LIABILITY OF THIRD PERSONS FOR BREACH OF TRUST

Two recent judgments of the Manitoba Court of Appeal raise the question of the liability of third parties for breach of trust. In both actions a cestui que trust sought to charge a bank on account of dealings with a trust company, the trustee of the respective plaintiffs. In *White* v. *Dominion Bank*,[1] negotiable securities were hypothecated to the bank as security for advances to the trustee personally and which securities the bank realized and applied on the indebtedness. The trial judge dismissed the action on the grounds that the bank acted in good faith throughout; that it had not connived at or been a party to the fraud of the trustee, and had not been put on inquiry. The Court of Appeal reversed this judgment holding the bank liable. Two of the judges agree that there was "no suspicion of fraud" or "no suggestion of fraud" on the part of the bank. The Court was of the opinion that the bank knew or had been put on inquiry, on the following grounds : that certain hypothecations in 1923 included the words "E. W. White" or "E. W. White Estate" in the description of the securities, that the borrower, a trust company, was known to act as trustee, that it was borrowing en bloc, and that an analysis of its annual statements supplied to the bank by the trustee would indicate that trust securities were being disposited with the bank as security for the trustee's general indebtedness.

In *McPherson* v. *Dominion Bank*,[2] the trust company sold certain bearer bonds to the bank, the proceeds were credited to the company's loan account, and monies later were transferred to its trust account, from which they were disbursed by the trust company. The plaintiff as cestui que trust alleged the bank liable by reason of the original purchase of the bonds or the subsequent misapplication of the trust account by the trustee. The trial judge dismissed the action, on the ground that there was no evidence that the bank was privy to any breach of trust. The judgment was affirmed on appeal, by a majority of the court, on the grounds that the bank was a bona fide purchaser of the bonds, and was not privy to the subsequent misapplication.

In the respective actions, the trust company was guardian of the infants' estate,[3] and was not an executor or administrator,

[1] [1934] 3 W.W.R. 93; on appeal, at p. 385.
[2] [1935] 2 W.W.R. 1 (trial); [1935] 3 W.W.R. 390 (appeal).
[3] *White Case*, [1934] 3 W.W.R. 93 (Administrator and guardian of the estate of infants, but payments had been made to the beneficiaries, and the relation of trustee may have "been assumed".) *Attenborough* v. *Solomon*, [1913] A.C. 76-85; *McPherson Case*, [1935] 2 W.W.R. 2 (Guardian of the infant's estate).

or at least was not dealt with as such.[4] Hence the ordinary rules relating to the immunity of purchasers from known executors or administrators would not apply.[5] But in each action the trial judge stated the onus was on the plaintiff to prove fraud of the trustee, and that the bank was a party to it.[6] The facts and the judgments on appeal concern two distinct cases of relief; the proprietary right[7] of the cestui que trust to specific recovery of trust property, and the personal right of the cestui que trust to an account. The onus of proof would appear to vary according to the form of action.

As to the proprietary remedy, the cestui que trust will have established a prima facie right to recover trust property by evidence of the trust, and the identity of the funds in the hands of the defendant as part of the prior trust.[8] The onus is then shifted to the defendant to prove a purchase that will give him as superior equity.[9] In many instances, when the defendant has proved his purchase of a negotiable security for value, he will be presumed to have taken in good faith, and the

[4] *In re Morgan, Pillgrem* v. *Pillgrem* (1881), 18 Ch. D. 93; *Solomon* v. *Attenborough*, [1912] 1 Ch. 451 at p. 454 (Cozens Hardy M.R.); *Cf. Hill* v. *Simpson* (1802), 7 Ves. 152.

[5] *Nugent* v. *Giffard* (1738), 1 Atk. 463; *Graham* v. *Drummond*, [1896] 1 Ch. 968; *Wilson* v. *Moore* (1834), 1 Myl. & K. 126, 337; *M'Leod* v. *Drummond* (1807), 14 Ves. 353; (1810), 17 Ves. 152; *Keane* v. *Robarts* (1819), 4 Madd. 332.

[6] [1934] 3 W.W.R. 96; [1935] 2 W.R.R. 5.

[7] By use of the expression "proprietary right" it is not intended to enter into the controversy whether an equitable right is *in personam* or *in rem* (Hanbury, *A Periodical Menace to Equitable Principles* (1928), 44 L.Q.R. 468; *Review of Hanbury, Essays in Equity*, by Zechariah Chaffee, JR. (1935), 48 Harv. L.R. 523 at p. 528) but rather to suggest the peculiar consequences of certain equitable rights by reason of the efficacy of their remedies (*Frith* v. *Alliance Investment Co.* (1914), 49 Can. S.C.R. 384, Duff J. at p. 390). The term may therefore serve to denote those remedies that result in a specific recovery such as tracing specific performance and redemption. And having regard only to the consequences of such remedies, the rights which underly such relief may be called proprietary rights (*McKillop & Benjafield* v. *Alexander* (1911), 45 Can. S.C.R. 551 at p. 567) or equitable interests (45 S.C.R. 581). From this view point, the right of a *cestui que* trust would be proprietary when it is made the basis of the remedy in tracing but would be personal when it is sought to charge the trustee in account and without regard to the recovery of any particular fund or property (*Lister & Co.* v. *Stubbs* (1890), 45 Ch. D. 1). Under the latter circumstances, the obligation of the trustee has been called an "equitable debt" (*Clarkson* v. *Davies*, [1923] A.C. 110). The distinction between personal and proprietary would appear warranted when the court of Chancery recognizes that notice may "bind his title but not his conscience". (*McKillop & Benjafield* v. *Alexander* (1911), 45 Can. S.C.R. at p. 568).

[8] *Frith* v. *Cartland* (1865), 2 H. & M. 417 at p. 422; *Begley* v. *Imperial Bank of Canada*, [1935] S.C.R. 87; *Hardy* v. *Metropolitan Land and Finance Co.* (1872), L.R. 7 Ch. 427; *Ernest* v. *Croysdill* (1860), 2 DeG. F. & J. 175, Knight Bruce L.J.; *Thorndike* v. *Hunt* (1859), 3 DeG. & J. 563.

[9] *Laidlaw* v. *Vaughan-Rhys* (1901), 44 Can. S.C.R. 458, citing *In re Nisbett and Pott's Contract*, [1906] 1 Ch. 386 at p. 410.

onus will be shifted to the plaintiff to rebut this presumption.[10] This issue is no part of the plaintiff's case. Furthermore, good faith in this sense has its origin in the law merchant,[11] and is quite distinguishable from the bank being privy to any misapplication by a trustee, which is part of the equitable doctrine of constructive trust.[12] The other remedy suggested by the facts was the personal obligation of the bank to account. This remedy depends upon a trust relation; if the bank has become a trustee it would be under a duty to account; if it be not a trustee, there is not this obligation.[13] Hence the plaintiff's remedy against the bank in account would depend upon proof of such facts as would permit the court to regard the bank as a trustee by construction. It is sufficient for the immediate purpose, that a stranger becomes liable as a trustee when he has "received trust property and dealt with it in a manner inconsistent with the trust of which he was cognizant" or "where he has knowingly assisted a nominated trustee in a fraudulent and dishonest disposition of the trust property."[14] If the limitations of the trust forbid the particular transaction then knowledge of such limitation will make the purchaser a trustee;[15] on the other hand if the trustee purport to exercise the powers conferred by the trust and the breach arise from his fraudulent intention, then the trustee must be privy to such intent.[16] In both instances it is essential that the third party knowingly participate in a breach of trust.[17] This trust by construction would appear to be merely a particular application of the equitable principle that anyone who knowingly interferes with an equitable relation has trans-

[10] Trueman J.A. in *White* v. *Dominion Bank*, [1934] 3 W.W.R. 385 at p. 407, citing BEVEN, NEGLIGENCE, 4th ed., p. 1485; *Thompson* v. *Clydesdale Bank*, [1893] A.C. 90; *Jones* v. *Gordon* (1877), 2 App. Cas. 616 at pp. 627, 631; *Goodman* v. *Harvey* (1836), 4 Ad. & E. 870.

[11] *London Joint Stock Bank* v. *Simmons*, [1892] A.C. 201; *Jones* v. *Gordon* (1877), 2 App. Cas. 616.

[12] *Soar* v. *Ashwell*, [1893] 2 Q.B. 390; *Barnes* v. *Addy* (1874), L.R. 9 Ch. 244.

[13] *Mara* v. *Brown*, [1896] 1 Ch.1 99; *In re Barney*, [1892] 2 Ch. 265; *Taylor* v. *Davies*, [1920] A.C. 636 at pp. 651, 652; *Barnes* v. *Addy* (1874), L.R. 9 Ch. 244.

[14] *Soar* v. *Ashwell*, [1893] 2 Q.B. 390 at pp. 395-397; *In re Eyre-Williams*, *Williams* v. *Williams*, [1923] 2 Ch. 533; *Hardy* v. *Metropolitan Land and Finance Co.* (1872), L.R. 7 Ch. 427.

[15] *British America Elevator Co.* v. *Bank of British North America*, [1919] A.C. 658; *Corporation Agencies Ltd.* v. *Home Bank of Canada*, [1927] A.C. 318; *Keane* v. *Robarts* (1819), 4 Madd. 332 (constructive knowledge of the will).

[16] *Keane* v. *Robarts* (1819), 4 Madd. 332; *Hill* v. *Simpson* (1802) 7 Ves. 152; *Wilson* v. *Moore* (1834), 1 Myl. & K. 126, 337.

[17] *In re Blundell*, *Blundell* v. *Blundell* (1888) 40 Ch. D. 370; *In re Dixon*, *Heynes* v. *Dixon* [1900] 2 Ch. 561; *Soar* v. *Ashwell*, [1893] 2 Q.B. 390; *In re Eyre-Williams*, *Williams* v. *Williams*, [1923] 2 Ch. 533; *Hardy* v. *Metropolitan Land and Finance Co.* (1872), L.R. 7 Ch. 427.

muted to him an obligation equivalent to that arising under the original relation.[18]

The distinction between specific recovery and account is not without importance, in that in many instances one remedy only may be available. Laches may bar the right of specific recovery without affecting the remedy in account,[19] and conversely there may be a right of specific recovery without any remedy in account. The cestui que trust may have a superior equity and the consequential right to a specific recovery where the absence of notice would preclude the implication of a trust by construction and the remedy in account.[20] The doctrine of constructive notice, where applicable,[21] may charge the defendant with the knowledge necessary to create the trust relation, but there are circumstances where it will not do so and where the prior equity will permit specific recovery.[22]

The divergence between the two remedies must be more marked in actions against purchasers of negotiable instruments, where the doctrine of constructive notice has no application.[23] In such actions, there may be many instances where the prior equity of the cestui que trust will permit specific recovery by reason of the purchaser having been put on inquiry, but the absence of knowledge by the purchaser will preclude a trust relation and its consequent liability in account. Both remedies would be available only if it could be assumed that being put on inquiry and knowledge of a breach of trust are equivalents. While a purchaser who knowingly participates in a breach of trust by taking the negotiable security is "put on inquiry", it by no means follows that the converse is true. The contrast between the two issues is suggested in two reported cases arising

[18] *G. W. K. Ltd.* v. *Dunlop Rubber Co., Ltd.* (1926), 42 T.L.R. 376, 593; *Lord Strathcona Steamship Co.* v. *Dominion Coal Co.*, [1926] A.C. 108.

[19] *In re Gallard, Ex parte Gallard*, [1897] 2 Q.B. 9.

[20] *Hardy* v. *Metropolitan Land and Finance Co.* (1872), L.R. 7 Ch. 427; *In re Morgan, Pillgrem* v. *Pillgrem* (1881), 18 Ch. D. 93 at p. 101.

[21] *Keane* v. *Robarts* (1819), 4 Madd. 332; *Bank of Montreal* v. *Sweeny* (1887), 12 App. Cas. 617; *Sheffield* v. *London Joint Stock Bank* (1888), 13 App. Cas. 333; *Stroughill* v. *Anstey* (1852), 1 DeG. M. & G. 635; *Hill* v. *Simpson* (1802), 7 Ves. 152.

[22] *In re Morgan, Pillgrem* v. *Pillgrem* (1881), 18 Ch. D. 93. The executor took a renewal lease in his own name without any reference to his title as executor, and deposited the lease as security for his debt to a third party. The beneficiary was held to have the stronger equity by reason of having been prior in time. It would be difficult to see how any search of the title would have given notice of the relation of executor. See *Jones* v. *Smith* (1841), 1 Hare 43 at p. 63; AMES, CASES ON TRUSTS, p. 533. A donee will take subject to the right of specific recovery irrespective of notice. *McKillop and Benjafield* v. *Alexander* (1911), 45 Can. S.C.R. 551 at p. 568, refers to a notice that will bind the title but not the conscience.

[23] *London Joint Stock Bank* v. *Simmons*, [1892] A.C. 201 at p. 222.

out of the misappropriation of funds by a fiduciary. In *Begley* v. *Imperial Bank of Canada*,[24] the Chief Justice stated that the plaintiff was asserting her "proprietary right" or "equitable title" to the monies paid to the defendant. The question, therefore, was whether the defendant had been put on inquiry, that is whether it had the "slightest knowledge or suspicion" that the fiduciary was not acting in the performance of his duty. In *Gray* v. *Johnston*,[25] the plaintiff sought to charge the defendant banker in account on the ground that he had knowingly participated in the fiduciary's misapplication of the fund on deposit. The Lord Chancellor stated that "mere suspicion or curiosity" was insufficient; the plaintiff must prove the defendant "knew" that he was "in privity with the breach of trust". In *British America Elevator Co.* v. *The Bank of British North America*,[26] the bank was declared a trustee by construction and liable in account on evidence that it knew that the funds were supplied by the plaintiff to its agent for the sole purpose of purchasing grain, and knowing that, it permitted the agent to apply the funds on account of his personal debt to the bank. On these facts it could be said that the bank was put on inquiry and also knowingly participated in a breach of trust.

By reason of the limitations peculiar to the remedy of specific recovery, the plaintiff is often obliged to resort to the remedy in account. Specific recovery is not available where the funds have ceased to exist,[27] or where the cestui que trust is unable to identify the property in the hands of the defendant.[28] Because "money had no ear-mark" the equitable right of specific recovery of trust funds was formerly passed over in many instances in favour of the remedy in account.[29] The possibilities of this proprietary remedy have been extended by *Hallett's Case*,[30] and again by a recent judgment of the Privy Council,[31] in which it was held that the trust funds having been traced into the assets of a business would be presumed to exist until

[24] [1935] S.C.R. 89.

[25] (1868), L.R. 3 H.L. 1. See also *British America Elevator Co.* v. *Bank of British North America*, [1919] A.C. 658; *Ross* v. *Chandler* (1901), 45 Can. S.C.R. 127.

[26] *Op. cit.*

[27] *Lister & Co.* v. *Stubbs* (1890), 45 Ch. D. 1; *Roscoe* v. *Winder*, [1915] 1 Ch. 62.

[28] *In re West of England and South Wales District Bank: Ex parte Dale & Co.* (1879), 10 Ch. D. 771; *In re Hallett & Co.: Ex parte Blane*, [1894] 2 Q.B. 237; Broadhurst, *Following Property in the Hands of an Agent* (1898), 14 L.Q.R. 272.

[29] See note 28, *supra*.

[30] *In re Hallett's Estate* (1879), 13 Ch. D. 696 at p. 709.

[31] *Madras Assignee* v. *Krishnaji Bhat.* (1933), 49 T.L.R. 432. See a comment in 12 Can. Bar Rev. 379 by D. G. Farquharson.

the contrary was proved; and that the cestui que trust should have a lien upon the assets of the business.

In the Manitoba cases, the proprietary remedy would permit specific recovery of the proceeds of the bonds, mortgaged or sold to the bank providing the bank were put on inquiry.[32] These proceeds went into the bank's assets and there would appear no such difficulty in tracing as would preclude this remedy. Under such circumstances the plaintiff may have undertaken an unnecessary burden by claiming an account on the ground that the bank had knowledge of the breach of trust. On the other hand, the cestui que trust sought to charge the bank by reason that the trustee had deposited in its trust account with the defendant bank, certain funds from the plaintiff's trust and had wrongfully paid these funds to a third party. The remedy claimed was in account on the ground that the bank had knowingly been a party to this misapplication by honouring the cheque or otherwise. It would appear there is no right of specific recovery under such circumstances.

The position of a bank as depositary is anomalous. One might expect that a bank receiving known trust funds on deposit, would be regarded as a purchaser of such funds,[33] and that the cestui que would have the choice of either remedy, specific recovery by tracing the funds into the bank's assets,[34] and asserting a lien thereon, or alternatively, account on any of the various grounds whereby the court may regard as a trustee a person knowingly taking trust funds.[35] These possible liabilities would be subject to this limitation: that a bona fide purchase by the bank would terminate any equitable relation of the cestui que trust to the funds, and destroy any basis for the remedy in tracing or for the imposition of a trust by construction.[36] The authorities indicate these remedies do not apply to a bank as depositary. The lien is asserted against the account of the trustees and not against the assets of the bank, and is only available to the extent of the trustee's credit balance.[37] The receipt of known trust funds for deposit does not make the bank

[32] *Begley* v. *Imperial Bank of Canada*, [1935] S.C.R. 89.
[33] *Foley* v. *Hill* (1848), 2 H.L.C. 28.
[34] *Madras Assignee* v. *Krishnaji Bhat.*, *supra*.
[35] See the authorities cited *supra*, note 14.
[36] *Thorndike* v. *Hunt* (1859), 3 DeG. & J. 563; *London Joint Stock Bank* v. *Simmons*, [1892] A.C. 201.
[37] *In re Hallett* (1879), 13 Ch. D. 709; *In re Hallett, Ex. parte Blane*, [1894] 2 Q.B. 237; Vaughan-Williams J. at p. 241; excepts the instance where the bank takes the money with knowledge of breach of trust. *Pennell* v. *Deffell* (1853), 4 DeG. M. & G. 372 at p. 382. Knight Bruce L. J. suggests the analogy between a deposit and the funds being placed in a box.

a constructive trustee,[38] and it becomes personally liable only when it has knowingly assisted the trustee in a misapplication of the trust funds or the credit received therefor.[39] The equivalent rules apply to an agent or solicitor of the trustee dealing with trust funds at the request of the trustee.[40] A considerable body of judicial opinion emphasizes the importance of facilitating the administration of trusts,[41] particularly by curtailing the liabilities of those who may assist a trustee in the administration. This object appears in the way of being realised by disregarding the fact that a banker, solicitor or agent, who receives trust funds to be disbursed for the trustee is frequently a purchaser in that the property in the funds has passed to him, and by regarding such persons as custodians only.[42] A custodian incurs the obligation of a constructive trustee, only when he knowingly assists in a misapplication.[43]

In the two Manitoba cases first mentioned, the Dominion Bank obtained portions of the trust property, in one instance by way of mortgage, in the other by purchase, and hence the cestui que trust would have two possible grounds of recovery, namely, that the circumstances made the defendant bank a trustee; this is the basis enphasized by the trial judge.[44] Alternatively that the cestui que trust should have specific recovery by reason of his proprietary right; this is considered the basis of the claim in several of the judgments on appeal.[45] Whether

[38] *Shields* v. *Bank of Ireland*, [1901] 1 I.R. 222; *Ross* v. *Chandler* (1911), 45 Can. S.C.R. 127; *Coleman* v. *Bucks and Oxon Union Bank*, [1897] 2 Ch. 243. See Maurice H. Merritt, *Bankers Liability for Deposits of Fiduciary* (1927), 40 Harv. Law Rev. 1077.

[39] *Gray* v. *Johnston* (1868), L.R. 3 H.L. 1; *Ross* v. *Chandler* (1911), 45 Can. S.C.R. 127.

[40] *Brinsden* v. *Williams*, [1894] 3 Ch. 185; *Mara* v. *Browne*, [1896] 1 Ch. 199; *Barnes* v. *Addy* (1874), L.R. 9 Ch. 244; *cf. Blyth* v. *Fladgate*, [1891] 1 Ch. 337.

[41] *Barnes* v. *Addy* (1874), L.R. 9 Ch. 244; *In re Barney*, [1892] 2 Ch. 265; *Keane* v. *Robarts* (1819), 4 Madd. 332.

[42] *Ross* v. *Chandler* (1911), 45 Can. S.C.R. 127; *cf. Foley* v. *Hill* (1848), 2 H.L.C. 28; *Brinsden* v. *Williams*, [1894] 3 Ch. 185; *cf. Harries* v. *Rees* (1867), 37 L.J. Ch. 102.

[43] *Gray* v. *Johnston* (1868), L.R. 3 H.L. 1; *Ross* v. *Chandler* (1911), 45 Can. S.C.R. 127; Scott, *Participation in Breach of Trust* (1921), Harv. Law Rev. 454.

[44] *White* v. *Dominion Bank*, [1934] 3 W.W.R. 93 at p. 96: "There is no ground or foundation whatever for the suggestion that the bank or any of its officials connived at or were party in any way, shape or form to the frauds which the company did no doubt perpetrate." *McPherson* v. *Dominion Bank*, [1935] 2 W.W.R. 1 at p. 5: "In the case at bar there is no notice, and the plaintiffs (as I understand the authorities) must establish (1) fraud on the part of the trust company and (2) that the defendant was a party to such fraud in order to succeed. If they were put upon inquiry and deliberately closed their eyes, that would be fraud."

[45] *White* v. *Dominion Bank*, [1934] 3 W.W.R. 393 at pp. 403-413; *McPherson* v. *Dominion Bank*, [1935] 3 W.W.R. 390 at p. 408.

the bank had been put on inquiry is regarded in various judgments of the Manitoba Court as relevant to the question whether the bank had acquired a title sufficient to preclude specific recovery[46] and as equally applicable to the claim in account, as proof that the bank had knowledge of the trustee's intent to commit a breach of trust.[47]

This expression "put on inquiry" is part of two distinct doctrines, with distinct origins, and it likewise has two meanings and applications as distinct as the respective origins. It may well be open to question whether "being put on inquiry" has any application to the question whether the bank was privy to the intent of the trustee to misappropriate the trust funds.

The distinction of the doctrines "being put on inquiry" in the respective applications may be found when a plaintiff asserts a right to property held by the defendant. If the plaintiff asserts an equitable right such right would be defeated by the plea that the defendant was a purchaser in good faith, for value and without notice and had obtained the legal interest.[48] This notice is ascertained by charging him with constructive knowledge of those facts at least which would have been ascertained by reasonable inquiry, when he has made no inquiry,[49] or when he had notice of circumstances that might affect the title and made no inquiry.[50] The latter is known in equity as being put on inquiry.[51]

Being put on inquiry in the other sense appears in actions based on a legal or equitable right to a negotiable instrument. To such action, it is a defence that the defendant is a purchaser in good faith and for value.[52] This defence arises from the law merchant, and good faith is there ascertained by inquiring whether the purchaser was honestly bargaining for a perfect

---

[46] *White* v. *Dominion Bank*, [1934] 3 W.W.R. 393 at pp. 394, 403, 413; [1935] 3 W.W.R. 408.

[47] *McPherson* v. *Dominion Bank*, [1935] 2 W.W.R. 1 at p. 5 (quoted in footnote 44); *McPherson* v. *Dominion Bank*, [1935] 3 W.W.R. 390 at pp. 397, 398, 415; *White* v. *Dominion Bank*, [1934] 3 W.W.R. 393 at p. 399. There is some apparent difficulty in deciding whether two or more of the judgments are on the footing of a superior equity to property in the hands of the defendant, or on the basis of a participation in a breach of trust.

[48] *Pilcher* v. *Rawlins* (1872), L.R. 7 Ch. 259; *Thorndike* v. *Hunt* (1859), 3 DeG. & J. 563.

[49] *Wilson* v. *Hart* (1866), L.R. 1 Ch. 463; *Kettlewell* v. *Watson* (1882), 21 Ch. D. 685 at p. 706; *West* v. *Reid* (1843), 2 Ha. 249 at p. 260.

[50] *Jones* v. *Smith* (1841), 1 Ha. 43; *Kettlewell* v. *Watson* (1882), 21 Ch. D. 685; *Ware* v. *Egmont* (1854), 4 DeG. M. & G. 460; *West* v. *Reid* (1843), 2 Ha. 249 at p. 259; *Macbryde* v. *Eykyn* (1871), 24 L.T.R. 461.

[51] See the cases in note 50 *supra*.

[52] *Jones* v. *Gordon* (1877), 2 App. Cas. 616; *London Joint Stock Bank* v. *Simmons*, [1892] A.C. 201.

title or whether he merely pretended to do so.[53] To ascertain this good faith the court has at various times relied upon different tests; whether he purchased in a market overt,[54] whether he paid a fair price,[55] whether he purchased in the ordinary course of business,[56] or whether he was put on inquiry.[57]

Being put on inquiry has a distinct and separate significance, depending upon whether it is used in the legal or equitable application. The two points of view are distinctly opposed. The law merchant accepts the view that the buyer is entitled to rely upon the seller's apparent title : there is no duty to make inquiry.[58] Hence, being put on inquiry merely signifies that the buyer suspected the title offered him; if he did suspect a defective title, it could then be said that he was not in fact relying

[53] *Begley* v. *Imperial Bank*, [1935] S.C.R. 89 at p. 100; "The slightest knowledge or suspicion on the part of the bankers". Lord Halsbury in *London Joint Stock Bank* v. *Simmons*, [1892] A.C. 201 at pp. 208, 210, 211, 212; Lord Watson at p. 213; Lord Herschell at pp. 221, 223. In *Dyer* v. *Pearson* (1824), 3 B. & C. 38 at p. 39, the trial judge's direction to the jury included the following : "If a man takes upon himself to purchase from another under circumstances which ought to have excited his suspicion and induced him to distrust the authority of the person selling." A new trial was directed on other grounds.

[54] JONES, BONA FIDE PURCHASE OF GOODS, p. 14, footnote.

[55] *Jones* v. *Gordon* (1877), 2 App. Cas. 616 at pp. 624, 632; *McRorie* v. *Seward* (1910), 3 Sask. L.R. 69 at p. 74; *Lee* v. *Hart* (1854), 10 Ex. 555 at p. 559.

[56] *McRorie* v. *Seward* (1910), 3 Sask. L.R. 69 at p. 73; *Midland Bank Ltd.* v. *Reckitt*, [1933] A.C. 1; *Oppenheimer* v. *Attenborough*, [1908] 1 K.B. 221; *Devas* v. *Venables* (1837), 3 Bing N.C. 400 at p. 404.

[57] *Gill* v. *Cubitt* (1824), 3 B. & C. 466 at p. 467. The direction to the jury included the following : "Whether he took it under circumstances which ought to have excited the suspicion of a prudent and careful man." *Jones* v. *Gordon* (1877), 2 App. Cas. 616; Lord Blackburn at p. 628 :" I take it that in order to make such a defence, ... it is necessary to shew that the person . . . . . was affected with notice that there was something wrong about it when he took it. I do not think it is necessary that he should have notice of what the particular wrong was. If a man, knowing that a bill was in the hands of a person who had no right to it, should happen to think that perhaps the man had stolen it, when if he had known the real truth he would have found, not that the man had stolen it, but that he had obtained it by false pretences, I think that would not make any difference if he knew there was something wrong about it and took it. If he takes it in that way he takes it at his peril." *Dyer* v. *Pearson* (1824), 3 B. & C. 38 at p. 39; *Goodman* v. *Harvey* (1836), 4 Ad. & E. 870 at p. 876.

[58] Certain judgments had declared that good faith depended upon whether the purchaser had made reasonable inquiries. Lord Herschell in *London Joint Stock Bank* v. *Simmons*, [1892] A.C. 201 at p. 218, cited several authorities to the effect that negligence did not "fix" a purchaser with a defective title and, at p. 217 affirmed the right to take without any inquiry. Alse see *Goodman* v. *Harvey* (1836), 4 Ad. & E. 870 : "Gross negligence may be evidence of *mala fides* but it is not the same thing. We have shaken off the last remnant of the contrary doctrine. Where the bill has passed to the plaintiff without proof of bad faith in him, there is no objection to his title. The evidence in this case as to the material marks could only weigh as rendering it less likely that the bill should have been taken in perfect good faith." *Thomson* v. *Clydesdale Bank*, [1893], A.C. 282.

upon a valid title.[59] An apparent similarity has given rise to some attempt to rationalize this principle of the law merchant in terms of estoppel,[60] the common question being whether the apparent title in the one instance and the representation in the other were in fact relied upon. Also being put on inquiry does not connote a knowledge of the particular facts which created a defective title but rather a general suspicion that the title was defective.[61] The sole concern of the law merchant was whether the title had been relied upon and this could be ascertained under various circumstances which would not necessarily indicate a knowledge of the particular facts which gave rise to the defect. For example, if the purchase were not in the ordinary course of business the buyer could be deemed to have been put on inquiry.[62] Furthermore, whether the buyer did suspect the title was ascertained with reference to the actual facts in his mind,[63] and without regard to those facts that might have been obtained by reasonable inquiry. No doubt the court would consider whether a reasonable man would have suspected the title on the facts known to the buyer,[64] but it would not inquire whether this buyer was negligent in not having learned other facts which might have put him on inquiry.[65] The equitable view presupposes a duty to make certain inquiries,[66] and the buyer is therefore presumed[67] to have acquired the knowledge obtainable by such inquiries. Equity is concerned with a constructive state of mind set up by certain objective standards of the court which have regard to the knowledge that might reasonably have been acquired rather than knowledge in fact.[68] Therefore, in equity the absence of reasonable inquiry may permit the court to impute knowledge of particular facts independently of actual knowledge;[69] a suspicion of some defect would impose a duty to inquire and would impute to the buyer

---

[59] See the cases cited in note 57, *supra*.

[60] J. S. Ewart, *Negotiability and Estoppel* (1900), 16 L.Q.R. 135.

[61] See note 57 *supra*.

[62] *Begley* v. *Imperial Bank of Canada*, [1935] S.C.R. 89.

[63] *Raphael* v. *Bank of England* (1855), 17 C.B. 161; *Goodman* v. *Harvey* (1836), 4 Ad. & E. 870; *Dyer* v. *Pearson* (1824), 3 B. & C. 38. Whether reasonable man would be put on inquiry.

[64] See note 57, *supra*.

[65] See cases cited in note 63, *supra*.

[66] *Wilson* v. *Hart* (1866), L.R. 1 Ch. 463 at p. 467; *Jones* v. *Smith* (1841), 1 Ha. 43 at pp. 60 - 61; *West* v. *Reid* (1843), 2 Ha. 249 at p. 260; *Bailey* v. *Barnes*, [1894] 1 Ch. 25 at p. 35.

[67] *West* v. *Reid* (1843), 2 Ha. 249 at p. 260; *London & Canadian Loan and Agency Co. Ltd.* v. *Duggan*, [1893] A.C. 506; *Hiern* v. *Mill* (1806), 13 Ves. 114.

[68] *Wilson* v. *Hart* (1866), L.R. 1 Ch. 463.

[69] See *Wilson* v. *Hart*, *op. cit.*

a knowledge of those facts obtainable by inquiry.[70] On the other hand, if it were reasonably certain that no inquiry would be effective, then knowledge would not be presumed to have been obtained from those inquiries that ought to have been made.[71] It would appear, therefore, that to charge a buyer with knowledge of a particular fact by reason of having been put on inquiry, resort must be had to the equitable doctrine of constructive notice. On the equity side only, being put on inquiry signifies some duty to inquire[72] and that such person must be deemed to have made those inquiries.[73] In law it signifies merely that the buyer had the right to rely on the seller's title and did not do so.

The legal right to rely on the seller's title, and the equitable duty to inquire, lead to divergent results particularly marked in those judgments dealing with purchase from a trustee, and which equally indicate the separate significance of being put on inquiry in the respective jurisdictions. If a trustee sells trust property other than a negotiable security, and the seller be known to be a trustee, the purchaser is in equity put on inquiry and may be charged with knowledge of the terms of the trust.[74] Similarly, if a seller be known to have a limited authority, the purchaser may be charged with knowledge of those limits,[75] or in any event to the extent that knowledge might have been obtained by reasonable inquiries. Numerous judgments declare the doctrine of constructive notice does not apply to commercial transactions.[76] It will be sufficient time to pay full attention to such warnings when our higher courts shall have ceased applying it.[77] However, if the subject matter of the purchase

[70] *Macbryde* v. *Eykyn* (1871), 24 L.T.R. 461; *Bailey* v. *Barnes*, [1894] 1 Ch. 25.

[71] *Carter* v. *Williams* (1870), L.R. 9 Eq. 678.

[72] *Bank of Montreal* v. *Sweeny* (1887), 12 App. Cas. 617; *Hill* v. *Simpson* (1802), 7 Ves. 152; *Simpson* v. *Molson's Bank* (1895), 64 L.J.P.C. 51.

[73] See note 67, *supra*.

[74] *Hill* v. *Simpson* (1802), 7 Ves. 152, cited in *Hiern* v. *Mill* (1806), 13 Ves. 114, as an instance of constructive notice; *Bank of Montreal* v. *Sweeny* (1887), 12 App. Cas. 617; *London & Canadian Loan and Agency* v. *Duggan*, [1893] A.C. 506; *Muir* v. *Carter* (1889), 16 Can. S.C.R. 473; *Cartwright* v. *Lyster*, [1934] O.R. 161 at p. 168; *Simpson* v. *Molson's Bank* (1895), 64 L.J.P.C. 51.

[75] *Sheffield* v. *London Joint Stock Bank* (1888), 13 App. Cas. 333; *Cuthbert* v. *Robarts Lubbock & Co.*, [1909] 2 Ch. 226; *Jameson* v. *Union Bank of Scotland* (1914), 109 L.T.R. 850.

[76] *Manchester Trust Co.* v. *Furness*, [1895] 2 Q.B. 539; *Joseph* v. *Lyons* (1884), 15 Q.B.D. 280; *Dawson* v. *Prince* (1857), 2 DeG. & J. 41 at p. 50; *Hiern* v. *Mill* (1806), 13 Ves. 114.

[77] In the cases referred to in footnote 74, the doctrine of constructive notice, was held applicable to charge a purchaser with knowledge of the limitations of the trust where he knew the seller to be a trustee and the

(Footnote continued on p. 214)

be a negotiable security, then good faith is determined by the common law without the application of the equitable rules of notice, and a purchaser may obtain a good title from a known trustee.[78] In respective judgments a creditor has been held to have,[79] and to have not[80] obtained a good title to monies known to be trust funds and applied on the personal debt of the trustee or fiduciary. These authorities would indicate that there may be some difficulty in a given instance in ascertaining whether a reasonable man would be put on inquiry,[81] but in any event they do not apply the phrase in its legal sense to impute a knowledge of the interest of the cestui que trust or of the limitations of the trust.

The distinct significance of being put on inquiry is indicated by the consequence of the respective applications. The rule in its legal sense is usually applied to the issue whether the title acquired by the purchaser of a negotiable instrument is sufficient to cut off some competing right, such as an equitable right of specific recovery,[82] a remedy consequential on a legal right of property as trover or money had and received,[83] or possibly a personal defence to a bill of exchange.[84] If the competing right

subject matter of the transaction was personal property other than negotiable securities. In *Simpson* v. *Molson's Bank* (1895), 64 L.J.P.C. 51 a case involving dealings in shares by a known trustee, Lord Shand stated that the defendant would have been deemed to know the limitations of the trust except for the statute. These applications of the doctrine would appear difficult to distinguish from that in *Cumming* v. *The Landed Banking and Loan Co.* (1893), 22 Can. S.C.R. 246.

See *Macbryde* v. *Eykyn* (1871), 24 L.T.R. 461 at p. 464, quoting Turner L.J. in *Dawson* v. *Prince* (1857), 2 DeG. & J. 50. In *Shropshire Union Railways* v. *The Queen* (1875), L.R. 7 H.L. 496, shares were placed in the name of a director in trust, but the share certificate contained no reference to the trust; it was held that the *cestui que* trust took priority over a subsequent equitable charge by deposit. Apart from a duty to inquire, an estoppel would appear available. *Colonial Bank* v. *Cady* (1890), 15 App. Cas. 267.

[78] *London Joint Stock Bank* v. *Simmons*, [1892] A.C. 201; *Thomson* v. *Clydesdale Bank*, [1893] A.C. 282; *Coleman* v. *Bucks & Oxon Union Bank*, [1897] 2 Ch. 243; *Bank of N.S. Wales* v. *Goulburn Valley Butter Co.*, [1902] A.C. 543.

[79] See the cases in note 78.

[80] *Begley* v. *Imperial Bank of Canada*, [1935] S.C.R. 89; *John* v. *Dodwell & Co.* (1918), 87 L.J.P.C. 92. The remedy allowed was account but specific recovery was also discussed.

[81] Lord Herschell in *Thomson* v. *Clydesdale Bank*, [1893] A.C. 282 at p. 287; *Begley* v. *Imperial Bank of Canada*, [1935] S.C.R. 89.

[82] *Coleman* v. *Bucks & Oxon Union Bank*, [1897] 2 Ch. 243; *Bank of N.S. Wales* v. *Goulburn Valley Butter Co.*, [1902] A.C. 543; *Begley* v. *Imperial Bank*, [1935] S.C.R. 89.

[83] Conversion : *Midland Bank Ltd.* v. *Reckitt* (1933), 102 L.J.K.B. 297; *Lloyd's Bank, Ltd.* v. *Savory & Co.*, [1933] A.C. 201; *Morison* v. *London County & Westminster Bank*, [1914] 3 K.B. 356; *Toronto Club* v. *Dominion Bank* (1912), 25 O.L.R. 330. Money had and received : *Banque Belge* v. *Hambrouck*, [1921] 1 K.B. 321.

[84] *Jones* v. *Gordon* (1877), 2 App. Cas. 616.

be unimpaired, the appropriate remedy in trover or otherwise will follow, but no new right arises merely by reason that the purchaser was put on inquiry. In equity the fact that the purchaser had been put on inquiry is capable of an analogous application to limit the title so acquired,[85] but it is also relevant as part of the doctrine of constructive notice to impose on the purchaser the relation of trustee, and thereby impose the additional liability in account.[86] A purchaser from a known trustee will be deemed put on inquiry and may be charged with the knowledge of the limitations in the settlement.[87] If, therefore, the sale be in breach of the terms of the settlement, the purchaser, being in equity aware of such limitations, must be privy to the intent of the trustee to make such misapplication. Under such circumstances the purchaser may be deemed trustee of the property so acquired. On the other hand, to charge a purchaser of a negotiable security, as a constructive trustee, the cestui que trust has not the assistance of the doctrine of constructive notice,[88] therefore he must assume the onus of proving that the purchaser had actual knowledge that the trustee committed a breach of trust in selling to him.[89] In those judgments that decree an account, the fact that the purchaser had knowledge of the breach of trust is evident. Such knowledge was proved by evidence that the purchaser knew of the trust and its limitations,[90] or that he knew the seller was a trustee and was acting beyond his apparent power as trustee. If a trustee, to the knowledge of the creditor, pay his personal debt with trust funds, then it is apparent that he is acting as equitable owner rather than as trustee and the creditor will have knowingly participated in the breach of trust.[91] But if other circumstances indicate such a power is vested in the particular trustee, it has been held there is not such knowledge, and therefore no trust by construction or remedy in account. The fact that the creditor and not the cestui que trust is receiving the apparent benefit of the funds, may be the deciding fact.[92]

[85] See cases cited in note 49, *supra*.

[86] *Hill* v. *Simpson* (1802), 7 Ves. 152; *Keane* v. *Robarts* (1819), 4 Madd. 332.

[87] See the cases in note 86.

[88] *Jones* v. *Gordon* (1877), 2 App. Cas. 616; *London Joint Stock Bank* v. *Simmons*, [1892] A.C. 201.

[89] See the cases cited in note 17, *supra*.

[90] *British America Elevator Co.* v. *Bank of British North America*, [1919] A.C. 658; *Gray* v. *Lewis* (1869), L.R. 8 Eq. 526.

[91] *John* v. *Dodwell & Co.* (1918), 87 L.J.P.C. 92; *Ex parte Kingston* (1871), L.R. 6 Ch. 632; *Wilson* v. *Moore* (1832), 1 Myl. & K. 126; *M'Leod* v. *Drummond* (1810), 17 Ves. 152, explained in *Keane* v. *Robarts* (1819), 4 Madd. 332; *Hill* v. *Simpson* (1802), 7 Ves. 152.

[92] *Keane* v. *Robarts* (1819), 4 Madd. 332; *Coleman* v. *Bucks & Oxon Union Bank*, [1897] 2 Ch. 243; *Bank of N.S. Wales* v. *Goulburn Valley Butter Co.*, [1902] A.C. 543; *Gray* v. *Johnston* (1868), L.R. 3 H.L. 1.

It would appear, therefore, that when a cestui que trust asserts his proprietary right to a negotiable security as a footing for specific recovery, then the legal doctrine of being put on inquiry is applicable to determine whether the purchaser has obtained a superior title.[93] It is then relevant to inquire whether the purchaser suspected the title. But if the cestui que trust relies on the equitable doctrine of constructive trust for an account, suspicion is not sufficient; there must be knowledge of the breach of trust.[94] Suspicion of a title leaves open the possibility that it may be valid. Knowledge of a breach of trust will arise when this possibility has been excluded. Hence being put on inquiry and knowledge of a breach of trust cannot be equivalents.

In the Manitoba cases, whether the plaintiff's proprietary rights to the negotiable securities permit specific recovery must depend upon whether the bank had been put on inquiry under the law merchant.[95] In the *White Case*, two of the appeal judges held that the bank was put on inquiry but agreed with the finding of the trial judge that there was no fraud.[96] Such a distinction is possible under the constructive standard of equity, whereby actual knowledge may be distinguishable from constructive knowledge and actual fraud from fraud by construction, but under the law merchant, there is only one test, that of good faith, and there is an absence of good faith where the buyer suspects the title to be defective, equally as if he knew it to be so.[97] For this reason there would appear to be no legal standard to measure such distinction, both instances being merely beyond the concept of good faith.[98] In any event it would appear open to objection to say that the bank was guilty of "nothing more than a mistake of law".[99] That is merely applying the doctrine of constructive notice to negotiable instruments. The quotation is quite applicable in its origin[100] to the purchase of shares from a known trustee, when it may be said that the purchaser was in legal error in thinking he could rely on the seller's title, whereas he was within the ambit of the doctrine of constructive notice. But such a case is not parallel to the sale of a negotiable instrument, in which case the buyer is entitled to rely on the seller's title, the only question being did he honestly do so.[101]

[93] *Begley* v. *Imperial Bank*, [1935] S.C.R. 89.
[94] *Gray* v. *Johnston* (1868), L.R. 3 H.L. 1.
[95] See cases cited in note 88, *supra*.
[96] *White* v. *Dominion Bank*, [1934] 3 W.W.R. 389 at pp. 393, 394.
[97] See cases cited in note 88, *supra*.
[98] *Jones* v. *Gordon* (1877), 2 App. Cas. 616, Lord Blackburn at p. 628.
[99] *White* v. *Dominion Bank*, [1934] 3 W.W.R. 394 at p. 426.
[100] *Bank of Montreal* v. *Sweeny* (1887), 12 App. Cas. 617.
[101] See cases cited in note 88, *supra*.

The facts of the two cases offer some indication of the difficulty of foreseeing the ultimate result in these actions. In the *White* action, former hypothecations in 1923 had charged the enumerated bonds with the present and future indebtedness of the borrower, and had included in the description of the bonds in question, the words "E. W. White" or "E. W. White Estate", and in the description of other enumerated bonds, a reference to certain other estates. As against this there were some earlier hypothecations and many subsequent hypothecations, including those on which the bank relied, and these contained no reference to any estate. In the *McPherson Case*, the trustee had purchased the bonds from the bank by cheque on its trust account, and on delivery took a receipt which contained the serial numbers of the bonds. In both instances the bank had in its possession records of previous transactions which would indicate there had been a trust relation with reference to those bonds. In the *White Case* the court over-ruled the trial judge who had held that the bank knew the trustee was exceeding his powers or was put on inquiry. That the *White* transactions were capable of putting the bank on inquiry appears borne out by authority; the facts indicate that the Trust Company was exercising powers not usually exercised by a trustee. However, respective judgments cite *Sheffield* v. *London Joint Stock Bank*,[102] and *Bank of Montreal* v. *Sweeny*,[103] to the effect that the bank was "guilty of a mistake in law", or that a person put on inquiry "is deemed to know the facts which he would have ascertained if he had made inquiry". In both judgments cited, a known trustee was disposing of non-negotiable securities and to such a transaction the doctrine of constructive notice is applicable.[104] Such references raise the question whether in the *White Case* the court was directing its undivided attention to the question whether the bank did suspect, or whether it has not to some extent given effect to the equitable doctrine of constructive notice and charged the bank with knowledge that reasonable inquiries would have disclosed.

The bank was also charged in account on the ground that it had knowingly assisted the trustee in a breach of trust and had thereby become a trustee. The fact that the bank was put on inquiry appears to have been applied to charge the bank with knowledge of the trustee's intent. One instance appears from a portion of the judgment at trial: "the plaintiffs . . . . .

[102] (1888), 13 App. Cas. 333.
[103] *Op. cit.*
[104] See the cases cited in note 77, *supra*.

must establish (1) fraud on the part of the Trust Company, and (2) that the defendant was a party to such fraud in order to succeed. If they were put upon inquiry and deliberately closed their eyes that would be fraud."[105] It is open to question whether the fact that the bank was put on inquiry has any application.

The constructive trust if any, arose out of two transactions; from the purchase of the bonds, absolutely or by hypothecation, or from the misapplication by the trustee of the funds to the credit of the trust account. The sale of the bonds to the bank in breach of trust would make the bank a trustee provided that it purchased knowing of the breach, if it were privy to the trustee's intent.[106] The equitable doctrine of constructive notice would not be applicable as the subject matter of the purchase was a negotiable security.[107] It is therefore irrelevant to inquire whether the bank was put on inquiry in equity. The legal doctrine of being put on inquiry does not denote a knowledge of a particular intent or defect but rather a suspicion of the title generally.[108] The fact that the bank was put on inquiry at law, results in its title being insufficient to terminate the cestui que trust's equity, but that equity does not give a right to an account unless there is proof of knowledge.[109] Furthermore, it is at least doubtful whether the legal doctrine has any application in equity to prove such knowledge. It would be incongruous to permit a cestui que trust to recover in trover;[110] for the same reason it would appear conspicuously out of place if the common law principle of being put on inquiry were to be found in the court of chancery as a part of the equitable doctrine of constructive trust. Saying that the bank was put on inquiry would be equally ineffective to charge the bank as depositary with knowledge of the trustee's intent to misappropriate the deposit. If the bank be regarded as a custodian, and this view is suggested by authority,[111] the privity which imposes a duty of care is with the trustee and not with the cestui que trust.[112] In the absence of any privity there would appear no relation whereby the cestui que trust could impose a

[105] *McPherson* v. *Dominion Bank*, [1935] 2 W.W.R. 1 at p. 5.
[106] *Gray* v. *Johnston* (1868), L.R. 3 H.L. 1.
[107] *Jones* v. *Gordon* (1877), 2 App. Cas. 616; *London Joint Stock Bank* v. *Simmons*, [1892] A.C. 201.
[108] Lord Blackburn in *Jones* v. *Gordon*, *op. cit.*, at p. 628.
[109] *Gray* v. *Johnston*, *op. cit.*
[110] *Joseph* v. *Lyons* (1884), 15 Q.B.D. 280.
[111] See note 42, *supra*.
[112] *Rae* v. *Meek* (1889), 14 App. Cas. 558 at p. 569; *Stokes* v. *Prance*, [1898] 1 Ch. 212 at p. 225; *Brinsden* v. *Williams*, [1894] 3 Ch. 185.

duty of reasonable inquiry. Moreover, certain judgments have indicated that the knowledge which makes a depositary privy to the intent is actual knowledge only.[113] *Gray* v. *Johnston*[114] states that it is immaterial if the bank suspect an intended misapplication, and that such suspicion does not permit the bank to dishonour the trustee's cheques.[115]

F. A. SHEPPARD.

College of Law,
University of Saskatchewan.

---

[113] *Gray* v. *Johnston* (1868), L.R. 3 H.L. 1 at p. 11; *Ross* v. *Chandler* (1911), 45 Can. S.C.R. 127 at p. 132; *Corporation Agencies, Ltd.* v. *Home Bank of Canada*, [1927] A.C. 318 at p. 324; *Bank of N.S. Wales* v. *Goulburn Valley Butter Co.*, [1902] A.C. 543, at p. 550.

[114] (1868), L.R. 3 H.L. 1.

[115] The effect of sec. 96 of the Bank Act, and the reasons in *Simpson* v. *Molson's Bank* (1895), 64 L.J.P.C. 51, should also be considered.