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The Right and Wrong of "Knowing Receipt" in the Law of Restitution

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Those who venture into the restitution thicket not infrequently become lost.
It is part of our task to see that they are heard from again.[1]

Introduction

1. One distinctive feature of the common law system is its duality. No legal analysis is complete without considering both the rules of common law and the principles of equity. Civilians (non-lawyers in common law countries and lawyers from civil law countries) struggle to understand why there are two systems of justice in the legal discourse and how they interact with one another. The trite proposition that equity prevails whenever there is a conflict belies the complexity of the relationship. The other distinctive feature is that much of the law continues to be made in the courts rather than by legislation. Judge-made law derives empirically from cases, from which principles are then deduced, and not the other way around. The development of any new subject in the law is almost always a slow and tortuous process. The law of restitution is a relatively new subject, and its boundaries and content are still controversial. One of the enduring controversies is the place of the equitable liability in knowing receipt within the law of restitution. Recent decisions in the Commonwealth have shown how the boundaries may be redrawn.

Restitution

Restitution to Reverse Unjust Enrichment

2. Academics in the law of restitution draw the boundaries of the law of restitution in different places. Restitution is a remedy, and it is important to understand what it is the cause of action. The modern meaning of restitution focuses on the remedy to reverse the unjust enrichment of

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[1] Levin J in *Snider v Dunn* 160 NW 2d 619, 628 (1968, Michigan Court of Appeal). Cited in "Understanding the Law of Restitution: a Map through the Thicket" in A Burrows, *Understanding the Law of Obligations* (1998) at 45.

the defendant at the expense of the plaintiff. The core example is the common law claim for money had and received. It is a monetary claim to reverse the unjustified flow of wealth from the plaintiff to the defendant. The defendant is strictly liable for the value of the enrichment received, subject to defences like bona fide purchase and bona fide change of position. This is the law of unjust enrichment. The defendant's duty to make restitution is correlative to the plaintiff's right based on the principle against unjust enrichment.[2]

Restitution for Wrongs

3. Restitution is also a remedy to transfer to the plaintiff the gain that the defendant has made by the commission of a wrong against the plaintiff. There is no flow of wealth from the plaintiff to the defendant as such. The core examples in the law are the common law claims in waiver of tort,[3] and the account of profits claim in equity.[4] This is still discussed in most textbooks on the law of restitution. Restitution in this sense is often referred to as "disgorgement"[5] to distinguish it from restitution for unjust enrichment. The defendant's duty to make restitution in this case arises from the wrong committed against the plaintiff.

"Restitution" and Compensation[6]

4. There are two other types of personal remedies where "restitution" may be used in the law to signify concepts of *loss* especially in the context of trusts and equity and much to the dismay of unjust enrichment lawyers. Care must be taken to distinguish them from the senses above. Restitution is sometimes used to mean the *restoration* of a fund to its state before a breach of duty.[7] The classic example is the duty of an express trustee to preserve the property of a trust. Restitution in this context refers to the reconstitution or restoration of the trust fund by returning any property taken out of the trust in breach, or the money equivalent thereof. Generally, a trustee (at least of a traditional trust) comes under a duty to make to restitution to reconstitute the trust fund in the event of a breach.[8] There is no question of causation,

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[2] *Lipkin Gorman (A Firm) v Karpnale* [1991] 2 AC 548; *Seagate Technology Pte Ltd v Goh Han Kim* [1995] 1 SLR 17 (CA).
[3] *United Australia Ltd v Barclays Bank Ltd* [1941] AC 1.
[4] One controversial example is the account of profits claim for breach of contract: AG v Blake [2001] 1 AC 268; *Teh Guek Ngor Engelin v Chia Ee Lin Evelyn* [2005] 3 SLR 22 (CA).
[5] L Smith, "The Province of the Law of Restitution" (1992) 71 Can Bar Rev 672.
[6] See generally, J Edelman and S Elliott, "Money remedies against trustees" (2004) 18 TLI 116, S Elliott and C Mitchell, "Remedies for Dishonest Assistance" (2004) 67 MLR 16.
[7] *Ex p Adamson* (1878) 8 Ch App 807 at 819. See also *Target Holdings Ltd v Redferns (A Firm)* [1996] 1 AC 421.
[8] The extent to which this principle applies to commercial trusts is controversial. Compare *Target Holdings Ltd v Redferns (A Firm)* [1996] 1 AC 421 with *Youyang Pty Ltd v Minter Ellison Morris Fletcher* (2003) 212 CLR 484, [2003] HCA 15.

remoteness, or mitigation involved; the trustee is called upon to perform its duty to the trust. Where the value of the property has remained constant, the loss suffered will coincide with the gain received by the defendant, but the basis of the measure is the loss.

5. Finally, restitution is used in the sense of monetary compensation to repair the damage suffered by the plaintiff. The purpose of this *reparative* measure is to put the plaintiff in the position as if the defendant's breach had not occurred. The critical question is what the position the plaintiff would have been *but for* the breach of duty. In this sense "restitution" is virtually indistinguishable from "compensation" as understood in the common law. However, the extent to which equitable compensation is measured differently from common law damages remains controversial, and the nature of the equitable duty is likely to make a difference.[9] In any event, while this measure may overlap with the restorative sense of restitution above, it is broader because it may include consequential losses, eg, the loss of a business opportunity as a result of the deprivation of property. The terminology is not stable, and equitable compensation is used to refer to both the restorative and reparative measures of loss.[10] "Restitution" should be avoided in these contexts in the interest of clarity.

Restitution and Property

6. There are two further senses in which "restitution" is used, but to refer to proprietary remedies. These fall outside the scope of this paper.[11]

Knowing Receipt and Knowing Assistance

[9] See eg, *Bristol & West Building Society v Mothew* [1998] Ch 1; J Edelman and S Elliot, "Money remedies against trustees" (2004) 18 TLI 116.

[10] It has been said that the "restitutionary" character (putting the plaintiff in the position before the wrong occurred) of equitable compensation has been used to distinguish it from common law damages (putting the plaintiff in the position as if the wrong had not occurred): *Swindle v Harrison* [1997] 4 All ER 705 (CA). But the distinction drawn is really between the restorative and reparative measures, both of which "equitable compensation" has been used in the case law to describe.

[11] First, restitution is also used to refer to a claim by the plaintiff that the defendant holds property on a constructive trust for the plaintiff, ie, *proprietary restitution*. It is a matter of controversy when the proprietary remedies are available in addition to the personal remedies mentioned above, and many have argued that this is really the subject of property law. For example, the Court of Appeal (England and Wales) in *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* [2011] EWCA Civ 347 refused to follow the proposition in *A-G v Reid* [1994] 1 AC 324 that a fiduciary holds bribes on constructive trust for his principal on the basis that it was bound by its own previous decisions (including *Lister v Stubbs* (1890) 45 Ch D 1), thus putting Singapore law at variance (*Kartika Ratna Thahir v PT Pertambangan Minyak dan Gas Bumi Negara (Pertamina)* [1994] 3 SLR 257 (CA)). Secondly, *specific restitution* is an order that the defendant should return the plaintiff's property in the defendant's possession to the plaintiff. This is a relatively uncontroversial area, and the order is usually made to support a common law claim for wrongful detention of property because the common law only awards damages.

7. Any attempt to understand the law on knowing receipt must start with the classic statement of Lord Chancellor Selborne in *Barnes v Addy*.[12]

> .. strangers are not to be made constructive trustees merely because they act as the agents of trustees in transactions within their legal powers, transactions, perhaps of which a Court of Equity may disapprove, unless those agents *receive and become chargeable with some part of the trust property*, or unless they *assist with knowledge in a dishonest and fraudulent design on the part of the trustees*.

The two italicised parts of the passage came to be recognised as references to liability for "knowing receipt" and "knowing assistance" respectively in subsequent case law and textbooks.

Liability for Assistance

8. The law on knowing assistance has been more or less rationalised in a series of cases, and today, it is generally recognised that the liability is based on the defendant's wrong of dishonestly assisting in a breach of trust or fiduciary duty; it is generally referred to as "dishonest assistance" today.[13] The test of dishonesty in Singapore law is an objective one: the defendant is liable if he has "such knowledge of the irregular shortcomings of the transaction that ordinary honest people would consider it to be a breach of standards of honest conduct if he failed to adequately query them".[14] It is a type of civil secondary liability, and the defendant is jointly and severally liable with the trustee or fiduciary in breach. The defendant is a "constructive trustee" only in the sense that his liability is equated to that of the defaulting trustee. The defendant never was a trustee in any sense of holding property on trust.

Liability for Receipt

Compensation within Trusts Law

[12] (1874) LR 9 Ch App 244 at 251-252.
[13] *Royal Brunei Airlines Sdn Bhd* [1995] 2 AC 378 (PC, Brunei); *Twinsectra Ltd v Yardley* [2002] 2 AC 164 [2002] UKHL 12; *Barlow Clowes Internatinoal Ltd (in liq) v Eurotrust International Ltd* [2006] 1 WLR 1476, [2005] UKPC 37; *George Raymond Zage III v Ho Chi Kwong* [2010] 2 SLR 589 (CA). *Contra Farah Construction Pty Ltd v. Say-Dee Pty Ltd* [2007] HCA 22, (2007) 230 CLR 89 where the Australian High Court declined to follow the post-*Barnes v Addy* developments elsewhere. The result is that the requirement that the breach of trust be dishonest (dispensed with in English and Singapore law) still remains in Australian law, and the standard of liability may not be the same as that in English or Singapore law.
[14] *George Raymond Zage III v Ho Chi Kwong* [2010] 2 SLR 589 (CA) at [22].

9. Liability for "knowing receipt" is the more difficult case. It is widely accepted that the elements of the claim are correctly stated by Hoffmann LJ in *El Ajou v Dollar Land Holdings plc*:[15]

> This is a claim to enforce a constructive trust on the basis of knowing receipt. For this purpose the plaintiff must show, first, a disposal of his assets in breach of fiduciary duty; secondly, the beneficial receipt by the defendant of assets which are traceable as representing the assets of the plaintiff; and thirdly, knowledge on the part of the defendant that the assets he received are traceable to a breach of fiduciary duty.

10. Debate has been raging for many years as to the standard of liability. Constructive notice was the prevalent view in the 1960's and 1970's when this type of liability came into prominence.[16] The test then shifted to knowledge,[17] and then from 2000,[18] the English courts accepted that the test for liability was such knowledge of the circumstances of the breach that made it unconscionable for the defendant to retain the benefit of the receipt. This test has been endorsed recently by the highest courts in Singapore (*George Raymond Zage III v Ho Chi Kwong*)[19] and Hong Kong SAR (*Thanakharn Kasikorn Thai Chamkat (Mahachon) (aka Kasikornbank Public Co Ltd) v Akai Holdings Ltd (in liquidation)*).[20] Actual knowledge of the breach, or of suspicious or unusual circumstances which are not followed up by inquiries, can found liability.[21] "Unconscionable receipt" has become the new label for this head of liability, although it is not very informative since unconscionability is the threshold to invoke equitable jurisdiction in every case, and it bears different meanings in different contexts. If the Hong Kong case turns out to be influential, however, it may well be renamed "irrational receipt", though in substance there may not be any difference.

11. It is a matter of some debate what the basis of this liability is. On a traditional trusts analysis the liability for knowing receipt could be explained on the basis of a trustee's duty to preserve the property of the trust.[22] Generally, this personal duty to account needs to be invoked only if the property has been dissipated. The personal liability to account as a constructive trustee arises because the defendant had become a constructive trustee of the property received by

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[15] [1994] 2 All ER 685 (CA) at 700.
[16] *Carl Zeiss Stiftung v Herbert Smith & Co (No 2)* [1969] 2 Ch 276.
[17] *Re Montagu's Settlement Trusts* [1987] Ch 264; *Cowan de Groot Properties Ltd v Eagle Star plc* [1992] 4 All ER 700, at 760; *Eagle Trust plc v SBC Securities Ltd* [1993] 1 WLR 484 at 504.
[18] *Bank of Credit and Commerce International (Overseas) Ltd v Akindele* [2001] Ch 437, [2000] EWCA Civ 502.
[19] [2010] 2 SLR 589 (CA). See also *Yogambikai Nagarajah* v *Indian Overseas Bank* [1997] 1 SLR 258 C(A).
[20] [2010] HKCFA 63, (HKCFA, 8 November 2010).
[21] *George Raymond Zage III v Ho Chi Kwong* [2010] 2 SLR 589 (CA).
[22] P Jaffey, "The nature of knowing receipt" (2001) 15 TLI 151; S Gardner, "Moment of Truth for Knowing Receipt" (2009) 125 LQR 20.

virtue of his legal title in the property coupled with sufficient knowledge of the circumstances of the breach of trust. Where a defendant has received property traceable to a breach of trust,[23] then unless he is a bona fide purchaser of the legal interest for value without notice, he does not obtain the beneficial interest, and the beneficiary of the trust may maintain a proprietary claim for the return of the property. This is a straight priorities of title fight, and the state of the defendant's knowledge is only relevant in the context of the bona fide purchaser defence. Once the defendant is fixed with sufficient knowledge of the circumstances of the breach, he becomes a constructive trustee and the obligations of a constructive trustee are imposed on him.[24] However, the obligations of constructive trustees are not necessarily the same as those of express trustees. Unlike express trusteeship which is voluntarily assumed, constructive trusteeship is imposed by the law. In this context, the courts have sought to impose a higher threshold for the personal liability to account for the dissipated trust property.[25] On this analysis, the personal liability to account is derived from a real trust relationship (albeit imposed by the law), and it is accurate to call the defendant a constructive trustee. He may have disposed of the trust property, but his obligation as such a trustee subsists. As a matter of principle, such liability can only arise if the defendant has sufficient knowledge that he is dealing with trust property.

12. Alternatively, equitable liability could be founded on the basis of interference with property interests without reference to the constructive trust over property. For example, equitable liability for dishonest assistance is founded on the interference with a trust or fiduciary institution without the defendant touching any trust property. Similarly, inconsistent dealing by a person who is not a constructive trustee (eg, lawful but ministerial receipt of property by an agent) may also give rise equitable liability to compensate for loss to a trust.. Traditionally, however, knowing receipt has been treated differently.[26]

13. On either view, the remedy for the breach would be equitable compensation. It probably encompasses both the restorative measure of reconstituting the trust fund and the reparative

[23] In the case of property not the subject of trust by protected by a fiduciary institution, the property may be impressed by a constructive at the time of receipt by virtue of the breach of fiduciary duty, thus satisfying the requirement for receipt of property subject to a (constructive) trust. But this argument cannot be pressed too far – it cannot apply if a constructive trust is sought to be imposed on the property which was never held by either the fiduciary or the principle and is not a traceable proceed thereof: *Farah Construction Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22, (2007) 230 CLR 89.
[24] *Westdeutsche Landesbank Gironzentrale v Islington London Borough Council* [1996] AC 669 at 707.
[25] *Re Montague's Settlement Trusts* [1987] Ch 264.
[26] J Mowbray, L Tucker, N Le Poidevin, E Simpson and J Brightwell, *Lewin on Trusts* (18th ed, 2008) at [42.03] and [42.83]-[42.97].

measure for the losses arising from the dissipation of the property. The general assumption has been that because it is a receipt-based liability, the defendant's liability is for the value received if he had the requisite knowledge at that time.[27] This is consistent with the view that the duty is one to reconstitute the trust as the constructive trust came into existence at the point of receipt, or alternatively that the receipt itself was the wrongful conduct to base accessory liability.

Restitution: A Right in Unjust Enrichment Law

14. The view that the liability is *receipt-based*[28] has also spawned many arguments based on unjust enrichment. The law of the unjust enrichment generally imposes liability when (a) the defendant has been enriched; (b) at the expense of the plaintiff; (c) where the enrichment is unjust; and (d) there are no applicable defences. The late Professor Peter Birks was the main proponent of the view that liability in knowing receipt should be explained on the basis of these principles of unjust enrichment and thus liability should be strict.[29] Subsequently, he changed tack and supported the extra-judicial argument of Lord Nicholls[30] that knowing receipt was based on a wrong, but there is an alternative liability which can be made out on the principles of unjust enrichment.[31] Lord Millett was another proponent of the unjust enrichment analysis.[32] Unjust enrichment analysis imposes strict liability for the value received subject to restitutionary defences (in particular, bona fide purchase and the change of position).

15. If the property or its traceable product remains in the hands of the defendant, a proprietary claim may be made. The issue of personal liability usually arises only if the property has been

[27] C Harpum, "The Basis of Equitable Liability" in P Birks (ed), *The Frontiers of Liability* (1994) Vol 1, 9 at 19.
[28] *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378 (PC, Brunei) at 386; *Dubai Aluminium Co Ltd v Salaam* [2002] 3 WLR 1913, [2002] UKHL 48, at [87]; *Twinsectra Ltd v Yardley* [2002] 2 AC 164 [2002] UKHL 12 at [105]. See also *Tang Hsiu Lan v Pua Ai Seok* [2000] SGHC 163 at [12].
[29] See, eg, P Birks, "Trusts in the Recovery of Misapplied Assets: Tracing, Trusts, and Restitution" in E McKendrick, "Commercial Aspects of Trusts and Fiduciary Obligations" (1992) 149.
[30] Lord Nicholls of Birkenhead, 'Knowing Receipt: The Need for a New Landmark' in WR Cornish, R Nolan, J O'Sullivan, G Virgo (eds), *Restitution, Past, Present and Future : Essays in Honour of Gareth Jones* (1998) 231. See also *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378 (PC, Brunei) at 386.
[31] Birks, "Receipt", in Birks and Pretto (eds), *Breach of Trust* (2002); P Birks, "Knowing Receipt: *Re Montagu's Settlement Trusts* Revisited" (2001) 1 Global Jurist Advances Article 2; P Birks, 'The Role of Fault in the Law of Unjust Enrichment' in GH Jones and WJ Swadling (eds) *The Search for Principle: Essays in Honour of Lord Goff of Chieveley* (1999) 235.
[32] *Dubai Aluminium Co Ltd v Salaam* [2002] 3 WLR 1913, [2002] UKHL 48, at [87]; *Twinsectra Ltd v Yardley* [2002] 2 AC 164 [2002] UKHL 12 at [105].

dissipated.[33] In practical terms, this leads to two key differences between strict and fault lliability: (a) if the defendant is a purchaser who has been unable to invoke the bona fide purchase defence,[34] unjust enrichment analysis throws the burden on the defendant to prove lack of the requisite knowledge to invoke the change of position defence[35] while trusts law requires the plaintiff to prove the existence of the requisite knowledge for liability; and (b) if the defendant is a volunteer, unjust enrichment imposes liability subject to the defendant proving change of position, while trusts analysis only imposes liability if the plaintiff can show that the defendant has the requisite knowledge. The first effectively comes down to a difference in the burden of proof. The second problem may be ameliorated by more liberal rules of tracing as to allow greater scope for the strict liability proprietary claim against the volunteer, but will lead to greater incidence of proprietary claims generally.

16. It is impossible to do justice to the doctrinal arguments for and against the unjust enrichment analysis within the confines of this paper. In any event, courts have generally not been very sympathetic to it for two reasons. Because of a policy concern for the potential hindrance of commercial transactions, they have been reluctant to adopt the alternative unjust enrichment analysis because there are no direct judicial authorities in support.[36]

From Restitution to Compensation for a Wrong

17. Clear support for the view that knowing receipt liability is based on the wrongful conduct of the defendant comes from the English Court of Appeal in *Charter Plc v City Index Ltd*.[37] The issue arose whether a defendant found liable in knowing receipt could seek contribution from other parties. That question turned on whether the defendant's liability was "compensation"

[33] There may be an incentive to make a personal liability claim if the property has decreased in value since receipt. On this, see *Thanakharn Kasikorn Thai Chamkat (Mahachon) (aka Kasikornbank Public Co Ltd) v Akai Holdings Ltd (in liquidation)* [2010] HKCFA 63, (HKCFA, 8 November 2010), discussed below at [23].

[34] On the trusts analysis, bona fide purchase of legal interest for value without notice shields the defendant from the jurisdiction of equity, so it neither proprietary nor personal claims can be sustained. Bona fide purchase is also a defence to a personal restitutionary claim.

[35] The test of bona fide conduct in the change of position defence is very similar to if not the same as the test of unconscionability in knowing receipt.

[36] Rejected in England (*Bank of Credit and Commerce International (Overseas) Ltd v Akindele* [2001] Ch 437, [2000] EWCA Civ 502), Hong Kong SAR (*Akai Holdings Ltd (in liq) v Thanakharn Kasikorn Thai Chamkat (Mahachon) (aka Kasikornbank Public Ltd Co* [2008] HKCU 810) and Australia (*Farah Construction Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22, (2007) 230 CLR 89). In Singapore, the Court of Appeal has categorically rejected strict liability for knowing receipt (*George Raymond Zage III v Ho Chi Kwong* [2010] 2 SLR 589 (CA)). Although it did not expressly reject the possibility of an claim in unjust enrichment that is *alternative* to the claim in knowing receipt, it had referred to Lord Nicholls' extra-judicial argument on this point, and the concern of the court with the expectations of commercial parties suggests that it would not have accepted this argument if it had been made.

[37] [2008] Ch 325 (CA), [2007] EWCA Civ 1382.

in respect of "damage" under the Civil Liability (Contribution) Act 1978.[38] Carnworth and Mummery LJJ rejected receipt as the basis of liability.[39] Instead, liability arose because of retention and disposition of the property with sufficient knowledge that the property was trust property.[40] This is consistent with the analysis above that the personal liability arose from a real constructive trust over property. The most important proposition to emerge from this case is that the remedy for knowing receipt is to make good the loss of the claimants; it is a claim for *equitable compensation*. Arden LJ went further, and alluded to an alternative claim for account of profits based on the wrong of knowing receipt.

Similarity to Dishonest Assistance

18. The authorities so far have marginalised the unjust enrichment arguments, and what is emerging are the propositions that (a) a claim in knowing receipt is based on the wrongful conduct of the defendant; (b) the standard of liability is pegged to the possession of such knowledge of the circumstances of the breach of trust that would render the defendant's retention of the property unconscionable; and (c) the remedy is to compensate the beneficiary for losses suffered; (d) there may be a possible further remedy of account of profits. It is important to notice the similarities that this bears to the claim in dishonest assistance: (a) it is based on the wrongful conduct of the defendant; (b) the standard of liability is pegged to the possession of such knowledge of the circumstances of the breach of trust that would render the conduct of the defendant dishonest; and (c) the remedy is to compensate the beneficiary for losses suffered; and (d) there may be a possible further remedy of account of profits. However, the similarities are only superficial. There is a fundamental difference in the type of wrong committed. In dishonest assistance, the wrong is in rendering aid to the trustee in the breach, and the liability is pegged to the liability of the trustee, in respect of the losses caused by the breach by the primary trustee. In knowing receipt, the wrong is committed only in respect of the property received; the liability is in respect of the defendant's own breach of duty as trustee, not the primary trustee's breach of duty. There may however be overlapping claims on the facts. But passive receipt in itself cannot be the basis of a claim in dishonest assistance, as recognised by the Singapore Court of Appeal in *Zage III*.[41]

Equitable Compensation

[38] Sections 1(1) and 1(6), *in pari materia* with the Civil Law Act (Cap 33A, 2007 Ed), sections 15(1) and 15(6).
[39] Note 37, at [8] and [32] (Carnworth LJ. Mummery LJ agreed).
[40] Ibid.
[41] [2010] 2 SLR 589 (CA) at [43].

19. It is not surprising that comparisons have been made between knowing receipt liability and the tort of conversion at common law.[42] They are similar in the sense that the basic rationale for the claim is the protection of the plaintiff's interest in property from interference by the defendant. This comparison was taken to a new height in the Hong Kong Court of Final Appeal decision in *Thanakharn Kasikorn Thai Chamkat (Mahachon) (ala Kasikornbank Public Co Ltd) v Akai Holdings Ltd (in liq)* (the "Thai Farmers Bank" case).[43] To simplify the facts, a director of P had, in breach of fiduciary and lacking P's authority, pledged certain shares certificates belonging to P to D as security for a loan. P claimed against D in knowing receipt. The Court of First Instance denied the claim, but the Court of Appeal allowed the claim for HK$20m which was price D obtained upon selling the share certificates. On appeal to the HKCFA, the key issue was whether the director had ostensible authority at the time of the pledge agreement to enter into the agreement. The HKCFA (Lord Neuberger NPJ delivering the only reasoned judgment) held that D could not rely on ostensible authority because its conduct, although not dishonest, had fallen below the standard of rationality (which was a standard slightly less demanding than the standard of reasonableness) expected of a party in that situation.[44] This meant that the agreement was void for want of authority, no interest in the share certificates passed to D, and P had sufficient legal interest to maintain an action in the tort of conversion, and was entitled to HK$20m being the proceeds of the sale which was clearly an act of conversion by D. This tort claim emerged only in the HKCFA decision. The court went on to consider whether D was also liable in knowing receipt. The shares were roughly valued at HK$50m at the time of the pledge, HK$32m at the time the loan defaulted, HK$20m at the time D sold the shares, and were worthless by the time of trial. The strategic reason for P pressing the knowing receipt claim was to argue that it was entitled to either HK$50m (value at the time received) or HK$32m (value at the time D ought to have sold the shares).

20. The court assumed (based on the parties' concession) that the test for liability in knowing receipt is unconscionability.[45] It did not deal with the strict liability argument because it found unconscionability on the facts. It also assumed that where a plaintiff had concurrent claims in the tort of conversion and in knowing receipt, it had the freedom to choose which

[42] See, eg, L Smith, "W(h)ither Knowing Receipt" (1998) 114 LQR 394; P Jaffey, "The nature of knowing receipt" (2001) 15 TLI 151; P Birks, "The Role of Fault in the Law of Unjust Enrichment" in W Swadling and G Jones (eds), *The Search for Principle: Essays in Honour of Lord Goff of Chieveley* (1999) at 269.
[43] [2010] HKCFA 63, (HKCFA, 8 November 2010).
[44] Because the reasoning was based on general estoppel principles, this could have wider implications for the law of estoppel beyond agency law.
[45] [2010] HKCFA 63 at [128].

claim it wishes to proceed on (this point was also unchallenged). The court observed that equitable compensation for knowing receipt may not be assessed in the same way as common law damages, though it also warned against overstating the differences. There are three points of interest to the law of knowing receipt.

21. First, In respect of the standard of liability, the court held that, at least in a commercial context, the same standard of conduct applied to the question whether the defendant could rely on the ostensible authority of the director and the question whether it was liable for knowing receipt, absent any special facts.[46] In other words, in general, irrationality in relying on an agent's authority (a common law standard) refers to the same standard as unconscionability in the receipt or retention of property traceable to a breach of trust. This convergence of standards has an advantage of making it easier for parties to assess risks in commercial transactions.

22. Secondly, the court suggested that a broad view may be taken of the element of "benefit" received by D. D had argued that P remained the absolute owner of the share certificates as a result of the void contract; there was no beneficial receipt. The court had two answers. First, D became legal owner of the proceeds of the sale.[47] This must be understood in the context of the facts: given the antecedent breach of fiduciary duty, P could trace its property in the share certificates to the sale proceeds and assert a constructive trust over such proceeds.[48] Secondly, and more controversially, the court suggested that it is arguable (without actually considering the point) that when D purported to exercise its power of sale under the agreement, it had sufficient control over the shares to amount to beneficial receipt.[49] With respect, as the contract was void and there was therefore no pledge, it seems neither here nor there that the bank was exercising a non-existent right. Even though knowing receipt is based on wrongful interference and not the reversal of unjust enrichment, "beneficial receipt" still makes sense on the analysis that the personal liability springs from an actual constructive trust of property. However, it makes less sense if one were to look at it simply as an equitable wrong of interference with property.[50]

[46] [2010] HKCFA 63 at [135].
[47] [2010] HKCFA 63 at [141].
[48] The reason this proprietary claim was not made was probably a strategic one in the hope of getting more from the personal claim in knowing receipt.
[49] [2010] HKCFA 63 at [143]-[144].
[50] Here the analogy will be with dishonest assistance as well as the liability of parties who receive trust property lawfully in a ministerial capacity (who do not become constructive trustees) and deal with the property inconsistently. This is traditionally considered separately from liability in knowing receipt: J Mowbray, L

23. What was not answered was the question whether a knowing receipt claim could be made against a defendant receiving an item of property in which the plaintiff had remained the absolute owner. This would have been essential to the argument that the knowing receipt claim arose on the date of receipt of the share certificates. This is analogous to the problem of the thief and (proprietary) constructive trusts. Elsewhere, Lord Browne-Wilkinson had suggested that even though the theft victim remained the absolute owner a thief could become a constructive trustee even though there was no legal or equitable title vested in the trustee.[51] This is in the nature of a remedial constructive trust imposed to create the equity for intervention. Such an extraordinary step should be taken, if at all, only if it is clear that legal remedies are manifestly inadequate. An analogous difficulty also arises if the plaintiff had chosen to sue in unjust enrichment on the basis of benefits conferred under a void contract. This would have been an advantageous course of action because the claim is based on strict liability for the value received subject to change to position (which the bank would not have been able to make out on account of its unconscionable or irrational conduct).[52] However, the question is whether a defendant is enriched by the receipt of property of which the plaintiff remains the absolute owner has not been answered by the common law.

24. Thirdly, and this is probably the most intriguing aspect of this decision, it discusses the quantum of liability for knowing receipt, a point that is rarely subjected to judicial or academic attention. Because the liability is cast as one for equitable compensation, the focus is on what loss has been suffered by the plaintiff. Significantly, the court, citing *Target Holdings Limited v. Redferns*,[53] focussed on the need to establish that the loss would not have occurred *but for* the breach of duty by the defendant.[54] The court held that in the circumstances, the quantum of equitable compensation should be fixed at the date the bank sold the shares, even if the liability for knowing receipt arose some 18 months earlier on the date of receipt.[55] Significantly, the court noted that the on the uncontested evidence, P would have held on to the shares if they had been returned, until they became worthless, and that P

Tucker, N Le Poidevin, E Simpson and J Brightwell, *Lewin on Trusts* (18th ed, 2008) at [42.03] and [42.83]-[42.97].

[51] *Westdeutsche Landesbank Gironzentrale v Islington London Borough Council* [1996] AC 669 at 716.

[52] This was why Lord Nicholls thought that knowing receipt is generally irrelevant in the situation where an agent in breach of fiduciary duty enters into a contract under which property of the principal is transferred to the defendant and the contract is then set aside, in *Criterion Properties plc v. Stratford UK Properties LLC* [2003] 1 WLR 2108 at [4].

[53] [1996] 1 AC 421 at 434. Whether this case actually stands for the restorative or reparative measure remains to be decided in English and Singapore law. In Australia, it has been explained on the restorative measure: *Youyang Pty Ltd v Minter Ellison Morris Fletcher* (2003) 212 CLR 484, [2003] HCA 15.

[54] [2010] HKCFA 63 at [131], [151]-[152].

[55] [2010] HKCFA 63 at [153].

was in fact better off as a result of D's breach of duty.[56] So strong was the judicial desire to arrive at the same quantum at common law and in equity that the court observed that it would have been prepared to refashion the equitable rules had a different conclusion been reached.[57]

25. If the equitable compensation is intended to restore a fund to its state before the breach, and the constructive trust arose at the time of receipt, then the court appeared to have awarded too little. If the equitable compensation is intended to repair the actual losses suffered by P, then P could not point to any loss suffered *but for* the breach by D in failing to return the share certificates. After all, *Target Holdings* held that equitable compensation should be assessed at the date of trial with the full benefit of hindsight.[58] The clue lies in another part of the judgment discussing P's entitlement to interest, where the court noted that D had no duty to preserve the *value* of the property.[59] Thus, it is suggested that the measure of equitable compensation awarded in the case was in fact the restorative measure, but the value of the property was fixed at the time of the sale. Under the restorative measure, considerations of causation, remoteness and mitigation are irrelevant in the assessment; the only question is the valuation of the property. On the other hand, had consequential losses additionally been claimed, these losses would have been subjected to the tests of causation, remoteness and mitigation.

The Conversion Analogy

26. So far, we have seen the judicial rejection of, or at least the lack of enthusiasm for, the unjust enrichment analysis of the typical situation where unjust enrichment applies. What appears instead is the fault-based liability which arises because of the retention and inconsistent dealing with property. The alignment of the measure of loss with the tort of conversion presses the conversion analogy even further: the restorative measure in equity to reinstate the trust fund corresponds to the damages vindicating the property rights of the plaintiff in the tort of conversion.

27. One must approach any legal analogy with caution. The modern common law has a single system of property law comprising legal and equitable interests; there are not two systems of property laws.[60] Nevertheless, different incidents may flow from legal or equitable property

[56] [2010] HKCFA 63 at [153]-[154].
[57] [2010] HKCFA 63 at [155].
[58] [1996] 1 AC 421 at 438.
[59] [2010] HKCFA 63 at [159].
[60] *Tinsley v Milligan* [1994] 1 AC 340 at 371.

interests for historical and structural reasons. Judicial development of the law is necessarily constrained by doctrines and judicial precedents. On the other hand, the desire not to have different outcomes in common law and equity is not simply an academic aspiration. The law should be as rational and simple as possible.

28. Moreover, conversion is not an example of the common law at its lucid best. The tort of conversion serves three different functions in the law within a single set of liability rules.[61] It is thus not surprising that it difficult to rationalise the rules internally. First, for want of another tool, conversion serves to protect the plaintiff's property rights at law. Secondly, as a tort it seeks to compensate the plaintiff for losses due to wrongful conduct of the defendant. Thirdly, it also strives to prevent the defendant from being unjustly enriched. Thus, strict liability is imposed on those who detain or deal inconsistently the plaintiff's property because the common law has no means of ordering the return of property. To reconcile with its role of property protection, "wrong" in this context is defined by the voluntary interference with the plaintiff's property right rather than any blameworthy conduct as such. The "loss" is, unlike the rest of tort law, not measured strictly terms of putting the plaintiff in the position as if the tort had not occurred, but also takes into account the loss of value in property, in vindication of property rights. The latter type of loss (like the restorative measure in equity) is not subject to any consideration of causation, remoteness or mitigation rules. Savings in expenditure and profits made from converted property may also be claimed, either as part of the loss (use value of property) or as account of profits. Lord Nicholls suggested splitting up the law of conversion such that the restitutionary aspect of the claim can remain based on strict liability (on the basis of property protection and unjust enrichment principles), but that the liability for losses should be based on fault, possibly dishonesty.[62] He noted the particular hardship that strict liability in the tort of conversion may cause the defendant who no longer possesses the goods.[63] From this perspective, it appears that equity has performed better, in differentiating between proprietary and personal accountability claims.

Defences

29. If the basis of liability for knowing receipt lies in the law of wrongs and not unjust enrichment, then it follows that the change of position defence, which is exclusive to the law

[61] A Tettenborn, "Conversion, Tort and Restitution", in N Palmer and E McKendrick, *Interests in Goods* (2nd ed, 1998) 825.
[62] *Kuwait Airways Corpn v Iraqi Airways Co (Nos 4 & 5)* [2002] 2 AC 883 at [79].
[63] Ibid, at [80].

of unjust enrichment, does not apply. In any event, given the convergence of the standard for disapplying the change of position defence and the standard of liability for knowing receipt,[64] the establishment of liability would practically rule out the defence anyway.[65]

30. It has generally been assumed that a claim in knowing receipt would be characterised as restitutionary for choice of law purposes and be subject to the choice of law rules for restitution,[66] but this was at a time when the "receipt-based" liability view held sway in English law. In general, the proper law of a restitutionary obligation is determined in the following manner: (a) if the obligation arises in connection with immovable property, the proper law of the restitutionary obligation is the *lex situs*; (b) if the obligation arises in connection with a contract, the proper law of the restitutionary obligation is the proper law of the contract; and (c) in other cases, the proper law of the restitutionary obligation is the law of the place of enrichment.[67] Now that "receipt-based" liability has given way to wrongful retention of or inconsistent dealing with property as the foundation of liability, the relevant choice of law rule requires reconsideration. After all, claims in conversion are subject to tort choice of law rules. Where an equitable duty arises from a factual matrix where the relationship between the parties is essentially tortious, this requires the application of torts choice of law rules, ie double actionability (actionability under the law of the forum as if the wrong had been committed in the forum, and civil liability under law of the place where the wrong was committed) subject to a flexible exception.[68] Most of these cases attract the place of enrichment rule anyway if characterised as restitutionary, and this is usually also the place of the tort if so characterised (the wrongful detention).[69] However, the law of the forum limb could make a difference in some cases.

Conclusion

31. If we decide that knowing receipt is indeed a wrong we should take the logical steps to rationalise it as such. The developments in *Charter Plc v City Index* in England and the

[64] *Niru Battery Manufacturing Co v Milestone Trading Ltd* [2004] QB 985 (CA); *Seagate Technology Pte Ltd v Goh Han Kim* [1995] 1 SLR 17 (CA).
[65] *Bank of Credit and Commerce International (Overseas) Ltd v Akindele* [2001] Ch 437 at 456, [2000] EWCA Civ 502.
[66] *Kartika Ratna Thahir v PT Pertambangan Minyak dan Gas Bumi Negara (Pertamina)* [1994] 3 SLR 257 (CA); *El Ajou v Dollar Land Holdings plc* [1993] 3 All ER 717 at 736, reversed on other grounds in [1994] 2 All ER 685 (CA); *Kuwait Oil Tanker Co SAK v Al Bader (No 3)* [2000] 2 All ER Com 271 (CA); *Haji-Ioannou v Frangos* [1999] 2 Lloyd's Rep 337 (CA); *Arab Monetary Fund v Hashim* 15 June 1994.
[67] *CIMB Bank Bhd v Dresdner Kleinwort Ltd* [2008] 4 SLR 543 (CA), adopting Rule 230 of *Dicey, Morris and Collins on the Conflict of Laws* (14th ed, 2006). Compare Yeo, Choice of Law for Equitable Doctrines (2004) at [8.67] and [9.30].
[68] *Rickshaw Investments Ltd v Nicolai Baron von Uexkull* [2007] 1 SLR 377 (CA).
[69] See, eg, *Focus Energy Ltd v Aye Aye Soe* [2009] 1 SLR 1086 at [37].

Thanakharn case in Hong Kong represent incremental steps in this direction. Although the Singapore courts have not gone to the same extent, these developments are highly relevant for the courts to consider how they want to develop Singapore law.

32. These steps taken in England and Hong Kong SAR explicitly carve out the law on knowing receipt from the law of restitution to the extent that the latter means the law of unjust enrichment. By explicitly recognising the remedy as equitable compensation, it places knowing receipt clearly in the law of equity and trusts, or from a different classification perspective, the law of wrongs. This has implications beyond the debate on the standard of liability. On this basis, liability is measured by the loss to the plaintiff, but this includes loss in the value of property taken from the trust. Change of position is an irrelevant defence both in theory and practice. Causation, remoteness and mitigation are not relevant when it comes to the restorative measure of compensation, but may be relevant in respect of consequential losses. However, the value of the property to be restored must still be assessed, and this is not necessarily the value of the property at the time of receipt. Further, the assumption that the choice of law rules for restitution applies to claims in knowing receipt will need to be reconsidered. Finally, the analogy with the tort of conversion needs to be approached with some caution.

33. Whether there is an alternative cause of action in unjust enrichment based on the receipt of equitable property (or perhaps property otherwise subject to a fiduciary institution) is a different question. It has been rejected by the Australian High Court, the Hong Court of First Instance and the English Court of Appeal, but the Supreme Court in the UK has yet to consider the question. It appears to have been rejected implicitly by the Singapore Court of Appeal, but it is not clear whether counsel had pressed the argument. On the whole the judicial acceptance of this line of argument looks increasingly unlikely.