

## Recipient liability under *Barnes v Addy*



BY  
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IN *ROBINS v Incentive Dynamics Pty Ltd* [2003] NSWCA 71 the NSW Court of Appeal has drawn attention to important unresolved issues with the much used rule in *Barnes v Addy*.<sup>1</sup>

The classic formulation of the rule in *Barnes v Addy* includes that:

"Those who create a trust clothe the trustee with a legal power 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 .... But, ....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."<sup>2</sup>

### The primary Judge

Funds were advanced by the plaintiff company to the defendant company which used them to acquire two properties. The defendant obtained the balance of the necessary funds by borrowing against the properties. The plaintiff received no benefit from the defendant's acquisition of the properties. seventy five percent of the shares in the defendant were held by a controller of the plaintiff.

The plaintiff sought proprietary relief, being a declaration that the defendant held the properties on trust for the plaintiff, arguing that the defendant had received property paid out in breach of fiduciary duties and was caught by the first limb of the rule in *Barnes v Addy*. The primary Judge refused this relief because he was not persuaded that the controllers of the plaintiff had any dishonest intent.

Since proprietary relief was refused, personal relief was granted in the form of an order for the repayment of the monies.

A consequence of these orders was that the defendant retained the appreciation in the value of the properties. Upon the primary Judge's approach, this flowed from the absence of dishonest intent.

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### The appeal

The Court of Appeal set aside these orders declaring that the defendant held its interest in both properties on trust for the plaintiff.

### Analysis

Two broad points merit comment.

First, this case draws attention to the unresolved question of what knowledge, if any, the recipient of property must have before being held liable under the first limb of *Barnes v Addy*. As noted above, the primary Judge held that that rule did not apply as he was not persuaded that the directors "were consciously in breach of their duties to" the plaintiff.<sup>3</sup> The Court of Appeal held that the required knowledge was less than this: it was sufficient that the defendant had actual knowledge of the (wrongful) circumstances in which the monies were paid to it.<sup>4</sup> As the facts disclosed such knowledge, the rule applied.

The Court of Appeal left for another day consideration of what lower level of knowledge may be sufficient.<sup>5</sup> This and allied issues merit attention by the High Court because they are surfacing regularly<sup>6</sup> and, by reason of their complexity and importance, cannot be finally resolved by a decision of an intermediate Court. The allied issues include the apparent divergence between England and Australia about the mens rea required to attract liability under the other limb of *Barnes v Addy*. Compare *Twinsectra Ltd v Yardley*<sup>7</sup> and *Consul Development Pty Ltd v DPC Estates Pty Ltd*<sup>8</sup> and the analysis by Ashley AJA in *Macquarie Bank v Sixty-Fourth Throne Pty Ltd*<sup>9</sup>

The answer lies in the identification of the conceptual basis for the recipient limb of the rule. Amongst the competing theories, unjust enrichment must be a strong candidate and, if it is the foundation for this limb of the rule, then knowledge may not be an essential pre-requisite for liability although it may be relevant to a defendant's entitlement to rely upon a defence such as change of position.

Secondly, this case highlights a practical point for legal advisors. To obtain the properties the plaintiff sought the imposition of a remedial constructive trust. Such relief is discretionary and can be defeated if, for example, the plaintiff affirms the transaction. The majority held<sup>10</sup> that for the plaintiff to obtain such relief rescission was essential where the loan transaction was voidable, rather than void (eg. for illegality), and that the Court would need to be satisfied that such a trust was necessary to protect the rights of the plaintiff

and did no injustice to third parties. This is a reminder to plaintiffs seeking proprietary relief to ensure that the formal transactions (eg. a loan from the plaintiff to the defendant) that disguise and effectuate a breach of trust or fiduciary duty are rescinded.

### Notes

- (1874) 9 LR Ch 244.
- Lord Selborne at 251-2.
- Paragraph 34.
- Paragraphs 58 – 59 (Mason P with whom Stein and Giles JJA agreed on this point.)
- Paragraphs 57 – 59.
- See, for example, *Fowkes v DPP* [1997] 2 VR 506, 521 ff (CA), *Koorootang Nominees Pty Ltd v ANZ* [1998] 3 VR 16 at 78 ff, *Hancock Family Memorial Foundation Ltd v Porteous* [1999] WASC 55 at para. 72 ff. In England, see *Baden v Societe Generale* [1993] 1 WLR 509, 575-6 where different levels of knowledge are categorized.
- [2002] 2 AC 164.
- (1975) 132 CLR 373.
- [1998] 3 VR 133, 163.
- Paragraphs 73 and 80.

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