SUPREME COURT OF QUEENSLAND

CITATION:	*Tara Shire Council v Garner & Ors* [2002] QCA 232
PARTIES:	**TARA SHIRE COUNCIL** (plaintiff/first respondent) v **CECIL EDWARD GARNER** and **JOSEPHINE MICHELE GARNER** (first defendants/second respondents) **ARCAPE PTY LTD** ACN 010 871 280 (first third party/second defendant/applicant) **COLIN WARWICK MARTIN** (second third party)
FILE NO/S:	Appeal No 1613 of 2002 DC No 2921 of 1998
DIVISION:	Court of Appeal
PROCEEDING:	Application for Leave s 118 DCA (Civil)
ORIGINATING COURT:	District Court at Brisbane
DELIVERED ON:	28 June 2002
DELIVERED AT:	Brisbane
HEARING DATE:	23 April 2002
JUDGES:	McMurdo P, Davies JA and Atkinson J Separate reasons for judgment of each member of the Court; McMurdo P and Atkinson J concurring as to the order made, Davies JA dissenting
ORDER:	**Application for leave to appeal refused**
CATCHWORDS:	CONVEYANCING - LAND TITLES UNDER THE TORRENS SYSTEM - INDEFEASIBILITY OF TITLE: CERTIFICATE AS EVIDENCE - EXCEPTIONS - GENERALLY - where the second respondents sold a piece of land to the first respondent - where purchase price paid - where the second respondents subsequently sold the piece of land to the applicant - where the applicant acquired its interest in the land with knowledge that the land had been sold to the first respondent - whether the applicant has indefeasible title of the land in accordance with s 184 of the *Land Title Act* 1994 (Qld) - whether the knowledge of the applicant was sufficient to give rise to an "equity" within the meaning of the exception to indefeasibility contained in s 185(1)(a) of the *Land Title Act*

CONVEYANCING - LAND TITLES UNDER THE TORRENS SYSTEM - INDEFEASIBILITY OF TITLE: CERTIFICATE AS EVIDENCE - EXCEPTIONS - GENERALLY - whether a cause of action based on the first limb of the Rule in *Barnes v Addy* is a sufficient equity to overcome indefeasibility - whether there must be dishonesty to overcome indefeasibility

CONVEYANCING - LAND TITLES UNDER THE TORRENS SYSTEM - TRUSTS, EQUITIES AND UNREGISTERED INSTRUMENTS AND INTERESTS - EQUITABLE ESTATES AND INTERESTS - where the applicant acquired its registered title with knowledge that the land had been sold to the first respondent - whether the applicant held its registered title subject to a constructive trust in accordance with the first limb of the Rule in *Barnes v Addy*

EQUITY - TRUSTS AND TRUSTEES - CONSTITUTION AND CLASSIFICATION OF TRUSTS GENERALLY - CLASSIFICATION OF TRUSTS IN GENERAL - IMPLIED TRUSTS - RESULTING TRUSTS - WHETHER INTENTION PRESUMED - WHEN ARISING - OTHER CASES - where the second respondents sold a piece of land to the first respondent - where purchase price paid - whether the second respondents held the land on trust for the first respondent

EQUITY - TRUSTS AND TRUSTEES - FOLLOWING TRUST PROPERTY - IN GENERAL - where applicant acquired its registered title with knowledge the land had been sold to the first respondent - whether knowledge pleaded was sufficient to sustain an action under the first limb of the Rule in *Barnes v Addy* - whether material that the trust was a resulting trust

Land Title Act 1994 (Qld), s 184, s 185(1)(a)

Baden Delvaux & Lecuit v Société Générale pour Favoriser le Développement du Commerce et de l'Industrie en France SA [1992] 4 All ER 161, applied
Bahr v Nicolay [No 2] (1988) 164 CLR 604, considered
Bank of South Australia Ltd v Ferguson (1998) 192 CLR 248, considered
Barnes v Addy (1874) LR 9 Ch App 244, applied
Breskvar v Wall (1971) 126 CLR 376, considered
Bunny Industries Ltd v FSW Enterprises Pty Ltd [1982] QdR 712, considered
Clark v Raymor (Brisbane) Pty Limited [No 2] [1982] QdR 790, considered
Consul Development Pty Ltd v DPC Estates (1975) 132 CLR 373, discussed

Doneley v Doneley [1998] 1 QdR 602, discussed
Doneley v Morris [2001] QSC 90; SC No 304 of 2001, 4 April 2001, considered
Goodwin v Gilbert [2000] QSC 309; SC No 5720 of 2000, 11 September 2000, considered
Hancock Family Memorial Foundation Ltd v Porteous (1999) 151 FLR 191, applied
International Sales and Agencies Ltd v Marcus [1982] 3 All ER 551, considered
Kern Corporation v Walter Reid (1987) 163 CLR 164, considered
Koorootang Nominees Pty Ltd v Australia and New Zealand Banking Group Ltd [1998] 3 VR 16, applied
Macquarie Bank Ltd v Sixty-Fourth Throne Pty Ltd [1998] 3 VR 133, not followed
McPhee v Zarb [2002] QSC 4; SC No 6277 of 2001, 8 January 2002, considered
Royal Brunei Airlines Sdn Bhd v Tan Kok Ming [1995] 2 AC 378, considered
US Surgical Corp v Hospital Products [1983] 2 NSWLR 157, considered

COUNSEL: W Sofronoff QC, with T Matthews, for the applicant
P F Allen for the first respondent
P J McHugh for the second respondents

SOLICITORS: Egans for the applicant
Hemming & Hart acting as town agents for Carvosso & Winship (Dalby) for the first respondent
Richard Ebbott & Co for the second respondents

[1] **McMURDO P:** I have had the benefit of reading the reasons for judgment of Davies JA and Atkinson J in which the facts and issues are set out. I will repeat only those necessary to give my brief reasons.

[2] This is an appeal against the interlocutory decision of a District Court judge to allow the plaintiff and respondent to this appeal, the Tara Shire Council ("the Council"), to join the first third party, Arcape Pty Ltd ("the applicant"), as a defendant in these proceedings.

[3] The case raises the tension between statutory indefeasibility of title and equitable principles. Although the system of land registration in Queensland provides for indefeasible title of registered land under s 184 *Land Title* Act 1994 (Qld), the exceptions provided for in s 185 of that Act include an equity arising from the act of the registered proprietor: see *Goodwin v Gilbert,*[1] *Doneley v Morris*[2] and *McPhee v Zarb*.[3]

[4] The Council claims that they purchased for $65,000, but did not register, Lot 3, the bore subdivision, from the Garners. The Garners orally informed the agents of the

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1 [2000] QSC 309 at [19] and [23].
2 [2001] QSC 090 at 19.
3 [2002] QSC 4 at [40].

applicant that Lot 3 did not belong to them but to the Council and that the sale of the motel and surrounds did not include the bore subdivision. After the sale and registration of the land, the applicant has refused to convey Lot 3 to the Council. The Council seeks $65,000 equitable compensation, a declaration that it holds Lot 3 on a constructive trust for the plaintiff, an order that it execute the trust by forthwith transferring such land to the plaintiff, interest and costs.

[5] The primary judge's decision in an interlocutory application to grant the Council leave to join the applicant as a second defendant in the proceeding and the consequential leave to amend the claim and statement of claim involved questions of discretion which are not lightly interfered with.

[6] For the reasons given by Atkinson J, the Council's claim against the applicant is arguable or at least not so clearly untenable that it cannot possibly succeed: cf *General Steel Industries Inc v Commissioner for Railways (NSW)*.[4] The complex issues of law involved are best determined in the light of clear factual findings, not in an interlocutory appeal.

[7] The ultimate outcome of the claim will turn in large part on findings of fact, particularly whether the Garners held Lot 3 as trustees for the Council and the state of the applicant's knowledge as to the ownership of Lot 3 at the time it acquired and registered the land. Depending on those findings, as Atkinson J demonstrates, it is arguable that the applicant held the land as trustee for the Council and its act in refusing to convey Lot 3 to the Council was a breach of trust.

[8] This is a matter in which the applicant needs leave to appeal under s 118 *District Court Act* 1967 (Qld). The applicant must demonstrate that the decision is attended with sufficient doubt to warrant it being reconsidered by this Court and also that supposing the decision were wrong, substantial injustice would result if leave were refused: *Westpac Banking Corporation v Klef Pty Ltd*.[5] This not such a case.

[9] I would refuse the application for leave to appeal.

[10] **DAVIES JA:** This is an application for leave to appeal against an interlocutory decision of a judge of the District Court on 22 January this year giving leave to the first respondent to join the applicant as a second defendant in an action in the District Court against the second respondents and consequent leave to amend the claim and statement of claim. The applicant was already a third party in the action.

[11] The application and, if leave is granted, the appeal are on alternative bases. First it is submitted that the learned primary judge erred in law in holding as arguable the proposed amended claim and statement of claim consequent upon joinder of the applicant as second defendant. Alternatively it is submitted that his Honour failed to give any or any proper consideration to the discretionary factors which he ought to have considered which militated against the orders sought in the application before him by the first respondent. In order to understand these alternative submissions it is necessary to say something about the amended claim and the facts alleged in the amended statement of claim.

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4 (1964) 112 CLR 125.

5 [1998] QCA 311, Appeal No 8204 of 1998, 16 October 1998, p 7.

[12] The opponent to this application is, of course, the first respondent. The second respondents were served and appeared but, having informed the Court that their involvement in the proceedings had been the subject of compromise, sought leave to and were given permission to withdraw.

[13] The first respondent's claim against the applicant is a declaration that the applicant holds certain land on a constructive trust for the first respondent and an order that it execute such trust together with interest and costs. The relevant facts alleged in support of that claim, as appears from the proposed statement of claim filed by the first respondent on its application, are as follows.

[14] Prior to 1 February 1990 the second respondents were the registered proprietors of land near the Moonie Motel described as Lot 3 on Registered Plan 218396. On 16 September 1987 the second respondent accepted an offer from the first respondent, subject to a condition, to purchase Lot 3 for $65,000; on 8 October 1987 the first respondent fulfilled that condition; and on 8 March 1988 the first respondent paid $65,000 to the second respondent for the purchase of Lot 3. Thereupon, it was alleged, the second respondent held Lot 3 on a bare trust for the first respondent.

[15] Then it was alleged that, in breach of that trust, the second respondent by a written contract dated 6 November 1989 sold land which included Lot 3 to the applicant for $960,000; a transfer of that land was executed on 12 January 1990; and the applicant became the registered owner of it on 1 February 1990.

[16] The first respondent's final and critical allegations should be set out in full.

> "8. At or near the Moonie Motel approximately two weeks before the making of the contract [between the applicant and the second respondents] the [second respondents] orally informed Jacqueline Urquhart and Kenneth Pfitzner, as agents of the [applicant] that Lot 3 did not belong to the [second respondents] but to the [first respondent] so that the sale by them of the Moonie Motel did not and could not include that lot.
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> 9.(a) The [applicant] has retained Lot 3 since becoming the registered owner of it;
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> …"[6]

[17] It was on the basis of those facts that the first respondent alleged it was entitled to the above relief against the applicant. The learned primary judge held that that relief was arguable on those facts. The applicant contends that it was not.

[18] Both in the District Court and in this Court the parties joined in submitting that the relevant Act governing indefeasibility of registered title, upon which this case turns, was the *Land Title Act* 1994 notwithstanding that the applicant became registered proprietor of the relevant land on 1 February 1990 and no act of the applicant after that date is relied on by the first respondent. That seems to me to be correct.[7]

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[6] The second respondents, in further and better particulars of their defence, alleged a more specific version of that conversation. However, if it matters, that version was not alleged in the first respondent's proposed statement of claim against the applicant and this appeal must be determined on the allegations in that proposed pleading.

[7] See Part 12 of the *Land Title Act* 1994, especially s 201(1)(a).

However, for the reason given later, I do not think that anything significant turns on this.

[19] The applicant's case before the learned primary judge and in this Court is a simple one. It submits that it is the registered proprietor of land which includes Lot 3. No fraud, within the meaning of s 184(3)(b) of the *Land Title Act*, is alleged against it. Nor, it is submitted, do the allegations assert an equity in the first respondent arising from any act of the applicant within the meaning of s 185(1)(a). Consequently, it is said to follow, the applicant's title to the land is indefeasible. In particular it holds the land free of any equitable interest which the first respondent may have had prior to registration.

[20] The first respondent concedes, at least by implication, that the statement of claim does not allege fraud within the meaning of s 184(3)(b). The statement of claim plainly does not do so. The law is clear that accepting a transfer with knowledge of a prior equitable interest is not fraud within the meaning of such a provision.[8]

[21] However the first respondent submits that its interest was one which gave rise to an equity against the applicant and consequently that the applicant holds its interest subject to that interest. It relies upon s 185(1)(a).

[22] Sections 184 and 185 relevantly provide:

> "184.(1) A registered proprietor of an interest in a lot holds the interest subject to registered interests affecting the lot but free from all other interests.
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> (2) In particular, the registered proprietor -
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> (a) is not affected by actual or constructive notice of an unregistered interest affecting the lot; and
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> (b) is liable to a proceeding for possession of the lot or an interest in the lot only if the proceeding is brought by the registered proprietor of an interest affecting the lot.
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> (3) However, subsections (1) and (2) do not apply -
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> (a) to an interest mentioned in section 185; or
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> (b) if there has been fraud by the registered proprietor, whether or not there has been fraud by a person from or through whom the registered proprietor has derived the registered interest.
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> 185.(1) A registered proprietor of a lot does not obtain the benefit of section 184 for the following interests in relation to the lot -
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> (a) an equity arising from the act of the registered proprietor;
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> … "

[23] It was rightly conceded by Mr Allen, for the first respondent, that s 185(1)(a) does no more than state the existing law.[9] Accordingly, as appears from the dicta below,

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8 *Friedman v Barrett, Ex parte Friedman* [1962] QdR 498 at 512; *Bahr v Nicolay [No 2]* (1988) 164 CLR 604 at 613, 630, 652 - 653; *Bourseguin v Stannard Bros Holdings Pty Ltd* [1994] 1 QdR 231 at 238 - 239.

9 *Land Title Act* 1994, s 3; Law Reform Commission Report No 40, "Consolidation of the Real Property Acts", March 1991, commentary to s 115. That is why I said in [18] that nothing significant turns on whether the *Land Title Act* or the *Real Property Acts* 1861 and 1877 are the relevant governing provisions.

the sole question which arises in this Court is whether the applicant either before or after registration acted in such a way as to give rise to a personal equity in the first respondent which was enforceable against the applicant.[10] When asked to state what that act of the applicant was, Mr Allen for the first respondent said, in effect, that it was the acquisition and retention of registered title with knowledge of a breach of trust by the second respondent in conveying that title to the applicant. Before turning to that submission in more detail I should say something about the law with respect to the exception to indefeasibility contained in s 185(1)(a).

[24] In *Breskvar v Wall*,[11] a case concerning the *Real Property Act* 1861 and the *Real Property Act* 1877, Barwick CJ, in a judgment agreed in by Windeyer and Owen JJ, after referring to the principle of indefeasibility said:

> "Proceedings may of course be brought against the registered proprietor by the persons and for the causes described in the quoted sections of the Act or by persons setting up matters depending upon the acts of the registered proprietor himself. These may have as their terminal point orders binding the registered proprietor to divest himself wholly or partly of the estate or interest vested in him by registration and endorsement of the certificate of title: or in default of his compliance with such an order on his part, perhaps vesting orders may be made to effect the proper interest of the claimants in the land."[12]

His Honour's reference to the quoted sections of the Act is a reference to statutory exceptions to indefeasibility[13] and the phrase "persons setting up matters depending upon the acts of the registered proprietor himself" is a reference to the exception now contained in s 185(1)(a). It is the content of that exception which, in my opinion, is determinative in this appeal.

[25] In *Bahr v Nicolay [No 2]*,[14] a case concerning the equivalent provisions of the Western Australian *Transfer of Land Act* 1893, Mason CJ and Dawson J, after referring to the indefeasibility provisions of that Act said:

> "Neither the two sections nor the principle of indefeasibility precludes a claim to an estate or interest in land against a registered proprietor arising out of the acts of the registered proprietor himself: *Breskvar v Wall*. [Their Honours referred to the above passage from the judgment of Barwick CJ.] Thus, an equity against a registered proprietor arising out of a transaction taking place after he became registered as proprietor may be enforced against him: *Barry v Heider*. So also with an equity arising from conduct of the registered

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10 The statement of the question in this way accords, in my opinion, with statements in *Bahr v Nicolay [No 2]* (1988) 164 CLR in the passages referred to below.

11 (1971) 126 CLR 376.

12 At 384 - 385.

13 That is, in s 44 of the *Real Property Act* 1861 and s 11 of the *Real Property Act* 1877.

14 (1988) 164 CLR 604.

> proprietor before registration (*Logue v Shoalhaven Shire Council*), **so long as the recognition and enforcement of that equity involves no conflict with sections 68 and 134**.[15]
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> …
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> There is no fraud on the part of a registered proprietor in merely acquiring title with notice of an existing unregistered interest or in taking a transfer with knowledge that its registration will defeat such an interest: *Mills v Stokman*; *Waimiha Sawmilling Co v Waione Timber Co*."[16]

The emphasis is mine. Their Honours referred to further authority and said:

> "And granted that an exception is to be made for fraud why should the exception not embrace fraudulent conduct arising from the dishonest repudiation of a prior interest which the registered proprietor has acknowledged or has agreed to recognize as a basis for obtaining title, as well as fraudulent conduct which enables him to obtain title or registration?"[17]

In this last passage their Honours equate this exception with fraud, that is, actual dishonesty. But it is not fraud in the means of becoming registered; it is in dishonestly repudiating an undertaking to acknowledge a prior interest. Their Honours went on to hold that in that case, the second respondent had agreed to recognize, as a basis for obtaining his title, an equitable interest in the appellant.

[26] In the same case Wilson and Toohey JJ, after citing with approval the above passage from the judgment of Barwick CJ and referring to *Frazer v Walker*,[18] said:

> "The point being made by the Privy Council [in *Frazer v Walker*] is that the indefeasibility provisions of the Act may not be circumvented. But, equally, they do not protect a registered proprietor from the consequences of his own actions where those actions give rise to a personal equity in another. Such an equity may arise from conduct of the registered proprietor after registration: *Barry v Heider*. And we agree with Mahoney JA in *Logue v Shoalhaven Shire Council* that it may arise from conduct of the registered proprietor before registration."[19]

Their Honours went on to conclude that, by taking a transfer on the basis of an agreement to be bound by a clause which conferred on the appellants an equitable interest in the land, the second respondent became subject to a constructive trust in favour of the appellants.

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15 Section 134 provided that, except in the case of fraud, no person taking a transfer of land "shall be affected by notice actual or constructive of any trust or unregistered interest any rule of law or equity to the contrary notwithstanding; and the knowledge that any such trust or unregistered interest is in existence shall not of itself be imputed as fraud".

16 At 613.

17 At 615.

18 [1967] 1 AC 569.

19 At 638.

[27] In the same case Brennan J, after referring to *Barry v Heider* and *Frazer v Walker* and citing the above passage from the judgment of Barwick CJ in *Breskvar v Wall*, said:

> "Orders of [the kind referred to in that passage] do not infringe the indefeasibility provisions of the Act. Those provisions are designed to protect the transferee from defects in the title of the transferor, not to free him from interests with which he has burdened his own title. In *Loke Yew v Port Swettenham Rubber Co Ltd*, Lord Moulton gave an example of a case where equity would enforce the terms on which a transfer was taken. He said:
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> > 'Take for example the simple case of an agent who has purchased land on behalf of his principal but has taken the conveyance in his own name, and in virtue thereof claims to be the owner of the land whereas in truth he is a bare trustee for his principal. The Court can order him to do his duty just as much in a country where registration is compulsory as in any other country, and if that duty includes fresh entries in the register or the correction of existing entries it can order the necessary acts to be done accordingly.'
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> By contrast, *Waimiha Sawmilling Co v Waione Timber Co* was a case where the purchaser had notice of a claim to an unregistered interest but had given no undertaking to be bound by it. That case illustrates the proposition that where a transferee has purchased with mere notice of an unregistered interest, registration of the transfer to him does defeat the unregistered interest, but *Waimiha Sawmilling Co v Waione Timber Co* does not suggest that a registered proprietor who has purchased on terms that his title will be subject to an unregistered interest is able to defeat that interest upon the registration of his transfer.
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> A registered proprietor who has undertaken that his transfer should be subject to an unregistered interest and who repudiates the unregistered interest when his transfer is registered is, in equity's eye, acting fraudulently and he may be compelled to honour the unregistered interest. A means by which equity prevents the fraud is by imposing a constructive trust on the purchaser when he repudiates the unregistered interest. That is not to say that the registration of the transfer to such a proprietor is affected by such fraud as may defeat the registered title: the fraud which attracts the intervention of equity consists in the unconscionable attempt by the registered proprietor to deny the unregistered interest to which he has undertaken to subject his registered title."[20]

[28] Thus, like Mason CJ and Dawson J, his Honour equated conduct sufficient to give rise to this exception with fraud. It consists of the dishonest repudiation of an undertaking by the registered proprietor to subject his transfer to a prior equitable interest.

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[20] At 653 - 654.

[29] However, all that is alleged in the first respondent's critical allegations is that the applicant acquired and retained its registered interest with knowledge of an asserted prior interest of the first respondents. That is insufficient to bring this case within the exception in s 185(1)(a).

[30] Mr Allen, for the first respondent, does not submit that there was any other relevant act of the applicant which gave rise to the exception. In particular he does not assert, and it is not alleged that there was anything which the applicant said or did by which he acknowledged or agreed to recognize the interest of the first respondent.

[31] What he submits is that it was the nature of the interest which the appellant knew the first respondent was asserting the second respondent to have when it, the appellant, acquired title, namely that of a beneficiary under a bare trust, which, in the circumstances, gave rise to the equity against the applicant. He relied for this submission on *Koorootang Nominees Pty Ltd v Australian and New Zealand Banking Group Ltd*,[21] *Doneley v Doneley*[22] and the dissenting judgment of Ashley AJA in *Macquarie Bank Ltd v Sixty-Fourth Throne Pty Ltd*.[23] I shall refer to those authorities below. However it should first be said that there are two answers to that submission.

[32] The first is that it follows from the above dicta, and from the authorities upon which they rely, that it must be the dishonest nature of the act, generally the repudiation of an acknowledgement or agreement to honour a prior equitable interest, not the nature of the prior unregistered interest asserted, which will give rise to an "equity" of the kind referred to in s 185(1)(a). And the second is that, even if it is correct to describe the relationship between the second and first respondents as that of bare trustee and beneficiary, because the first respondent had paid the purchase price in full to the second respondent, it was not pleaded that the applicant was aware of this. It was aware only of an assertion, upon no factual basis, by the second respondents that Lot 3 did not belong to them but to the first respondent so that the sale to the applicant did not and could not include that lot; and it was following that that the contract and transfer were both subsequently executed by the second respondents in favour of the applicant, including that lot.

[33] There is no authority, binding or persuasive, for the proposition that the interest of a purchaser of land who becomes registered as owner with knowledge that the transfer to it was in breach of trust by the vendor, let alone that of such a purchaser who becomes registered after the making of no more than an unsubstantiated assertion that an unregistered person is the owner of part of the land, is defeasible. Nor is there any basis in principle, for the purpose of the application of s 185(1)(a), for distinguishing an assertion of equitable ownership in an unregistered person from an assertion in such person of some lesser equitable interest. If it were otherwise, the fundamental proposition that the interest of a registered proprietor is

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21 [1998] 3 VR 16.

22 [1998] 1 QdR 602.

23 [1998] 3 VR 133.

not affected by his or her prior knowledge of unregistered interests[24] would need to be modified to accommodate different results depending on the nature of the prior unregistered interest.

[34] In the only decision of an intermediate appellate court, of which I am aware, which specifically deals with this question, *Macquarie Bank Ltd v Sixty-Fourth Throne Pty Ltd*, the majority of the Victorian Court of Appeal, Winneke P and Tadgell JA rejected a contention that the interest of the appellant in that case, a registered mortgagee, was defeasible at the suit of a trustee registered proprietor where registration of a forged mortgage had been procured by and for the benefit of a fraudulent third party but where the mortgagee was not a party to the forgery. Tadgell JA, with whom Winneke P substantially agreed, held that the doctrine of constructive notice had no application in the Torrens system to determine priority between legal and equitable interests;[25] and that, apart from fraud, there is no basis upon which the mere knowing receipt of trust property by registration may be set aside.[26] In my opinion his Honour was right and this Court should follow that decision. The decision of Hansen J in *Koorootang Nominees Pty Ltd v Australian and New Zealand Banking Group Ltd*, which might appear to be to contrary effect, involved, as Tadgell JA pointed out in *Macquarie Bank Ltd*, actual dishonesty.[27]

[35] I do not find it necessary, for the purpose of deciding this appeal, to decide whether, and if so to what extent, the principles of indefeasibility stated in s 184 and s 185 affect the application of the rule in *Barnes v Addy*.[28] It is sufficient to say that, to come within the exception in s 185(1)(a), there must be dishonesty on the part of the registered proprietor.

[36] The only other decision relied on for this proposition by Mr Allen was that of de Jersey J (as his Honour then was) in *Doneley v Doneley*.[29] It is true that that case appears, at first sight, to support Mr Allen's contention because his Honour appears to have held registered lessees and a registered mortgagee bank[30] constructive trustees of their respective interests over freehold property because, when they took those interests, they knew that the property was held upon a trust and knew facts which established that the lease and mortgage respectively were in breach of trust. No reference is made in the case to the principle of indefeasibility or the statutory provisions or authorities relevant thereto and it is unclear whether they were referred to in argument. Possible explanations for this decision may be that his

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24 Now summarised in s 184(2)(a). Some Torrens title legislation, for example, s 134 of the *Transfer of Land Act* 1893 (WA), considered in *Bahr*, refers specifically to trusts: see fn 15. But the phrase "unregistered interest" in s 184(2)(a) plainly includes beneficial interests under trusts.

25 [1998] 3 VR 133 at 152 line 25.

26 At 156 line 45, 157 line 20.

27 At 157 lines 25 - 35.

28 (1874) LR 9 Ch App 244.

29 [1998] 1 QdR 602.

30 Although the judgment recited that the lease was registered it did not state that the mortgage was. However we were informed by counsel for the first respondent, without objection from counsel for the applicant, that it was.

Honour's findings were sufficient to infer dishonesty;[31] or that the lessees and the bank did not wish to rely on indefeasibility. In any event, that decision does not bind this Court.

[37] In my opinion it is not reasonably arguable that the facts alleged in the statement of claim are sufficient to found a cause of action against the applicant for a declaration that it holds Lot 3 on a constructive trust for the first respondent. It is not alleged that the applicant at any time undertook to honour or even acknowledged the interest of the first respondent or even that it knew of facts which justified the second respondent's mere assertion that Lot 3 "belonged to" the first respondent. Indeed no act of the applicant, other than the acquisition of title with knowledge of the second respondent's assertion alleged in paragraph 8 of the statement of claim, is alleged to give rise to the equity relied on. The communication to the applicant of that mere assertion is not sufficient to bring this case within the exception in s 185(1)(a) so as to found such a declaration.

Orders

1. Grant the application for leave to appeal.
2. Allow the appeal with costs.
3. Set aside the judgment of the learned District Court judge.
4. Refuse leave to the first respondent to join the applicant as a defendant to seek the relief claimed in the proposed amended claim and on the facts alleged in the proposed amended statement of claim both exhibit C to the affidavit of Brian Thomas Egan filed 19 February 2002.
5. Order that the first respondent pay the applicant's costs of the application in the District Court.

ATKINSON J:

The factual background

[38] In January 1987, Cecil and Josephine Garner ("the Garners") became the registered proprietors of land described as Lot 2 on Registered Plan 204609, in Volume 6882 Folio 61, County of Pring, Parish of Dilbong having an area of 1.955 hectares ("the original Lot 2"). On the original Lot 2 were situated the Moonie Motel and a water bore which provided the water supply for the township of Moonie ("the water bore").

[39] In August 1987, the Tara Shire Council ("the Council") offered to purchase that part of the original Lot 2 on which the water bore was located for $65,000.00. In September 1987, subject to a condition that was satisfied in October 1987, the Garners agreed to sell that part of the land. The Garners had to register a subdivision of the original Lot 2 so that the land on which the water bore was situated could be sold as a separate lot.

[40] In March 1988, the Council paid the Garners the sum of $65,000.00 for the purchase of the land on which the water bore was located. In return for payment of the purchase price, the Garners allege that they signed and delivered a Memorandum of Transfer over the land on which the water bore was situated which was capable of immediate registration in the Office of the Registrar of Land Titles.

[41] However, the subdivision of the original Lot 2 was not registered until July or August 1989 when Lot 2 ("the new Lot 2") and Lot 3 on Registered Plan 218396

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[31] That seems unlikely in view of his Honour's finding that both the lessees and the Bank were well motivated: at 609 line 32.

were created by registration of that plan. The new Lot 2 was 1.9131 hectares in area, while Lot 3 was 419 square metres in area. Certificates of Title were issued on 3 August 1989 for the new Lot 2, in Volume 7369 Folio 238, and Lot 3, in Volume 7369 Folio 239, with the Garners shown as the registered proprietors of each lot. The new Lot 2 contained the land on which the Moonie Motel was situated and Lot 3 contained the land on which the water bore was located, which the Council had purchased and for which it had paid the purchase price in full. No transfer of Lot 3 from the Garners to the Council was ever registered. The Council alleges that it never received a transfer from the Garners. The Council alleges in its claim that after the sale the Garners held Lot 3 on a bare trust for the benefit of the Council.

[42] On 6 November 1989, the Garners entered into a contract of sale ("the Arcape contract") with Arcape Pty Ltd ("Arcape"). The Arcape contract was signed for and on behalf of Arcape and by the Garners. The land, the subject of the Arcape contract was described as Lot 2 on RP 209609 [*sic*], Volume 6882 Folio 61. The contract was allegedly drawn up by Mrs Garner, who was a real estate agent. There is no land which can be described as Lot 2 on RP 209609. The original Lot 2 was Lot 2 on RP 204609. The original Lot 2 had, by November 1989, been subdivided into the new Lot 2 and Lot 3 on RP 218396.

[43] The Garners allege in further and better particulars of their defence that, two weeks prior to the Arcape contract being signed, Jacqueline Urquhart and Kenneth Pfitzner, both of whom were agents for Arcape, stayed at the Moonie Motel. The Garners allege that they told Ms Urquhart and Mr Pfitzner that the water bore and the land surrounding it, which the Council had marked off with surveyors' pegs, did not belong to the Garners, and were not part of the Moonie Motel nor the land upon which the motel was situated; that the sale of the Moonie Motel did not and could not include the water bore or the land on which it was situated; that the Garners had sold the land in which the water bore was situated to the Council; and that the water bore and the land on which it was situated were now owned by the Council; and that it was now the Council's responsibility to maintain the bore. The Council alleges in its proposed claim against Arcape that the Garners informed Arcape's agents prior to the sale that Lot 3 belonged to the Council and that the sale of the Moonie Motel did not include that lot. Arcape has said that it will deny this allegation although it was accepted that the truth of these allegations was not in dispute for the purposes of this appeal.

[44] On 12 January 1990, a transfer was signed by Mrs Garner and by the solicitor acting on behalf of Arcape. Typewritten on the transfer was a description of the land as Lot 2 on RP 204609. This description is crossed out by a handwritten line and is replaced in handwriting with the description "Lot 2 on RP 218396 and Lot 3 on RP 218396". Those changes appear to be witnessed by the signatories to the transfer.

[45] On 31 January 1990, a Notification of Change of Ownership was lodged with the Valuer-General by the solicitors for the Garners referring to the transfer of Lot 2 on RP 209609. The same notification lodged by Arcape's solicitors refers to the transfer of Lot 2 on RP 204609. Both agree on the value as being $885,000.00, said by Arcape to represent $827,000.00 for the improvements, being the motel, licensed restaurant, newsagency and petrol station, and $58,000.00 for the unimproved value of the land. On 1 February 1990, Arcape became the registered proprietor of both the new Lot 2 and Lot 3 on RP 218396.

[46] Arcape, despite request by the Council, refused to transfer Lot 3 to the Council, and on 7 July 1998, the Council commenced an action against the Garners, claiming the sum of $65,000.00 as equitable compensation for breach of trust. On 22 January 2002, the Council brought an application in the District Court to have Arcape joined as a second defendant. The Council argued that Arcape held the property on constructive trust in accordance with the first limb of the rule in *Barnes v Addy*. This principle dictates that a person who knowingly receives and retains trust property in a manner that is inconsistent with the rights of the beneficiary is deemed to hold that property on constructive trust. The learned judge accepted the Council's argument and allowed the application to join Arcape as a second defendant.

[47] Arcape has sought leave to appeal against that decision and argues that, in accordance with s 184 of the *Land Title Act* 1994 (Qld), it obtained indefeasible title to Lot 3 immediately upon registration. In particular, Arcape relies upon s 184(2)(a) which states that a registered proprietor "is not affected by actual or constructive notice of an unregistered interest affecting the lot."

Indefeasibility

[48] Indefeasibility is at the core of the Torrens System of title by registration found in the *Land Title Act*. Section 184(1) of the *Land Title Act* states that: "A registered proprietor of an interest in a lot holds the interest subject to registered interests affecting the lot but free from all other interests." The paramountcy which this system gives to the registered title was explained by Barwick CJ in *Breskvar v Wall*:[32]

> "The Torrens system of registered title of which the Act is a form is not a system of registration of title but a system of title by registration. That which the certificate of title describes is not the title which the registered proprietor formerly had, or which but for registration would have had. The title it certifies is not historical or derivative. It is the title which registration itself has vested in the proprietor."

[49] As a consequence of indefeasibility, purchasers of land are able to rely upon the details of the register to confirm that the person from whom they are purchasing has the capacity to transfer the land.[33] In addition, indefeasibility permits registered proprietors to hold the land with certainty that their title cannot be impugned by actions taken in relation to the land by a previous owner.

Exceptions to indefeasibility

[50] Indefeasibility is not, however, an absolute principle. Section 184(3) provides that the indefeasibility of a registered interest does not apply to the exceptions outlined in s 185, or where there has been fraud by the registered proprietor. In the present case, the respondent Council makes no allegation of fraud by the registered proprietor, Arcape. Consequently, the only relevant exceptions to indefeasibility are those mentioned in s 185, and specifically the exception contained in s 185(1)(a):

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32 *Breskvar v Wall* (1971) 126 CLR 376 at 385-386.

33 See *Gibbs v Messer* [1891] AC 248 at 254 per Lord Watson: "The object is to save persons dealing with registered proprietors from the trouble and expense of going behind the register, in order to investigate the history of their author's title, and to satisfy themselves of its validity."

> "A registered proprietor of a lot does not obtain the benefit of section 184 for the following interests in relation to the lot-
> (a) an equity arising from the act of the registered proprietor…"

[51] This subsection states the law as it existed prior to the introduction of the *Land Title Act*. Before the enactment of s 185(1)(a) it was well recognised that a registered proprietor held title subject to equities created by the registered proprietor.[34] The principle was recently affirmed by the High Court in *Bank of South Australia v Ferguson*, in discussing the *Real Property Act* 1886 (SA):[35]

> "The legislation thus recognises the principle, propounded in an established line of cases dealing with Torrens system legislation, that an equity arising from the conduct of a registered proprietor before or after registration may be enforced against that registered proprietor notwithstanding the indefeasibility of registered titles."

[52] Consequently, if the Council were able to establish that there is an equity arising from the act of the registered proprietor, Arcape, that equity would be sufficient to overcome the indefeasible title that Arcape would otherwise enjoy, in the sense that Arcape's title would be subject to the interest held by the Council. It is not sufficient that the Council is able to show an equity arising from the act of the previous registered proprietors, the Garners. It must arise from the act of the present registered proprietor, Arcape.

[53] This principle recognises the *in personam* exception to indefeasibility. As Wilson and Toohey JJ recognised in *Bahr v Nicolay [No 2]*[36], indefeasibility does not protect a registered proprietor from the consequences of his or her own actions where those actions give rise to a personal equity in another.

[54] A personal equity or right *in personam* arises in circumstances where one person has an equitable or legal right of action against another.[37] The equity relied upon by the Council is knowing receipt of trust property by Arcape. This cause of action is derived from the judgment of Lord Selborne in *Barnes v Addy*.[38] In dismissing a claim against two solicitors for breach of trust, His Lordship stated:[39]

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

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34 *Barry v Heider* (1914) 19 CLR 197 at 213 per Isaacs J; *Frazer v Walker* [1967] 1 AC 569 at 585 per Lord Wilberforce; *Breskvar v Wall* (1971) 126 CLR 376 at 384-385 per Barwick CJ; *Bahr v Nicolay* (1988) 164 CLR 604 at 613 per Mason CJ, Dawson J, at 638 per Wilson, Toohey JJ.

35 *Bank of South Australia Ltd v Ferguson* (1998) 192 CLR 248 at 255.

36 (1988) 164 CLR 604 at 638.

37 *Grgic v Australian and New Zealand Banking Group Ltd* (1994) 33 NSWLR 202 at 222-223.

38 (1874) LR 9 Ch App 244.

39 (1874) LR 9 Ch App 244 at 251-252.

> unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees." (emphasis added)

The final sentence of this passage sets out two distinct equitable causes of action against a third party who is implicated in a breach of trust. The first limb applies to third parties who "receive and become chargeable with some part of the trust property" and is commonly referred to as "recipient liability"; the second limb applies to third parties who "assist with knowledge in a dishonest and fraudulent design on the part of the trustees", commonly referred to as "accessory liability". The Council relies upon the first limb which it characterises as the "knowing receipt (and retention) of misapplied trust property."

[55] The Council identifies the land in question as trust property in reliance upon what is said to be a general principle of law that, after the execution of a contract, a vendor of land holds the property on trust for the benefit of the purchaser until the transfer to the purchaser is complete. Counsel for the respondent relied upon the following passage from *Bunny Industries Ltd v FSW Enterprises Pty Ltd*:[40]

> "On the execution of the contract the vendor becomes a trustee for the purchaser. He is not however a bare trustee for he has a personal and substantial interest to the extent of the unpaid purchase moneys. He is 'in progress towards' bare trusteeship and finally becomes such when the whole of the purchase moneys are paid and he is bound to convey."

Counsel for the applicant disputed the concept that the vendor under an executed contract is a trustee for the purchaser. He referred to the discussion by Deane J in *Kern Corporation v Walter Reid Trading Pty Ltd*,[41] in which his Honour held that an unpaid vendor cannot be characterised as a trustee for the purchaser. Deane J emphasised that an unpaid vendor continues to have rights over the property, including the right to receive rent, and to maintain an action for trespass.[42]

[56] However, Deane J's dictum did not relate to the situation where, as here, the vendor has been paid. In his judgment, Connolly J draws a distinction between paid and unpaid vendors, noting that an unpaid vendor continues to have "a personal and substantial interest to the extent of the unpaid purchase moneys." However, once the purchase price is paid the position of the vendor progresses to a bare trusteeship, under which the only obligation is to convey the land. It may therefore be concluded that, whatever the position of an unpaid vendor, a paid vendor holds the land on bare trust for the purchaser. This analysis is consistent with the view expressed by Thomas J in *Clark v Raymor (Brisbane) Pty Limited [No 2]*[43]:

> "…it is not correct to say that the purchaser's interest never changed after entering into the contract. The rights of the parties certainly alter upon the payment of the purchase price upon a settlement, after which the vendor has no rights of his own outstanding, but is the bare

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40 *Bunny Industries Ltd v FSW Enterprises Pty Ltd* [1982] Qd R 712 at 715 per Connolly J (with whom Andrews SPJ and Thomas J agreed). Connolly J refers to a long line of authority for this proposition: *Green v Smith* (1738) 1 Atk 572; *Shaw v Foster* (1872) LR 5 HL 321; *Pollexfen v Moore* (1745) 3 Atk 272; *Haque v Haque* [No 2] (1965) 114 CLR 98 at 124 per Kitto J; *Wall v Bright* (1820) 37 ER 456.

41 (1987) 163 CLR 164.

42 (1987) 163 CLR 164 at 191-192.

43 [1982] Qd R 790 at 797.

> holder of the legal estate (*Chang v Registrar of Titles* (1976) 137 CLR 177 at 189)."

[57] In the present case, it follows that the Garners must be deemed to have held Lot 3 on a bare trust from the time when the purchase price was paid. This is a resulting trust arising from operation of law. Since Lot 3 was trust property it is possible, if the other prerequisites are met, that the knowing receipt and retention of that land could enliven the first limb of the rule in *Barnes v Addy*.

Is it necessary to prove dishonesty?

[58] The crucial element of the first limb is that the third party must receive the trust property with the requisite degree of knowledge. Before considering what degree of knowledge is required, it should first be considered whether it is necessary under the first limb to show that the third party recipient acted dishonestly or with a want of probity. In recent years, English courts have adopted a test of dishonesty as the touchstone of liability in cases involving the second limb of *Barnes v Addy*. In *Royal Brunei Airlines v Tan*,[44] the Privy Council heralded a new approach to accessory liability:[45]

> "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… 'Knowingly' is better avoided as a defining ingredient of the principle…"[46]

[59] The Privy Council expressly limited this ruling to the second limb of *Barnes v Addy*, and noted that different considerations apply to the first limb.[47] Nevertheless, there is some disagreement in the English authorities as to whether dishonesty is also required under the first limb. One line of cases contains the suggestion that the third party recipient must act with a "want of probity".[48] By contrast, other cases have denied that there is an additional requirement of dishonesty under the first limb.[49] For example, in *International Sales and Agencies Ltd v Marcus*,[50] Lawson J held that:[51]

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44 *Royal Brunei Airlines Sdn Bhd v Tan Kok Ming* [1995] 2 AC 378.

45 [1995] 2 AC 378 at 392 per Lord Nicholls.

46 Recent Australian authority has followed the view of the Privy Council: *Permanent Building Society (in liq) v Aqua Vital Australia Ltd* [2000] WASC 225 at [24] per Sanderson M; *Lurgi (Australia) Pty Ltd v Ritzer Gallagher Morgan Pty Ltd* [2000] VSC 277 at [45] per Byrne J; *Compaq Computer Australia Pty Ltd v Merry* (1998) 157 ALR 1 at 5-6 per Finkelstein J; *Capital Investments Corp Pty Ltd v Classic Trading Pty Ltd* [2001] FCA 1385 at [301] per Weinberg J; cf *Esanda Finance Corp Ltd v Reyes* [2001] NSWSC 234 at [113] per Simos J. The extent to which this view is consistent with the High Court decision in *Consul Development Pty Ltd v DPC Estates* (1974) 132 CLR 373 is a matter of debate beyond what is necessary for the purposes of this case.

47 [1995] 2 AC 378 at 386 per Lord Nicholls.

48 *Re Montagu's Settlement Trusts, Duke of Manchester v National Westminster Bank Ltd* [1987] Ch 264 at 285 per Megarry VC; *Cowan de Groot Properties Ltd v Eagle Trust Plc* [1992] 4 All ER 700 at 762 per Knox J; *Lipkin Gorman v Karpnale Ltd* [1992] 4 All ER 331 at 349 per Alliot J.

49 *El Ajou v Dollar Holdings plc* [1993] 3 All ER 717 at 739 per Millett J; *Agip (Africa) Ltd v Jackson* [1992] 4 All ER 385 at 405 per Millett J; *Johnathan v Tilley* (unreported, English Court of Appeal, Peter Gibson and Otton LJJ, 30 June 1995) *International Sales and Agencies Ltd v Marcus* [1982] 3 All ER 551 at 558 per Lawson J.

50 [1982] 3 All ER 551.

51 [1982] 3 All ER 551 at 558.

> "… in respect of actual recipients of trust property to be used for their own purposes the law does not require proof of knowing participation in a fraudulent transaction or want of probity, in the sense of dishonesty, on the part of the recipient."

[60] Whatever the position in England, in Australia, the foremost authority on the rule in *Barnes v Addy* is *Consul Development v DPC Estates*,[52] in which three of four judges in the High Court agreed that there was no need to show more than knowledge.[53] Gibbs J (as his Honour then was) stated, after quoting the salient passage from *Barnes v Addy*, that:[54]

> "Although in this passage Lord Selborne speaks of dishonesty and fraud it is clear that the principle extends to the case 'where a person received trust property and dealt with it in a manner inconsistent with trusts of which he was cognizant': *Soar v. Ashwell*[55]; *Lee v. Sankey*[56]; and in *In re Blundell; Blundell v. Blundell*[57]."

Stephen J (with whom Barwick CJ agreed) considered the distinction between the two limbs of *Barnes v Addy* and concluded that while knowledge, actual or constructive, was all that was required under the first limb, the second limb required a degree of knowledge such that the third party could be considered a participant in the dishonesty.[58] In this regard, Stephen J approved the comments made by Jacobs P in his dissenting opinion in the Court of Appeal below.[59] Stephen J then went on to say:[60]

> "It is not clear to me why there should exist this distinction between the case where trust property is received and dealt with by the defendant and where it is not; perhaps its origin lies in equitable doctrines of tracing, perhaps in equity's concern for the protection of equitable estates and interests in property which come into the hands of purchasers for value. Maitland has traced the gradual extension of the protection which equity has afforded these, culminating in its development of the doctrine of constructive notice – Maitland's Equity, 2nd ed. (1949) pp. 117-121."

[61] In this passage, Stephen J recognizes that a distinction exists between the limbs and notes, in referring to earlier cases, that significance is attached to receiving trust property.[61] A possible explanation for the absence of a dishonesty requirement under the first limb is that it is a restitution-based principle aimed at avoiding unjust enrichment.[62] Several more recent Australian cases have confirmed the view that

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52 (1975) 132 CLR 373.

53 McTiernan J did not address the point, which was obiter in the other judgments.

54 (1975) 132 CLR 373 at 396.

55 [1893] 2 QB 390 at 396-397.

56 (1872) LR 15 Eq 204 at 211.

57 (1888) 40 Ch D 370 at 381.

58 (1975) 132 CLR 373 at 410.

59 *DPC Estates Pty Ltd v Grey and Consul Development Pty Ltd* (1974) 1 NSWLR 443 at 459.

60 (1975) 132 CLR 373 at 410.

61 His Honour refers to *Selangor United Rubber Estates Ltd v Craddock (No. 3)* [1968] 1 WLR 1555 and *Karak Rubber Co. Ltd v Burden* [1972] 1 WLR 602.

62 *Royal Brunei Airlines Sdn Bhd v Tan Kok Ming* [1995] 2 AC 378 at 386 per Lord Nicholls: "Recipient liability is restitution-based; accessory liability is not." See also *Koorootang Nominees Ltd v ANZ Banking Group* [1998] 3 VR 16 at 105 per Hansen J: "I favour the view that the liability of a recipient of trust property is restitution based." *National Australia Bank Ltd v Rusu* [2001]

dishonesty is not a requirement of a cause of action resting on the first limb of *Barnes v Addy*.[63]

[62] The view that knowledge by itself is sufficient was applied in Queensland by de Jersey J (as his Honour then was) in *Doneley v Doneley*.[64] In that case, a bank took securities over a lease and reversion of land that was the subject of a trust. His Honour held that the bank held the securities on constructive trust for the beneficiaries since it had taken the securities with knowledge that the actions of the trustee were speculative, hazardous and in breach of trust. This decision was grounded firmly within the first limb of *Barnes v Addy*. His Honour held that the first limb includes not only a receipt of trust property but also receipt of an interest in trust property so that the recipient is a direct beneficiary of the breach of trust.[65] For present purposes, the significant point is that there was no finding of fraud or dishonesty; on the contrary his Honour noted that both the bank and the trustees were well motivated.[66]

[63] The principle of equity to be derived from a synthesis of these cases is that equity will hold liable a third party who takes trust property with knowledge that it is trust property. As Stephen J suggests in *Consul Development*, one reason for this strict rule is equity's concern for the sanctity of trust property. Therefore, under the rules of equity, it would not be necessary in the present case for the Council to show that the applicant had acted fraudulently or dishonestly, nor has it pleaded any fraud or dishonesty.

What is the requisite degree of knowledge?

[64] If not dishonesty, what degree of knowledge, actual or constructive, is sufficient to render a third party recipient a constructive trustee? The knowledge which the third party must possess is a) knowledge of the trust; and b) knowledge of the breach of trust.[67] However, the requisite degree of knowledge, under both the first and second limbs of the rule in *Barnes v Addy*, has been the subject of considerable judicial divergence. It is useful to refer to the categories of knowledge laid out by Peter Gibson J in *Baden v Societe Generale*,[68] although it must be acknowledged that it will not always be a simple matter to identify which category is illustrated by a given set of facts and that the categories are not rigid but can blend into or overlap one another.[69] In *Baden*, Peter Gibson J adopted the following five categories of knowledge:[70]

1. actual knowledge;
2. wilfully shutting one's eyes to the obvious;

NSWSC 32 at [43]-[44] per Bryson J; Simon Gardner "Knowing Assistance and Knowing Receipt: Taking Stock" (1996) 112 LQR 56 at 85-86.

63 *Hancock Family Memorial Foundation Ltd v Porteous* (1999) 151 FLR 191 at 209 per Anderson J, affirmed in (2000) 156 FLR 249 per Ipp, Owen, McKechnie JJ; *Koorootang Nominees Pty Ltd v New Zealand Banking Group Ltd* [1998] 3 VR 16 at 105 per Hansen J; *Ninety-Five Pty Ltd (in liquidation) v Banque Nationale de Paris* [1988] WAR 132 at 176 per Smith J.

64 [1998] 1 Qd R 602.

65 [1998] 1 Qd R 602 at 612.

66 [1998] 1 Qd R 602 at 609.

67 *Hancock Family Memorial Foundation Ltd v Porteous* (1999) 151 FLR 191 at 209 per Anderson J; *Koorootang Nominees Pty Ltd v Australia & New Zealand Banking Group Ltd* [1998] 3 VR 16 at 105 per Hansen J.

68 *Baden Delvaux & Lecuit v Societe Generale pour Favoriser le Development du Commerce* [1992] 4 All ER 161.

69 See *Polly Peck International plc v Nadir (No 2)* [1992] 4 All ER 769 at 777 per Scott LJ.

70 [1992] 4 All ER 161 at 235.

3. wilfully and recklessly failing to make such inquiries as an honest and reasonable person would make;
4. knowledge of circumstances which would indicate the facts to an honest and reasonable person;
5. knowledge of circumstances which would put an honest and reasonable person on inquiry.

[65] In this scale, the fifth category involves circumstances where the defendant does not in fact possess knowledge, whether of the trust itself or of the breach of trust, but is deemed to have such knowledge because an honest and reasonable person in his or her position would have made inquiries to discover the true facts. The class of fault involved in the fifth category goes no higher than mere negligence. It contrasts sharply with the second and third categories in which the class of fault is wilfulness or recklessness. It also contrasts with the fourth category where the defendant already has knowledge of all relevant facts and an inquiry to discover more is not necessary. The fault involved in the fourth category is the culpable failure to recognise that the known circumstances amount either to the existence of a trust or a breach of that trust. The fourth category involves a degree of culpability only a small step down from the defendant who has actual knowledge that he or she is participating in or benefiting from a breach of trust. It captures the defendant who is subjectively honest, or claims to be, but whose failure to recognise impropriety is egregious.

[66] To determine which categories of knowledge suffice for the purposes of recipient liability, it is useful to consider the reasons of the High Court in *Consul Development v DPC Estates*,[71] even though the decision related primarily to accessory liability.

[67] Gibbs J did not find it necessary to reach a concluded view on whether circumstances that would "put an honest and reasonable man on inquiry" (i.e. the fifth category) would constitute sufficient knowledge.[72] However, he stated:[73]

> "It may be that it is going too far to say that a stranger will be liable if the circumstances would have put an honest and reasonable man on inquiry, when the stranger's failure to inquire has been innocent and he has not wilfully shut his eyes to the obvious. On the other hand, it does not seem to me to be necessary to prove that a stranger who participated in a breach of trust or fiduciary duty with knowledge of all the circumstances did so actually knowing that what he was doing was improper. It would not be just that a person who had full knowledge of all the facts could escape liability because his own moral obtuseness prevented him from recognising an impropriety that would have been apparent to an ordinary man."

[68] The observations of Stephen J (with whom Barwick CJ agreed) are to a similar effect:[74]

> "In my view the state of the authorities as they existed before *Selangor* did not go so far, at least in cases where the defendant had neither received nor dealt in property impressed with any trust, as to

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71 (1975) 132 CLR 373.
72 (1975) 132 CLR 373 at 398.
73 (1975) 132 CLR 373 at 398.
74 (1975) 132 CLR 373 at 412.

> apply to them that species of constructive notice which serves to expose a party to liability because of negligence in failing to make inquiry. If a defendant knows of facts which themselves would, to a reasonable man, tell of fraud or breach of trust the case may well be different, as it clearly will be if the defendant has consciously refrained from enquiry for fear lest he learn of fraud. But to go further is, I think, to disregard equity's concern for the state of conscience of the defendant."

[69] In terms of the *Baden* categories, which were not, of course, in the minds of the judges in *Consul Development*, these statements suggest that knowledge in the first, second, third or fourth categories would suffice but that knowledge in the sense in which it is described in the fifth category would not. Gibbs J parallels the fourth category with circumstances in which the defendant's "own moral obtuseness prevented him from recognising an impropriety that would have been apparent to an ordinary man." Stephen J may be read in similar fashion when he postulates a defendant who "knows of facts which themselves would, to a reasonable man, tell of fraud or breach of trust".

[70] This is how the case appears to have been interpreted by the Court of Appeal of New South Wales in *US Surgical Corp v Hospital Products*.[75] The Court of Appeal understood the reasons of Gibbs and Stephen JJ to be agreeing that a negligent failure to inquire would not constitute sufficient knowledge, but that a third party would be liable where he or she knew all the relevant facts but did not recognise an impropriety in them.[76]

[71] It is now necessary to move on to a consideration of what knowledge will be sufficient to sheet home liability to a third party who receives trust property. There is some degree of judicial disagreement in the English and Australian authorities on this point. In Australia, the principal ground of contention is whether the fifth category of knowledge may be invoked as a sufficient basis for the cause of action.[77] An extensive review of the authorities on this point was conducted by Hansen J in *Koorootang Nominees Pty Ltd v Australia and New Zealand Banking Group Ltd*.[78] It is not necessary to repeat the discussion found in this learned judgment in which his Honour concludes that recipient liability may be established when the defendant had knowledge at the time he received the misapplied trust property that (a) it was trust property and (b) it was being misapplied. It is sufficient in this context to demonstrate knowledge falling within any of the first

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75 [1983] 2 NSWLR 157; reversed (on different grounds) in *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41.

76 [1983] 2 NSWLR 157 at 254. Cf M. Lodge "Barnes v Addy: The Requirements of Knowledge" (1995) 23 ABLR 25 who argues that Stephen J applied a more limited test to that of Gibbs J. In *Lord v Spinelly* (1991) 4 WAR 158 at 173, Commissioner O'Connor QC considered that Stephen J "tentatively says much the same" as Gibbs J. AJ Oakley, "Liability of a Stranger as a Constructive Trustee" in M. Coper (ed), Equity: Issues and Trends (1995) 62 at 75 considers the views of Gibbs and Stephen JJ are the same and that they both accept categories (i) to (iv).

77 See *Ninety Five Pty Ltd v Banque Nationale de Paris* [1988] WAR 132 at 173-174 per Smith J; *Equiticorp Finance Ltd (in liq) v Bank of New Zealand* (1993) 32 NSWLR 50 at 103 per Kirby P (dissenting); *Lord v Spinelly* (1991) 4 WAR 158 at 174 per Commissioner O'Connor; *Hancock Foundation v Belle Rosa* (1992) 8 WAR 435 at 439 per Adams M. A good discussion of these cases is found in Susan Barkehall Thomas, "Knowing Receipt and Knowing Assistance: Where do we Stand?" (1997) 20 UNSWLJ 1 at 12-14. See also *Westpac Banking Corp v Savin* [1985] 2 NZLR 41 at 53 per Richardson J opining that category (v) knowledge would suffice.

78 [1998] 3 VR 16.

four categories of knowledge defined by Peter Gibson J in *Baden*. On the assumption that cases in the fifth category are properly characterised as ones where the defendant is guilty of mere carelessness, his Honour did not think that degree of knowledge was sufficient.[79]

[72] The reasoning and conclusions of Hansen J were adopted by Anderson J in *Hancock Family Memorial Foundation Ltd v Porteous*,[80] and in my opinion those conclusions are correct. This results in the position that the degree of knowledge necessary to hold a third party liable under the first limb of the Rule in *Barnes v Addy* is precisely the same as that which the High Court required for the second limb in *Consul Development*. In *Consul Development*, Stephen J intimated that the standard of liability under the first limb was less strict than under the second limb.[81] The resolution of this apparent inconsistency is found in the fact that under the second limb it is necessary to show, in addition to knowledge, that dishonesty or want of probity on the part of the third party can be inferred from that knowledge. Since this requirement is absent under the first limb, the distinction between the first and second limb, lending significance to a receipt of trust property, is maintained. It follows, therefore, that equity will hold a third party liable as a constructive trustee if he or she takes property with knowledge of the existence of the trust and the breach of trust where the knowledge falls within the first to fourth categories in *Baden*, but the third party will not be liable if he or she has knowledge limited to the fifth category.[82]

[73] Even if this were not the case under ordinary equitable principles, I consider that under the *Land Title Act*, the phrase "equity arising from the act of the registered proprietor" in s 185(1)(a) does not include an equity arising from an act performed with knowledge of facts that would put an honest and reasonable person on inquiry. Under the first limb of the rule in *Barnes v Addy*, the "act" which is said to give rise to an equity is the receipt (and retention) of trust property by the registration of a transfer of title. Generally, the registration of a transfer of title would not constitute an "act" that creates an equity. However, when registration is effected with knowledge that the transfer is in breach of trust, the act of registration is coloured by the knowledge in the possession of the transferee. That act of registration, together with the subsequent retention, is an act that gives rise to an equity created by the registered proprietor. It seems clear that in order to give rise to an equity for the purposes of s 185(1)(a), the act of registering a transfer must be coloured by a degree of knowledge that involves more than the mere carelessness connoted by the fifth *Baden* category.

[74] It is not every equity that will operate as an exception to indefeasibility under the *Land Title Act*. This proposition may be derived from *Bahr v Nicolay*,[83] where Wilson and Toohey JJ held that, while mere notice of a prior equitable interest creates a cause of action in equity, it is not sufficient to defeat indefeasibility:[84]

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79 [1998] 3 VR 16 at 105.

80 (1999) 151 FLR 191 at 209; affirmed (2000) 156 FLR 249 per Ipp, Owen, McKechnie JJ.

81 (1974) 132 CLR 373 at 410.

82 Two cases have adopted reasons precisely to this effect: *Hancock Family Memorial Foundation Ltd v Porteous* (1999) 151 FLR 191 at 209 per Anderson J; *Koorootang Nominees Pty Ltd v Australia & New Zealand Banking Group Ltd* [1998] 3 VR 16 at 105 per Hansen J. The view is also taken by Kirby P (as he then was) in *Equiticorp Finance Ltd (in liq) v Bank of New Zealand* (1993) 32 NSWLR 50 at 103.

83 (1988) 164 CLR 604.

84 (1988) 164 CLR 604 at 629. See also Brennan J at 652-653.

> "Although the second respondents take their stand on the provisions of the *Transfer of Land Act* 1893 (WA) ("the Act"), it is useful to note the position of the parties divorced from those provisions. The second respondents were certainly purchasers with notice of the appellants' equitable interest in the land and, as such, they took their legal estate subject to that interest…. However, the real question is - having registered their interest under the provisions of the Act, did the second respondents acquire a title which was indefeasible in the sense that it was no longer open to attack by the appellants?"

[75] The case before this court requires a careful interpretation of the phrase "equity arising from the act of the registered proprietor". That phrase must be interpreted in the context of the Act in which it is found. The *Land Title Act*, like the other Torrens Title statutes in Australia, was introduced to eliminate the need for parties to look behind the register in order to determine whether the person from whom they were purchasing had adequate title. Therefore, at least for the purposes of s 185(1)(a), if not under the ordinary principles of equity, a cause of action resting on the first limb of the Rule in *Barnes v Addy* cannot be supported merely by knowledge of circumstances that would put a reasonable person on inquiry.

[76] By fixing the standard of knowledge at the fourth *Baden* category, but not beyond, the appropriate balance is reached between the need to preserve the sanctity of trust property and the need to recognise the legitimate interest of a third party recipient. Knowledge in the first to fourth categories implies that there was unconscionability or a want of due attention on the part of the third party sufficient to hold him or her liable as a constructive trustee. Knowledge in the fifth category, which connotes no more than mere negligence, is not a sufficient basis to undermine the interest of a third party who has obtained registered title under the *Land Title Act*.

The Knowledge in the Possession of Arcape

[77] For the purposes of this appeal, which is concerned with an application to join Arcape as a second defendant, the truth of the allegations made by the respondent Council in its pleadings are not in dispute. Paragraph 8 of the respondent's proposed amended statement of claim pleads that:

> "At or near the Moonie Motel approximately two weeks before the making of the contract referred to in para. 5(a) hereof, the first defendants orally informed Jacqueline Urquhart and Kenneth Pfitzner, as the agents of the second defendant, that Lot 3 did not belong to the first defendants but to the plaintiff, so that a sale by them of the Moonie Motel did not and could not include that lot."

[78] The substance of the conversation referred to in paragraph 8 is contained in the second respondent's Further and Better Particulars. There it is alleged that the Garners directed Ms Urquhart and Mr Pfitzner to the area surrounding the bore which was clearly marked by surveyors pegs said to have been placed there by the Council. The particulars continue that the Garners told Ms Urquhart and Mr Pfitzner that they had sold the land with the bore to the Council, and that the Council now owned that land. The applicant in its affidavit material deposes that its solicitors conducted a search of the register and discovered that the Garners were the registered proprietors of Lot 3.

[79] In summary then, if the respondent's allegations are accepted, the applicant, Arcape, had knowledge that Lot 3 had been sold to the Council and that the Council now owned it but that the Garners were still the registered proprietors. The respondent does not expressly plead that the applicant knew the purchase price had been paid by the Council although this fact is implicit in the concept of a sale and the change of ownership. It seems from these allegations that the applicant had knowledge of all the facts which gave rise to Lot 3 being held by the Garners on trust for the Council. Given that this was a bare trust under which the only obligation was to transfer the property to the beneficiary, the sale of the property to a third party is clearly in breach of trust. The precise category of knowledge into which these pleaded facts fall will depend very much on the colour that they acquire at trial. Nevertheless, the applicant's state of knowledge is sufficiently pleaded to make it a subject that should be determined at trial, and not upon an application for joinder of a defendant.

The Rule in *Barnes v Addy* and Indefeasibility

[80] The submissions of the applicant, however, raise two objections based on legal principle against a finding that an equity derived from knowing receipt of trust property is sufficient to defeat its registered title. The interplay between equitable causes of action and the Torrens system of indefeasibility was the principal subject of argument in this case. This case brings into sharp relief the great tectonic plates of law and equity as they grind against each other and struggle to settle into a stable position in the substratum of Australia's legal landscape.

[81] The first objection raised by the applicant is that under the principles of indefeasibility enacted in the *Land Title Act* the interest of a registered proprietor can never be defeated by mere notice of a prior unregistered interest. Hence, a cause of action based on the first limb of *Barnes v Addy*, and resting upon mere knowledge, is an insufficient equity to overcome indefeasibility.

[82] It is true that s 184(2)(a) states that a registered proprietor "is not affected by actual or constructive notice of an unregistered interest affecting the lot." However, s 184(3)(a) makes this principle expressly subject to the exceptions in s 185, including an equity arising from the act of the registered proprietor.

[83] The applicant relied on the decision of the High Court in *Bahr v Nicolay*.[85] In that case, the registered proprietor of a parcel of land sold the land to another and then leased the land from the new owner for three years. The contract between them provided that upon expiration of the lease, the original owner would repurchase the land for $45,000. The land was subsequently sold to a third party under a contract that included a clause acknowledging the repurchase option in the earlier contract. The third party purchaser also made representations to the original owner that he would agree to sell the land back in accordance with the repurchase clause. The third party purchaser registered his title to the land and subsequently refused to sell the land to the original owner.

[84] Each of the judgments stressed that mere notice of the existence of the repurchase clause was insufficient to create an equity that would defeat the registered proprietor's interest.[86] However, it was held that as a result of the undertaking to

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85 (1988) 164 CLR 604.

86 (1988) 164 CLR 604 at 613 per Mason CJ, Dawson J; at 631 per Wilson, Toohey JJ; at 652-653 per Brennan J.

abide by the repurchase clause the third party purchaser was bound to resell the land, even after registration of the transfer. When the third party purchaser attempted to repudiate the undertaking, equity would impose a constructive trust over the land and the court could order the execution of the agreement.[87]

[85] The applicant relied upon *Bahr v Nicolay* as authority for the proposition that mere notice of a prior interest is never sufficient to overcome indefeasibility. However, the decision in *Bahr v Nicolay* did not deal with the question here in issue. There was no suggestion in *Bahr v Nicolay* that the land taken by the third party purchaser was trust property. Mason CJ and Dawson J held that the third party purchaser held the land on an express trust from the point at which he agreed to resell the land to the original owner.[88] This, of course, is a different matter from receiving property with knowledge that it is trust property. The equity sought to be relied upon in this case is not founded upon mere knowledge; it takes its substance from the dealing by a third party with trust property. Knowledge is a fundamental ingredient of the cause of action but the culpable conduct which equity fixes upon is the taking of trust property – a class of interest that has always, and with good reason, been accorded special attention by courts of equity.

[86] The second objection raised by the applicant is that the respondent Council's submissions are inconsistent with the principle of indefeasibility and would undermine the certainty of the register and hence the Torrens system of title by registration.

[87] A similar argument was accepted by a majority of the Court of Appeal of Victoria in *Macquarie Bank Ltd v Sixty-Fourth Throne Pty Ltd*.[89] In that case, a bank took a mortgage over trust property with knowledge that it was trust property, and that the debtor did not own the land. The trial judge accepted an argument, based on the first limb of *Barnes v Addy*, that the bank held the mortgage as constructive trustee.[90] However, the decision was overturned in the Court of Appeal where Tadgell JA held:[91]

> "[T]o recognise a claim *in personam* against the holder of a mortgage registered under the *Transfer of Land Act*, dubbing the holder a constructive trustee by application of a doctrine akin to "knowing receipt" when registration of the mortgage was honestly achieved, would introduce by the back door a means of undermining the doctrine of indefeasibility which the Torrens system establishes…. In truth, I think it is not possible, consistently with the received principle of indefeasibility as it has been understood since *Frazer v. Walker* and *Breskvar v. Wall*, to treat the holder of a registered mortgage over property that is subject to a trust, registration having been honestly obtained, as having received trust property. The argument that the appellant is liable as a constructive trustee because it had "knowingly received" trust property should in my opinion fail."

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87 (1988) 164 CLR 604 at 638 per Wilson, Toohey JJ; at 654 per Brennan J. But note that Mason CJ and Dawson J (at 619) held that an express trust was created from the moment the third party purchaser agreed to resell the land.

88 (1988) 164 CLR 604 at 619.

89 [1998] 3 VR 133.

90 (1996) 130 FLR 411 per Hedigan J.

91 [1998] 3 VR 133 at 157.

Winneke P agreed with Tadgell JA:[92]

> "If, therefore, the registration of a mortgage over trust property is to be regarded as a "knowing receipt of trust property", the balancing of the competing philosophies requires, in my view, that the registration has been achieved as a result of conduct by the mortgagee amounting to a want of probity before its registered interest can be defeated.
>
> It is sufficient for me to say that I agree with Tadgell J.A. that it is not possible, consistently with the principles of indefeasibility, to treat the appellant as having "knowingly received trust property" where the registration of the mortgage was honestly obtained."

[88] Of these conclusions, the dissenting judge, Ashley AJA, said:

> "To accept such a position is, in my respectful opinion, effectively to deny the operation of a remedy which squarely falls within the *in personam* exception to indefeasibility, an exception which undoubtedly exists as a basis for indirect attack upon registration separate from the direct attack available by reliance upon statutory fraud. The approach accepts that, speaking generally, improper receipt of trust property can give rise to a constructive trust. But it says that, in the case of a dealing with trust property which is Torrens system land, recourse to imposition of such a trust is in part unnecessary; for dishonest receipt will constitute statutory fraud. Otherwise the possible scope of the remedy is denied application. The consequence of that approach is that the full range of operation of the particular remedy is emasculated. The proposition that an equity may be recognised and enforced so long as it involves no conflict with the indefeasibility provisions has not prevented the High Court from imposing constructive trusts so as to recognise equities in cases where the transfer of real property was effected at different stages in the course of events giving rise to the equities: thus *Bahr*, *Muschinski* and *Baumgartner*. In my opinion this court is not obliged to, nor should, deny the applicability of the constructive trust remedy in a case such as this. It is one thing to say (in the context of transfer) that, absent fraud, a potential transferee is not to be affected by notice, actual or constructive, of any trust. It is a quite separate matter to say that such a person is to be unaffected by notice, actual or constructive, of a breach of trust. Likewise, I consider, by analogy in the case of a mortgage of land. Moreover, it has been said that the purpose of indefeasibility is to protect a transferee from defects in the title of the transferor; not to free the transferee from interests with which he has burdened his own title. To deny the applicability of the *in personam* remedy now under discussion would not, I think, achieve that outcome."

[89] While according due respect to the majority in *Macquarie Bank v Sixty-Fourth Throne*, in my view the judgments of Ashley AJA in that case, of Hansen J in *Koorootang Nominees* and of de Jersey J in *Doneley v Doneley*[93] are more in

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92 [1998] 3 VR 133 at 136.

93 [1998] 1 Qd R 602. It should be noted that indefeasibility was not raised by the parties in either of these cases. Hansen J at 75 expressly adverts to this but appears to favour the view that

accordance with principle and more effectively balance the protection afforded to trust property against its knowing receipt by a third party and the protection afforded to the title of registered proprietors.

[90] The *Land Title Act* expressly preserves the operation of equitable rules, where an equity is created by the registered proprietor. In this sense, the provisions of the *Land Title Act* are clearer in their formulation than their predecessors in the *Real Property Acts*.[94] The provisions of the *Land Title Act*, in ss 184 and 185, make the rules about actual or constructive notice subject to any equities created by the registered proprietor. This is not to say that the *Land Title Act* has altered the law in this respect. It has always been the case that indefeasibility is subject to certain equitable principles. As outlined above, under the *Land Title Act*, some equities will not prevail over the registered title of a transferee. What must be kept steadily in mind, however, is that the Torrens system does not fundamentally alter the nature of equitable rights or *in personam* remedies. For instance, dishonesty is not an element of a cause of action based on the first limb of the rule in *Barnes v Addy* and, contrary to the majority view in *Macquarie Bank v Sixty-Fourth Throne*, it would be improper to introduce that element by virtue of a Torrens system statute. The *Land Title Act* was not intended to protect a registered proprietor who had gained title by knowingly participating in a breach of trust.

[91] The exception to indefeasibility for which the respondent argues is limited to the situation where the registered proprietor has received trust property. It is further limited by the requirement that the registered proprietor have knowledge that the property was trust property and that its receipt was in breach of trust. An exception in these limited terms is a narrow one and not, in my view, wide enough to undermine the operation of the Torrens System as the applicant has submitted.

[92] It follows in my view that the learned primary judge was correct to allow the application to join Arcape and the application for leave to appeal should be refused.

Order

[93] Application for leave to appeal refused.

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indefeasibility cannot be raised as a defence to knowing participation in, or benefit from, a breach of trust.

94 See ss 44, 109 *Real Property Act* 1861-1988.