

## Feature

### KEY POINTS

- Knowing receipt is an English law claim available to a beneficiary of a trust whose property has been transferred in breach of trust to a recipient whose knowledge renders it inequitable for that property to be received or retained.
- The destruction of the beneficiary's continuing proprietary interest in the property by or before the receipt is fatal to a claim in knowing receipt.
- The decision opens up the possibility of policy adjustment to reflect the different risk profile posed by different types of property and property governed by different applicable laws.

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# Knowing receipt and the proprietary base

A recent High Court decision in a knowing receipt claim against a Saudi Arabian bank has considered the vexed issue of whether a beneficiary must have a *continuing* equitable interest enduring upon receipt of the property by the recipient to establish a knowing receipt claim. In a detailed and well-reasoned judgment Mr Justice Fancourt answered that question in the affirmative.

### KNOWING RECEIPT: THE BASICS

In *El-Ajou v Dollar Land Holdings Plc* (No1) [1994] 2 All ER 685 Hoffman LJ, as he was then, stated that the ingredients for a knowing receipt claim were:

- a disposal of the claimant's assets in breach of fiduciary duty;
- the beneficial receipt by the defendant of assets which are traceable as representing the assets of the claimant; and
- knowledge on the part of the defendant that the assets received are traceable to a breach of fiduciary duty.

The knowledge required of the recipient at stage three "must be such as to make it unconscionable for him to retain the benefit of the receipt" (per Nourse LJ in *BCCI v Akindele* [2001] Ch 437). Knowledge is accordingly fact sensitive.

There are two important points worth making at this stage. First, the recipient is commonly referred to as a "constructive trustee" but this language can be misleading. Whilst a constructive trustee is liable to account for any gain or loss to the trust and to restore the trust property, it is not burdened by the other incidences of a true, express trust relationship.

Second, a claim in knowing receipt is a claim for a personal remedy, namely equitable compensation. In some cases, there may be a concurrent proprietary claim relying on the processes of tracing or following pursued in tandem, but this is not inevitably the case. As a consequence of knowing receipt being a personal claim, a defendant to a knowing receipt claim is not obliged to restore the

specific fund or property received to the beneficiary. Rather, a defendant's liability is to restore an equivalent amount of money.

Notwithstanding this distinction between a personal knowing receipt claim and a proprietary claim to recover trust assets, the language of "receipt" and, in Hoffman LJ's words, "beneficial receipt", carries proprietary undertones. The extent to which knowing receipt depends on a proprietary link between the beneficiary's assets and the assets in the recipient's hands was at the forefront of the dispute in the recent High Court case of *Byers and Dickson (as joint official liquidators of Saad Investments Company Limited) and Saad Investments Company Limited (in liquidation) v Samba Financial Group* [2021] EWHC 230 (Ch) (*SICL v Samba Financial Group*).

### SICL v SAMBA FINANCIAL GROUP

In the latest twist in this long-running dispute between the Saad Investments Company Limited (in liquidation) (SICL) and its joint liquidators on the one hand, and the Saudi-based banking entity, Samba Financial Group (Samba), on the other, the court was required to determine an issue arising out of the second of the *El-Anjou* criteria: does the beneficiary's interest have to subsist after receipt by the defendant?

The claimant company, a Caymans Island registered company, and a beneficiary under various Cayman Island trusts (Trusts) and its liquidators, claimed against Samba in knowing receipt. They alleged that shares in five Saudi Arabian companies (Shares) had been transferred to Samba in breach of trust by Mr Al-Sanea, the trustee, to discharge

part of a debt which he personally owed to Samba.

Rather unusually, whether Samba had the requisite knowledge for a knowing receipt claim was not in dispute in this case. As a result of breaching an unless order imposed in relation to disclosure, Samba was debarred from disputing the factual matters relied upon by the claimants. The consequence was that the claimants' factual allegations of knowledge were therefore taken to be proved. Whilst it was still open to Samba to argue that the facts as pleaded did not constitute sufficient knowledge to render it unconscionable for Samba to retain the Shares (within the meaning of the *Akindele* test), in the event Samba did not dispute that the facts met this threshold.

The case arose in an international context and accordingly English private international rules were applied to determine which governing law applied to determine key issues in the case. The position at trial was as follows:

- The claimants contended that the substantive claim against Samba was governed by English law (or the law of the Cayman Islands but for these purposes that was identical) and thus the claim was in knowing receipt. As a result of the debarring order referred to above, Samba was not permitted to dispute this and so the case proceeded as an English knowing receipt claim. It is worth remarking that in other cross-border knowing receipt claims where the trust property is "located" outside England and Wales and/or the recipient is outside England and Wales, establishing that the claim is governed by English law may not be straightforward.
- The parties agreed that the law of Saudi Arabia, as the *lex situs* of the Shares, applied to determine the effect of registration of the Shares in the name of Samba. The parties disputed

what the effect of registration was. This was resolved in Samba's favour by Mr Justice Fancourt. The effect of the transfer of the Shares to Samba was to extinguish or override SICL's equitable proprietary interest such that Samba took free of SICL's interest from the moment of receipt. The fact that the law of Saudi Arabia may permit a claim for compensation against Samba in these circumstances was not sufficient.

### "AN UNDESTROYED PROPRIETARY BASE"

Samba argued that a knowing receipt claim could only succeed if the claimants could prove "an undestroyed proprietary base". In other words, the claimants had to show that their equitable interest in the Shares continued after receipt, even if only momentarily. If so, then the judge's finding that the equitable proprietary interest was destroyed or overridden by registration would be fatal to the claim.

Conversely, SICL and the liquidators argued that knowing receipt arises where a recipient takes property known to belong to another and known to have been taken without that other's consent. It is a personal claim for an equitable wrong. There is no additional or further requirement of a continuing proprietary interest after receipt which is a condition of a proprietary claim.

Having reviewed the authorities, and the decision of (then) Millett J in *Macmillan Inc v Bishopsgate Investment Trust plc (No3)* [1995] 1 WLR 978 in particular, Mr Justice Fancourt rejected the claimants' arguments. The essence of knowing receipt was receipt of property belonging to another:

"[45] It is clear from these cases that liability in knowing receipt arises where a stranger to the trust receives property to which he is not entitled, knowing that the transfer to him was a breach of trust or fiduciary duty. The equity arises upon receipt of property that belongs to another."

The learned judge criticised the claimants for eliding the ingredients for dishonest assistance requiring proof of dishonesty

– a true "fault-based" liability – with the ingredients required for knowing receipt which could be satisfied whether the recipient was dishonest or not.

"The knowing recipient's liability depends on his knowledge that the property he receives is trust property and is to be dealt with in that way. His receipt is not wrongful in the sense that he has acted dishonestly or culpably (unless he has also dishonestly assisted in the breach of trust), but his liability to deal with the property as if he were a trustee arises at the moment of receipt because of his knowledge that the property is trust property. If the transferee then deals with the property otherwise than as a trustee should (whether by failing to restore it to the trust or by dealing with it as his own) he is at fault and will be liable for the consequences. In those circumstances, a personal claim against the transferee can properly be said to be fault-based, but the reason for liability is that the transferee has knowingly dealt with (or retained) property that belongs to the trust inconsistently with his duty. If the property is not trust property, there cannot be liability of that kind."

The absence of a continuing proprietary interest at the time of receipt on the facts in this case was therefore fatal to the knowing receipt claim. Tantalisingly, the judge hinted that dishonest assistance might have been made out on the facts but noted that no such pleading had been made.

### THE LAND REGISTRATION ACT 2002 ARGUMENT

The absence of a continuing proprietary base is not only an issue which arises in cases where the applicable law is something other than English law. By virtue of s 26(1) of the Land Registration Act 2002 (LRA 2002), in England a transferee obtains good title upon registration notwithstanding that an unregistered limitation on the transferor's powers of disposition (such as that impressed on trustees) rendered the transfer unlawful. In respect of real property subject to

registration, therefore, registration could also sever a continuing proprietary interest thereby defeating knowing receipt claims to this type of property.

Mr Justice Fancourt commented that:

"... absent dishonesty or a pre-existing equity, a registered transferee of land, whose title has priority under the 2002 Act over the equitable interest of the beneficiary, is not liable in knowing receipt, even if he has knowledge that the transfer was made in breach of trust. Notice and knowledge are irrelevant to the scheme of priorities in registered land under the 2002 Act except to the extent that the Act otherwise provides (as it does e.g. in Sched 3, paras 2(c), 3(1)). The equitable interest of the beneficiaries is overridden by the registration of the proprietor and therefore there is no basis for an argument that the proprietor must deal with trust property as if he were a trustee, respecting the proprietary interest of the beneficiary."

### IMPLICATIONS FOR THE FUTURE

The decision puts beyond doubt the need to show a proprietary link in knowing receipt claims. There are a number of implications to consider for the future.

- **Narrowing of the potential knowing receipt liability:** A knowing receipt claim can only succeed if the beneficiary's interest continues at the moment of receipt. This will have the effect of ruling out claims against banks who receive property governed by a *lex situs* which holds that a transferee takes good title on receipt. It will also rule out claims in English law in specific cases where statute or other legislative provisions provide for the transferee to obtain good title.
- **The basket of shares issue:** As the claimants pointed out, the consequence of the ruling is that a defendant bank's liability in knowing receipt for receipt of "a basket of shares" will be different in respect of the *lex situs* of each of the shares (or other property). Mr Justice Fancourt noted that this was merely the

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### Biog box

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ordinary consequence of the English private international rules which applies the law of another country if certain criteria is met. The learned judge considered that it was an inconvenience which a beneficiary is taken to have accepted when it took an interest in property governed by that law. One might add that it is a risk which a bank takes when accepting the transfer of a “basket of shares”.

- **English real property:** Similarly, a bank’s liability even in a purely domestic context will differ depending on the nature of the property, and in particular whether the effect of the transfer on property rights is governed by the general law or a specific and different set of rules, such as the LRA 2002.
- **Incongruous effects:** There is a sense that the ruling in *SICL v Samba Financial Group* has the effect of rewarding an unconscionable recipient if, by or prior to the transfer, they succeed in destroying or overriding the beneficiary’s interest. Whilst a claim in dishonest assistance may in theory lie in many knowing receipt situations, in reality it is difficult to establish the relevant level of dishonesty, especially in cases involving banks.
- **Potential inconsistency with ministerial receipt:** A rigid insistence upon the beneficiary having an interest in the transferred property in a strict legal sense is arguably at odds with the approach to ministerial receipt cases where the bank’s strict proprietary rights to the property are not determinative of the question of receipt. Rather the courts look to the person or entity which takes the economic benefit of the property.
- **An increased role for dishonest assistance:** The narrowing of the knowing receipt cause of action and the general tenor of the judgment being that a dishonest assistance claim may have met with success, may lead to an increased tendency to see dishonest assistance claims run instead of, or as well as, knowing receipt claims. Yet it can

be difficult to discharge the evidential burden of proving dishonesty in such cases and running dishonest assistance as an automatic alternative to knowing receipt is also likely to significantly increase the evidence which a claimant adduces, leading to a concomitant increase in costs.

### PRACTICE POINT

The current state of the law is therefore that a knowing receipt claim will only succeed if the beneficiary can show a continuing beneficial interest in the property after receipt by a transferee. Whether a claim will suffer from this fatal flaw will depend upon the particular property and the applicable law. Further, any particular English judgment on whether a particular applicable law recognises a continuing proprietary interest will be case-specific, based upon the evidence and in particular the expert evidence which was adduced and accepted in that particular case. In theory it is possible for another court faced with an analogous question to decide the proprietary question differently. The possibilities are in many respects manifold.

On the other hand, the decision in *SICL v Samba* does open up the possibility of banks developing policies and procedures specific to the nature of the trust property received or the *lex situs* of the trust property. Most obviously, banks may in future be more willing to accept trust property which can be registered and so take the benefit of s 26(1) of the LRA.

### CONCLUSION

*SICL v Samba Financial Group* is firm authority for the proposition that knowing receipt requires a claimant to prove a continuing equitable interest in the property after receipt by a defendant. In many “pure” English cases this adds little. English law recognises the concept of the trust and hence a continuing equitable interest after transfer in breach of trust, save where a recipient has a bona fide purchaser defence. However, in cases where the proprietary interest is not governed by the general law or is governed by a different applicable law, the decision in

*SICL v Samba Financial Group* will have an impact.

The judgment is well-reasoned and relies on earlier High Court authority which was approved by the Court of Appeal. In many cases that might be enough to doubt the prospects of the claimants upon appeal, permission for which was granted by Mr Justice Fancourt. However, the case in an earlier incarnation has already been to the Supreme Court ([2017] UKSC 6), and on a separate issue to the Court of Appeal ([2019] EWCA Civ 416), so it is almost certain that we have not heard the last of *SICL v Samba Financial Group*. ■

### Further Reading:

- Teaching an old dog new tricks: liability of banks in equity for misappropriated funds (2016) 8 JIBFL 451.
- Wrongful dealing with trust property: time for a clearer approach? (2011) 4 JIBFL 191.
- LexisPSL: Bona fide purchase, knowing receipt and proprietary claims to land and carbon credits.