trust that can be imposed where there is inequitable conduct in relation to the victim.[83] The development has been treated by several textwriters as an extension of the category of constructive trusts imposed as a result of fraudulent or unconscionable conduct and as not affecting other categories such as constructive trusts imposed on fiduciaries and strangers.[84] However, it is suggested that this development has the potential to cut across all categories developed in English law and to form the basis of a general equitable remedy for unjust enrichment on a

83 See for example the cases of *Hussey* v. *Palmer* [1972] 3 All E.R. 744; *Eves* v. *Eves* [1975] 3 All E.R. 768; *Cooke* v. *Head* [1972] 2 All E.R. 38; *Heseltine* v.*Heseltine* [1971] 1 All E.R. 952. In *Hussey* v. *Palmer* at 747 Lord Denning said: "[A constructive trust] is a trust imposed by law whenever justice and good conscience require it. It is a liberal process, founded on large principles of equity, to be applied in cases where the defendant cannot conscientiously keep the property for himself alone, but ought to allow another to have the property or a share in it. It is an equitable remedy by which the court can enable an aggrieved party to obtain restitution".

84 See for example A. J. Oakley *Constructive Trusts* supra n.4.

similar basis as in the United States. Clearly this has not happened yet and must be very carefully considered before any such step is taken.

Lord Denning's attempted creation of a "new model constructive trust" has met with much criticism. In New Zealand Mahon J. in *Carly* v. *Farrelly*[85] expressed the following opinion:[86]

> [This is] a supposed rule of equity which is not only vague in its outline but which must disqualify itself from acceptance as a valid principle of jurisprudence by its total uncertainty of application and result. It cannot be sufficient to say that wide and varying notions of fairness and conscience shall be the legal determinant. No stable system of jurisprudence could permit a litigant's claim to justice to be consigned to the formless void of individual moral opinion.

This may well be so.[87] But if the law of constructive trusts is to continue to develop by separation and development of categories it must be ensured that there is some measure of consistency in principle and policy in forming the outline of those categories. The use of Lord Denning's general equitable principle may well be of assistance in defining, on a consistent and logical basis, the detailed requirements necessary for the imposition of a constructive trust.

85 [1975] 1 N.Z.L.R. 356.
86 Ibid 367.
87 For a further statement of Mahon J's view see *Avondale Printers and Stationers Ltd.* v. *Haggie* [1979] 2 N.Z.L.R. 124. For a different view of the effect of the introduction of unjust enrichment and just what is meant by that term see the note by L. McKay "*Avondale Printers* v. *Haggie*: Mr Justice Mahon and the Law of Restitution" [1980] N.Z.L J. 245.