Unlike s 177, s 182(2) makes it clear that directors must use one of the three prescribed methods of declaration. Sections 184–187 elaborate on these, and in particular provide rules for sole directors of companies that ought to have two or more directors, and for shadow directors. Presumably a failure to make a declaration in the prescribed manner will render the declaration either a nullity or incomplete, and a further declaration will be required (s 182(3)); how this requirement will be reconciled with s 182(6)(b), indicating that the duty does not apply if the other directors are already aware of the interest, or ought to be aware of the interest, is unclear. As with s 177, certain interests do not have to be declared.

Unlike the duty to declare an interest in a *proposed* transaction or arrangement (s 177), it is a criminal offence not to comply with the duty to declare an interest in an*existing* transaction **(p. 446)** or arrangement. The Attorney General, Lord Goldsmith, in Grand Committee explained the rationale behind this:

> because one is here concerned with an existing transaction or arrangement, the failure to declare cannot affect the validity of the transaction or give rise to any other civil consequences. That is to be contrasted with the position where there is a failure to disclose an interest in relation to a proposed transaction where the law can say that as a result of the failure to disclose that interest—and the company then enters into the transaction in ignorance of that—consequences follow. The transaction may be voidable, to be set aside. The company may wish to claim financial redress in one form or another as a result of what has taken place. But, as I say, that is different from a failure to declare an interest in an existing transaction where those considerations probably cannot arise. That is why a criminal offence is created. (HL GC Day 4, Hansard HL 678, 9/2/06, col 338)

This does not appear to be an accurate description of the differences between these two provisions. If a director *complies* with s 177, then the company can decide on a fully informed basis whether to proceed with the proposed transaction or arrangement. Section 180 indicates that this declaration replaces the need for the approval of the company's members under the equitable rules, although any additional requirements imposed by the articles will still have to be met. Assuming these additional requirements (if any) have also been met, the transaction cannot be impugned for breach of s 177 or for breach of the no conflict and no profit rules in relation to transactions with the company. However, note that the deal might nevertheless be a breach of some other general statutory duty, and give rise to an action for a remedy under some other head. The availability of the relevant remedies in those particular circumstances will then need to be assessed in the usual way.

On the other hand, if s 177 is *not* complied with, and the company nevertheless enters into the proposed transaction or arrangement, then the director will be in breach of s 177 and, if the breach continues, will also be in breach of s 182. The equitable remedies for breach of the general statutory duty can be pursued against the defaulting director (and, again, an assessment will have to be made about the availability of various remedies—eg rescission will not be available against a bona fide third party purchaser, but will be available against other parties not protected by this equitable rule, including the director). In addition, the director will also be liable for the criminal offence described in s 183. Put this way, there is no logical divide between the remedies available for breach of ss 177 and 182; indeed, if s 177 is breached, and the proposed arrangement is pursued, s 182 will also be breached so long as the director fails to declare the interest. Section 177 is therefore not a provision designed to*impose* liability on directors, but a provision designed to afford protection to those who comply with it.

In this sense, there is the same relationship between ss 183 and 178 (as influenced by s 180) as there is between CA 1985 s 317 and the equitable consequences of breach of the no conflict and no profit rules (as influenced by any relevant consents given by the members or given in the way allowed by the articles). See *Guinness plc v Saunders* [1990] 2 AC 663, 697 (Lord Goff) **[5.01]**; *Coleman Taymar Ltd v Oakes* [2001] 2 BCLC 749.

Transactions with directors requiring the approval of members

Certain transactions between the company and its directors are deemed sufficiently 'risky' to require members' approval for their validity, rather than the simpler procedure of board approval set out in s 177. The details of the statutory provisions are not addressed here, but the sections repay careful reading. Several categories of transactions are affected:

(i) Directors' long-term service contracts: ss 188–189

See 'Directors' service contracts', pp 270ff.

(p. 447) ***(ii) Substantial property transactions: ss 190–196***

Section 190 replaces CA 1985 s 320(1), and makes certain changes. Substantial property transactions (defined in s 191) are permitted, provided they are approved by the members. Failure to obtain the necessary authorisation will not result in any liability for the company (s 190(3)).

An 'arrangement' includes an agreement or understanding that does not have contractual effect (*Re Duckwari plc* **[7.41]**). Note the exceptions in ss 192–194. The civil consequences are described in s 195. These sections apply equally to shadow directors: s 223(1)(b).

The remedies provided by s 195 enlarge both the types of recovery (including recovery of losses, and not just profits) and the persons against whom recovery is available, when compared with the remedies available in equity for breach of fiduciary duty in entering into transactions involving a conflict of interest. These remedies are not available if the members approve the transaction within a reasonable time (s 196). Also see s 1157 (power of court to grant relief in certain circumstances) (replacing CA 1985 s 727).

See *Re Duckwari plc* **[7.41]** (general remedies issues) and *Re Ciro Citterio Menswear plc* **[7.42]** (no constructive trust before rescission).

(iii) Loans, quasi-loans and credit transactions: ss 197–214

Sections 197–214 are derived from CA 1985 ss 330ff. The significant change is that loans to directors and connected persons are no longer generally prohibited but are subject to the requirement of member approval, and sometimes also approval of the members of its holding company. The sections apply equally to shadow directors (s 223(1)(c)).

The provisions relating to loans apply to all UK-registered companies (with the exception of wholly owned subsidiaries (s 197(5)). The provisions for quasi-loans and credit transactions apply only to public companies and associated companies (ss 198 and 201). See other related restrictions (ss 198–203).

The requirement for members' approval is subject to the exceptions in ss 204–209 inclusive: the exceptions extend to expenditure on company business; expenditure on defending proceedings etc, in connection with regulatory action or investigation; expenditure for minor and business transactions; expenditure for intra-group transactions and expenditure for money-lending companies). Of these, the most general is s 207, which sets the minimum threshold value for transactions requiring the approval of members (£10,000 for loans, etc; £15,000 for credit transactions).

The remedies are set out in s 213, and there is, again, a provision for subsequent affirmation (s 214).

(iv) Payments for loss of office: ss 215–222

See 'Compensation claims for loss of office', pp 288ff.

(v) Directors' service contracts—definition and inspection rights of members: ss 227–230

See 'Directors' service contracts', pp 270ff.

(vi) Contracts not in the ordinary course of business with sole member who is also a director: s 231

Outside the range of Pt 10, directors are subject to a raft of statutory provisions imposing liability for:

- **(i)** losses of capital, for example through issuing shares without complying with the statutory rules about payment; or for making an improper repurchase of shares out of capital (see 'Redemptions and repurchases of shares', pp 520ff);
- **(ii)** 'insider dealing': see 'Insider dealing', pp 729ff;

(iii) directors are liable to reimburse the company if political donations are made without shareholder authorisation: CA 2006 ss 366ff and see 'Corporate gifts', pp 134ff.

(p. 448) Remedies: indemnities

It is crucial to read the relevant statutory provisions if you want to understand this area.

Statutory remedies for breach of duty may include losses not caused by the breach itself.

[7.41] Re Duckwari plc [1999] Ch 253, [1998] 2 BCLC 315 (Court of Appeal)

Mr Cooper was a director of Offerventure Ltd and also of Duckwari plc. Offerventure had contracted to buy a property in High Wycombe for development for £495,000 (a fair price). Cooper offered to pass on the property to Duckwari at cost, on terms that he would receive a 50% share of any profits resulting from the development. This offer was accepted by the board of Duckwari, but not approved by its members. After Duckwari had bought the property, there was a fall in the market and the property was eventually sold for £177,970. The Court of Appeal held that Cooper, Duckwari's other directors and Offerventure (as an associated company) were liable under CA 1985 ss 320–322 [now CA 2006 ss 190ff] to indemnify Duckwari for the whole of its loss, including that due to the fall in market value, and not simply for the difference between the price paid for the property and its value at the time of the transaction (which would have been nil).

NOURSE LJ: It is convenient to start with the judge's comparison of the purchase with an unauthorised investment by a trustee. The assets of a company being vested in the company, the directors are not accurately described as trustees of those assets. Nevertheless, they have always been treated as trustees of assets which are in their hands or under their control. The principle is best stated by Lindley LJ in *Re Lands Allotment Co*:[81]

> Although directors are not properly speaking trustees, yet they have always been considered and treated as trustees of money which comes to their hands or which is actually under their control; and ever since joint stock companies were invented directors have been liable to make good moneys which they have misapplied upon the same footing as if they were trustees …

As to what is meant by a misapplication in this context, I adopt as correct the statement in *Gore-Browne on Companies*, 44th edn (1986), p 27/010, para 27.6:

> any disposition of the company's property which by virtue of any provision of the company's constitution or *any statutory provision* or any rule of general law the company or the board is forbidden or incompetent or unauthorised to make, or which is carried out by the directors otherwise than in accordance with their duty to act bona fide in the interests of the company and for the proper purposes. (Emphasis added.)

A statutory provision well known in this context was section 54 of the Companies Act 1948 (now re-enacted, though with substantial amendments, by sections 151 to 158 of the Act of 1985), which prohibited a company from giving financial assistance for the acquisition of its own shares. It has been held that directors who cause the company's funds to be applied in breach of that prohibition are to be treated as trustees of those funds: see, for example, *Belmont Finance Corpn Ltd v Williams Furniture Ltd (No 2)* **[10.10]**. Similarly, by virtue of section 320(1)(b) Duckwari was prohibited from entering into the arrangement with Offerventure pursuant to which it purchased the property unless the arrangement was first approved by a resolution of Duckwari in general meeting. Such approval not having been obtained, the payment of £495,000, together with the other costs of the acquisition, was a misapplication of Duckwari's funds which, had section 320 stood alone, the directors responsible would have been liable to make good as if they were trustees.

The basis on which trustees would have been liable to make good the misapplication is well settled. If a trustee applies trust moneys in the acquisition of an unauthorised investment, he is liable **(p. 449)** to restore to the trust the amount of the loss incurred on its realisation: see *Knott v Cottee* (1852) 16 Beav 77. He is also liable for interest. Where more than one trustee is responsible for the acquisition their liability is joint and several.

If these rules were to apply to the present case, the directors responsible would prima facie appear to be jointly and severally liable to restore to Duckwari the difference between the gross acquisition cost, £505,923, and the £177,970 which has since been realised on the sale of the property, plus interest, credit being given for the amount of any rents and profits received before completion of the sale.

That would have been the position if section 320 had stood alone, which it does not. A company's remedies for a contravention of that section are spelled out in section 322, in this case in section 322(3)(b). So the question is what loss or damage is comprehended by that provision. The persons who are rendered liable to indemnify Duckwari are not only Mr Cooper and the other directors responsible but also Offerventure, as a person connected with Mr Cooper.

[His Lordship outlined the arguments of counsel and continued:] In considering these rival submissions I return once more to the wording of section 322(3)(b), which provides for an indemnity 'for any loss or damage resulting from the arrangement or transaction.' Plainly those words, if read in isolation, are capable of including a loss incurred by Duckwari on a realisation of the property for less than the cost of its acquisition. Such a loss can fairly be said to result from the purchase, on the ground that if the purchase had not been made the loss would not have been incurred. But the loss can also fairly be said to result from the fall in value of the property. So it is necessary to look at the other provisions of sections 320 and 322 and the general law in order to see whether a loss of the former kind was intended to be included.

I agree with Mr Richards [counsel for the company] that the judge was wrong both in thinking that the general distinction between the decision-making powers of directors and trustees had some relevance to the question and in restricting the mischief addressed by the provisions to acquisitions at an inflated value or disposals at an undervalue. It is obvious that there will be many other circumstances in which it is appropriate for the approval of shareholders to be obtained. In the present case, for example, the shareholders might well have declined to approve the purchase either because it was a new kind of venture or, more pertinently, because Offerventure or Mr Cooper was to take 50 per cent of any profits arising from the development of the property but was not to bear a share of any loss. A one-sided arrangement thus favourable to the director would seem to be an exemplar of the kind of arrangement which was intended to be within the scope of section 320.

Bearing in mind the evident purpose of sections 320 and 322 to give shareholders specific protection in respect of arrangements and transactions which will or may benefit directors to the detriment of the company, I am unable to construe section 322(3)(b) as denying the company a remedy which appears to flow naturally from a combination of section 320(1)(b) and the general law. No doubt it is possible to cite instances where Parliament has been held to take away with one hand what it appears to give with the other. But I cannot conceive that one would be found where the result was to give a narrow effect to provisions plainly intended to afford a protection and equally amenable to being given some wider effect.

This broad approach to section 322(3)(b) is entirely consistent with the provisions of section 322(2)(a) and (3)(a) …

It is well recognised that the basis on which a trustee is liable to make good a misapplication of trust moneys is strict and sometimes harsh, especially where, as here, there has been a huge depreciation in the value of the asset acquired. I can understand what I believe to have been the reluctance of the judge to visit Mr Cooper (with whom I include Offerventure) with the consequences of the loss. But the loss has to fall somewhere and, if a proposal to purchase the property had been put to and rejected by the shareholders, it would have lain with Mr Cooper. The approval of the shareholders not having been obtained, it is not unfair that the loss should continue to lie with Mr Cooper rather than Duckwari …

PILL and THORPE LJJ concurred.

(p. 450) ***Not every case in which a director receives a loan (or a quasi-loan) results in a constructive trusteeship.***

[7.42] Ciro Citterio Menswear plc v Thakrar [2002] EWHC 662, [2002] 1 WLR 2217 (Chancery Division)

ANTHONY MANN QC: The principal question in this part of this case is whether an unlawful loan gives rise to constructive trusteeship at any stage. I take as a starting point that a loan to a director is not of itself the sort of transaction that is inevitably a misapplication of company moneys. There is nothing inherently wrong with such a transaction in the abstract. It may or may not be a misapplication on any particular set of facts, but it is not, as such, a breach by a director of his trusteeship of company assets. Statute did not intervene until the Companies Act 1929, when the predecessor of section 330 made its first appearance. The bar was repeated in the Companies Act 1948, but without the civil consequences of the bar being spelt out. It was not until 1985 that statute specified civil consequences.

The civil consequences are specified as being that the loan is voidable. That is of obvious significance to this part of the case. If a loan is voidable, it stands until avoided. That means that property in the money paid under the loan passes to the borrower. In my view that concept is inimical to the existence of a constructive trusteeship, or any form of tracing claim, at least in the absence of special circumstances. That view is supported by the speech of Lord Goff of Chieveley in*Guinness plc v Saunders* **[5.01]**, 698. Lord Goff was considering a breach by a Guinness director of the disclosure rules in section 317 of the companies Act 1985 [CA 2006, s 177]. The consequences of that breach were that the contract in question, under which the director took considerable financial benefits, was voidable, not void. The Court of Appeal had held that the director, therefore, became a constructive trustee of the moneys he had received under that contract and had to pay them back. Lord Goff, with whom Lord Griffiths agreed, held that this part of the analysis could not be sustained. A voidable contract stood until avoided. He considered, at p 698, an argument by counsel for Guinness to the effect that the director

> 'having received the money as constructive trustee, must pay it back. This appears to have formed, in part at least, the basis of the decision of the Court of Appeal. But the insuperable difficulty in the way of this proposition is again that the money was on this approach paid not under a void, but under a voidable, contract. Under such a contract, the property in the money would have vested in Mr Ward (who, I repeat, was ex hypothesi acting in good faith); and Guinness cannot short circuit an unrescinded contract simply by alleging a constructive trust.'

In my view, that reasoning applies in this case. Until any avoidance by the company the loan stood, and there was no constructive trust. In the case of section 330 that conclusion is reinforced by the terms of section 341 [now see CA 2006 s 213]. That sets out the civil consequences, and it seems to me that in the absence of special facts making the loan a breach of fiduciary duty they leave no room for constructive trusteeship. Section 341(2)(a) [CA 2006 s 213(3)(a)] seems to presuppose the absence of constructive trusteeship, because it expressly provides for what would otherwise be one of the consequences of constructive trusteeship, namely an obligation to account for gains made.

Also see *Currencies Direct Ltd v Ellis* [2002] 2 BCLC 821, CA, which addresses the issue of whether payments received by a director from his company should be characterised as loans or remuneration. In *Brown v Button* [2011] EWHC 1034 (Ch) the point was made that the six-year limitation period (see *Gwembe Valley Development Co Ltd v Koshy* **[7.37]**) does not apply to actions to recover illegal loans from directors (now CA 2006 s 213(3)(a)), where the claim is in reality a claim to recover property which a director has obtained from the company **(p. 451)** in breach of trust; but that the six-year limitation period applies to claims against all the directors rendering them jointly and severally liable to indemnify the company for the losses in relation to such unauthorised loans (now CA 2006 s 213(3)(b)).

Secondary liability (liability of third parties associated with directors' wrongs)

When directors act in breach of their fiduciary duties to the company, third parties may sometimes also be liable to the company for their role in the wrongdoing. The company may be keen to pursue such claims, especially if the defaulting director has absconded or is insolvent. The favoured third parties to sue are 'deep pockets', such as banks and law firms. Third parties may be:

(i) Personally liable as '*knowing recipients*', that is, people who 'knowingly' receive the company's property as a result of the director's breach of duty. Since liability is personal, not proprietary, it is irrelevant whether these people still have the property or its proceeds in their possession when the claim is brought. The necessary degree of knowledge to make these people liable remains unsettled (see the unconscionability test, later). These people are liable to the extent of the personal benefit received.
(ii) Personally liable as '*dishonest accessories*', that is, people who dishonestly assist or procure the director's breach of duty. These people are liable with the defaulting director, as accessories.[82]
(iii) Subject to a proprietary claim, having received the company's property without being able to assert the protection of bona fide purchaser for value without knowledge of the company's interests; that is, people who are donees of gifts of the company's property, or who purchase it without the necessary bona fides. These people hold the property on trust for the company.

The following case extracts illustrate the types of claims.

Required knowledge for secondary liability

In *Baden Delvaux & Lecuit v Société Général pour Favoriser le Développement du Commerce et de l'Industrie en France SA* [1983] BCLC 325 at 407, [1993] 1 WLR 509n at 575, Peter Gibson J identified five different kinds of mental state which might be relevant in assessing the knowledge required for the secondary liability, as follows:

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

(p. 452) However, in *Bank of Credit and Commerce International (Overseas) Ltd v Chief Akindele* [2000] BCLC 968, the Court of Appeal ruled that it was time to make a clean break, and that there should be a single test of knowledge for *knowing receipt*: was the recipient's state of knowledge such as to make it unconscionable for him to retain the benefit of the receipt? Although the fivefold classification had often been found 'helpful', the new test would 'better enable the courts to give common-sense decisions in the commercial context in which claims in knowing receipt are now frequently made'.

With '*dishonest assistance*' (formerly 'knowing assistance'), there has also been radical change. In the *Royal Brunei Airlines* case (also sometimes referred to simply as *Tan*) **[7.43]**, it was held that what is relevant is the state of mind of the person who, as an accessory, procures or assists in the breach of trust or other fiduciary obligation. For this purpose it must be shown that the accessory was dishonest.

The test of dishonesty applied by Lord Nicholls in *Tan* was widely assumed to be an objective test: would a reasonable person in the same circumstances have thought the transaction or arrangements dishonest? But in *Twinsectra Ltd v Yardley* [2002] UKHL 12, [2002] 2 AC 164 the majority of the House adopted a double objective–subjective test of dishonesty. Not only must the transaction be dishonest according to reasonable standards of honesty, but the defendant must also appreciate that fact. Lord Hutton gave the leading speech, purporting to apply the *Royal Brunei Airlines* principles of accessory liability, and Lord Hoffmann added that these required 'more than knowledge of the facts which make the conduct wrongful. They require a dishonest state of mind, that is to say, consciousness that one is transgressing ordinary standards of honest behaviour' [20]. Lord Hoffmann went on to clarify: 'I do not suggest that one cannot be dishonest without a full appreciation of the legal analysis of the transaction. A person may dishonestly assist in the commission of a breach of trust without any idea of what a trust means. The necessary dishonest state of mind may be found to exist simply on the fact that he knew perfectly well that he was helping to pay away money to which the recipient was not entitled' [24]. Lord Millett gave a powerful dissent, suggesting the subjective element was inappropriate in civil cases, and wrongly borrowed from the criminal law.

Lord Millett's (and Lord Nicholls's) views now seem to have prevailed. In *Barlow Clowes v Eurotrust International* [2005] UKPC 37, [2006] 1 WLR 1476, Lord Hoffmann delivered the opinion of the Privy Council (which included Lord Nicholls), and explicitly adopted the objective test of honesty: would a reasonable person, knowing what the defendant knew, regard the transaction or arrangement as dishonest? Indeed, the *Barlow Clowes* approach was explicitly endorsed by the Court of Appeal in *Starglade Properties Ltd v Roland Nash* [2010] EWCA Civ 1314:

> There is a single standard of honesty objectively determined by the court. That standard is applied to specific conduct of a specific individual possessing the knowledge and qualities he actually enjoyed [25]…
>
> [After considering *Twinsectra* and *Barlow Clowes*:]
>
> There is no suggestion in this case either that the standard of dishonesty is flexible or determined by any one other than by the court on an objective basis having regard to the ingredients of the combined test as explained by Lord Hutton in *Twinsectra* and Lord Hoffmann in *Barlow Clowes*.

Also see *Bank of Ireland (UK) plc v Jaffery* [2012] EWHC 1377 (Ch).

'Dishonest assistance'—meaning of dishonesty.

[7.43] Royal Brunei Airlines Sdn Bhd v Tan Kok Ming [1995] 2 AC 378, [1995] 3 All ER 97 (Privy Council)

Royal Brunei Airlines appointed Borneo Leisure Travel as its agent to sell passenger and cargo transportation, on written terms which provided that moneys collected by BLT for the **(p. 453)** sale of such services should be held by it on trust for RBA. BLT became insolvent owing over $335,000 to RBA. The question was whether Tan Kok Ming, who was BLT's managing director and principal shareholder, was accountable to RBA for this sum as a constructive trustee. In holding that he was, the Privy Council formulated revised rules of liability.

> The opinion of the Judicial Committee was delivered by LORD NICHOLLS OF BIRKENHEAD: The proper role of equity in commercial transactions is a topical question. Increasingly plaintiffs have recourse to equity for an effective remedy when the person in default, typically a company, is insolvent. Plaintiffs seek to obtain relief from others who were involved in the transactions, such as directors of the company, or its bankers, or its legal or other advisers. They seek to fasten fiduciary obligations directly onto the company's officers or agents or advisers, or to have them held personally liable for assisting the company in breaches of trust or fiduciary obligations.
>
> This is such a case. An insolvent travel agent company owed money to an airline. The airline seeks a remedy against the travel agent's principal director and shareholder. Its claim is based on the much-quoted dictum of Lord Selborne LC, sitting in the Court of Appeal in Chancery, in *Barnes v Addy*.[83]
>
> [His Lordship quoted from the judgment in this case and continued:] In the conventional shorthand, the first of these two circumstances in which third parties (non-trustees) may become liable to account in equity is 'knowing receipt', as distinct from the second, where liability arises from 'knowing assistance'. Stated even more shortly, the first limb of Lord Selborne LC's formulation is concerned with the liability of a person as a *recipient* of trust property or its traceable proceeds. The second limb is concerned with what, for want of a better compendious description, can be called the liability of an *accessory* to a trustee's breach of trust.

Liability as an accessory is not dependent upon receipt of trust property. It arises even though no trust property has reached the hands of the accessory. It is a form of secondary liability in the sense that it only arises where there has been a breach of trust. In the present case the plaintiff airline relies on the accessory limb. The particular point in issue arises from the expression 'a dishonest and fraudulent design on the part of the trustees'. …

In short, the issue on this appeal is whether the breach of trust which is a prerequisite to accessory liability must itself be a dishonest and fraudulent breach of trust by the trustee.

The honest trustee and the dishonest third party

… Take the simple example of an honest trustee and a dishonest third party. Take a case where a dishonest solicitor persuades a trustee to apply trust property in a way the trustee honestly believes is permissible but which the solicitor knows full well is a clear breach of trust. The solicitor deliberately conceals this from the trustee. In consequence, the beneficiaries suffer a substantial loss. It cannot be right that in such a case the accessory liability principle would be inapplicable because of the innocence of the trustee. In ordinary parlance, the beneficiaries have been defrauded by the solicitor. If there is to be an accessory liability principle at all, whereby in appropriate circumstances beneficiaries may have direct recourse against a third party, the principle must surely be applicable in such a case, just as much as in a case where both the trustee and the third party have been dishonest. Indeed, if anything, the case for liability of the dishonest third party seems stronger where the trustee is innocent, because in such a case the third party alone was dishonest and that was the cause of the subsequent misapplication of the trust property.

The position would be the same if, instead of *procuring* the breach, the third party dishonestly *assisted* in the breach. Change the facts slightly. A trustee is proposing to make a payment out of the trust fund to a particular person. He honestly believes he is authorised to do so by the terms of **(p. 454)** the trust deed. He asks a solicitor to carry through the transaction. The solicitor well knows that the proposed payment would be a plain breach of trust. He also well knows that the trustee mistakenly believes otherwise. Dishonestly he leaves the trustee under his misapprehension and prepares the necessary documentation. Again, if the accessory principle is not to be artificially constricted, it ought to be applicable in such a case.

These examples suggest that what matters is the state of mind of the third party sought to be made liable, not the state of mind of the trustee. The trustee will be liable in any event for the breach of the trust, even if he acted innocently, unless excused by an exemption clause in the trust instrument or relieved by the court. But his state of mind is essentially irrelevant to the question whether the *third party* should be made liable to the beneficiaries for the breach of trust. If the liability of the third party is fault-based, what matters is the nature of his fault, not that of the trustee. In this regard dishonesty on the part of the third party would seem to be a sufficient basis for his liability, irrespective of the state of mind of the trustee who is in breach of trust. It is difficult to see why, if the third party dishonestly assisted in a breach, there should be a further prerequisite to his liability, namely that the trustee also must have been acting dishonestly. The alternative view would mean that the dishonest third party is liable if the trustee is dishonest, but if the trustee did not act dishonestly that of itself would excuse a dishonest third party from liability. That would make no sense.

[His Lordship discussed the authorities further, and continued:]

Drawing the threads together, their Lordships' overall conclusion is that dishonesty is a necessary ingredient of accessory liability. It is also a sufficient ingredient. A liability in equity to make good resulting loss attaches to a person who dishonestly procures or assists in a breach of trust or fiduciary obligation. It is not necessary that, in addition, the trustee or fiduciary was acting dishonestly, although this will usually be so where the third party who is assisting him is acting dishonestly.

[It was held, accordingly that, even on the assumption that dishonesty could not be imputed to BLT, Tan Kok Ming's own dishonesty rendered him liable. But it was also held that BLT's breach of trust was itself dishonest.]

➢ Questions

1. Compare the *objective* test used in *Tan*, *Barlow Clowes* and *Starglade Properties* with the *Ghosh* test of dishonesty under criminal law. Is there a difference between how 'dishonesty' is interpreted in criminal and civil cases? Should there be such a difference? What about 'quasi-criminal' cases such as fraud?

2. In *Secretary of State for Justice v Topland Group plc* [2011] EWHC 983 (QB), Mr Justice King interpreted the *dishonesty* test as follows:

> 96 First, on any current understanding of the law on accessory liability (see the analysis of recent authority by the Chancellor in *Starglade Properties Ltd v Nash*[2010] EWCA Civ 1314), although the test of dishonesty or put another way the standard of honesty, is an objective one, there being a single standard of honesty objectively determined by the court and the views of the Defendant on what is dishonest are irrelevant, (see *Barlow Clowes Ltd v Eurocrest Ltd* [2006] 1 WLR 1476 where the Privy Council explained and interpreted the decision of the House of Lords in *Twinsectra v Yardley* [2002] 2 AC 164), the subjective state of mind of the Defendant, and what he knew or did not know about the circumstances of the impugned transaction, is still highly relevant since it is to the conduct of the Defendant in the light of that subjective state of mind that the court has to apply the objective test.

Is this explanation compelling, or does it once again risk muddling the line between an *objective* and a *subjective* test if the defendant's 'state of mind' and 'knowledge' are both material?

(p. 455) ***Remedies associated with secondary liability.***

[7.44] Ultraframe (UK) Ltd v Fielding [2005] EWHC 1638 (Chancery Division)

The facts, so far as necessary, appear from the judgment.

> LEWISON J:
>
> 1 This is (for the moment) the culmination of a long war of attrition … The trial alone, on liability only, occupied 95 days of court time. Both Ultraframe and Burnden are competitors in the market for the manufacture and supply of conservatories, and conservatory roofs in particular … The war has been bitterly fought. There have been accusations and counter-accusations of forgery, theft, false accounting, blackmail and arson, not to mention the widespread allegations that many of the principal witnesses are lying. At the heart of the litigation is a dispute about the ownership of businesses in the field of conservatory roof design and manufacture originally developed by Mr Howard Davies …
>
> [Lewison J's judgment is extremely long and thorough: at [1476]ff he describes the two types of secondary liability and how they arise; at [1511]–[1576] he surveys the law on remedies for fiduciary breaches; and at various places, extracted in the following, he addresses the issue of remedies against third parties.] …
>
> *Personal or proprietary liability?*
>
> 1484 It is important to keep distinct the two forms of secondary liability; because they have different consequences in terms of remedy.
>
> *Knowing receipt*
>
> 1485 In *Twinsectra* Lord Millett said:
>
> > 'Liability for "knowing receipt" is receipt-based. It does not depend on fault. The cause of action is

> restitutionary and is available only where the defendant received or applied the money in breach of trust for his own use and benefit …'

1486 Although a claim in knowing receipt is receipt-based, it is not dependent on the recipient having retained the trust property. If he has retained it, or if he has retained property which is an identifiable substitute for the original trust property, then the claimant is entitled simply to assert his proprietary rights in that property. He does this by invoking the principles of following and tracing. If the original recipient has passed on the property or its substitute to another person then, subject to any defence which that other may be entitled to raise, the principles of following or tracing continue to apply to the property or its substitute in the hands of that other. If the recipient has not retained the trust property, and its proceeds are no longer identifiable, then the claimant has a personal remedy against the recipient.

What counts as trust property for the purposes of knowing receipt?

…

1488 Plainly, property which is vested in the company, both legally and beneficially, before any disposition in breach of fiduciary duty, will count as trust property. This was the case in *JJ Harrison (Properties) Ltd v Harrison* **[7.36]** where a director who had bought land belonging to the company, without disclosing its development potential, was held to have acquired the property as constructive trustee.

1489 But property will also count as the company's property if it is property which the fiduciary has acquired for his own benefit but which, consistently with his fiduciary duties, he ought to have acquired on behalf of the company … [He cited *Attorney General of Hong Kong v Reid* [1994] 1 AC 324 and *Keech v Sandford*(1726) Sel Cas Ch 61, and continued:]

(p. 456) *Dishonest assistance*

1495 In *Tan* Lord Nicholls said (p 387):

> 'Within defined limits, proprietary rights, whether legal or equitable, endure against third parties who were unaware of their existence. But accessory liability is concerned with the liability of a person who has not received any property. His liability is not property-based. His only sin is that he interfered with the due performance by the trustee of the fiduciary obligations undertaken by the trustee. These are personal obligations. They are, in this respect, analogous to the personal obligations undertaken by the parties to a contract.'

1496 In similar vein Lord Millett said in *Twinsectra* (p 194, dissenting, although not on this point):

> 'The accessory's liability for having assisted in a breach of trust is quite different. It is fault-based, not receipt-based. The defendant is not charged with having received trust moneys for his own benefit, but with having acted as an accessory to a breach of trust. The action is not restitutionary; the claimant seeks compensation for wrongdoing. The cause of action is concerned with attributing liability for misdirected funds. Liability is not restricted to the person whose breach of trust or fiduciary duty caused their original diversion. His liability is strict. Nor is it limited to those who assist him in the original breach. It extends to everyone who consciously assists in the continuing diversion of the money. Most of the cases have been concerned, not with assisting in the original breach, but in covering it up afterwards by helping to launder the money.' …

What counts as dishonest assistance?

1509 It is clear that the passive receipt of trust property does not count as assistance: *Brown v*

Bennett [1999] BCLC 525, 533. As Morritt LJ said:

> '… if there is no causative effect and therefore no assistance given by the person … on whom it is sought to establish the liability as constructive trustee, for my part I cannot see that the requirements of conscience require any remedy at all.'

1510 Likewise in *Brink's Ltd v Abu-Saleh* Rimer J held that Mrs Elcombe's presence in the car accompanying her husband abroad on money laundering trips did not amount to assistance 'of a nature sufficient to make her an accessory'. She was in the car merely in her capacity as Mr Elcombe's wife …

Remedies against the knowing recipient

1577 In addition to the proprietary remedy (if it is still available) the claimant has a personal remedy for an account against the knowing recipient. Obviously, the personal remedy depends on establishing knowing receipt, but it does not depend on retention. Indeed it is needed precisely where the recipient has not retained the property. In addition, the personal remedy requires the knowing recipient to account for any benefit he has received or acquired as a result of the knowing receipt. However, a knowing recipient is not, in my judgment, liable to account for a benefit received by someone else. [He then went on to explain that the remedy must be fashioned to ensure that there is no double recovery, and continued:]

Fashioning the account

1579 The ordering of an account is an equitable remedy. It is not discretionary in the true sense. It is granted or withheld on the basis of equitable principles. But one of those principles is that of proportionality. In *Satnam Investments Ltd v Dunlop Heywood* [1999] 3 All ER 652 property agents had acquired confidential information about a potential development site in the course of acting for a client. In breach of duty they disclosed that information to a rival (Morbaine). The question arose **(p. 457)** whether Morbaine (which had since purchased the site) could be made liable to account for profits. Nourse LJ said:

> 'What the judge found was that some at least of the information was confidential at the time that it was disclosed, in that its disclosure to a rival developer would or might be detrimental to Satnam. However, even assuming that but for the disclosure Morbaine would not have acquired the Brewery Street site, it does not follow that it would be a proportionate response to hold it liable for an account of profits. All the circumstances must be considered. The information, though confidential, was not of the same degree of confidentiality as the information in the *Spycatcher* case and in *Schering Chemicals Ltd v Falkman Ltd*. All of it was either already available to Morbaine or would have been available to it on reasonable inquiry once, as was inevitable, the news of Satnam's receivership became known. There being no other basis of recovery available, it would in our view be inequitable and contrary to commercial good sense to allow Satnam to recover simply on the basis that there was a degree of confidentiality in the information at the time that it was disclosed to Morbaine.'

[He then considered various cases, including *Warman v Dwyer* (Note 2 following *Foster Bryant Surveying Ltd v Bryant, Savernake Property Consultants Ltd* **[7.29]**, p 394), and *CMS Dolphin v Simonet* **[7.31]**, and continued:]

1588 … The governing principles are, in my judgment, these:

- **i)** The fundamental rule is that a fiduciary must not make an unauthorised profit out of his fiduciary position;
- **ii)** The fashioning of an account should not be allowed to operate as the unjust enrichment of the claimant;
- **iii)** The profits for which an account is ordered must bear a reasonable relationship to the breach of duty proved;