

RESEARCH ARTICLE

# Security interests and knowing receipt

Jamie Glister\*<sup>†</sup> 

The University of Sydney, Sydney, Australia

\*Author email: [jamie.glister@sydney.edu.au](mailto:jamie.glister@sydney.edu.au)

(Accepted 11 November 2022)

## Abstract

Third parties who receive trust property with knowledge that the transfer to them was a breach of trust will be liable in knowing receipt. Knowing receipt has grown quickly in importance in recent years and many of the finer points of the doctrine are still being worked out. This paper discusses one such issue: whether liability can exist when the third party acquires a security interest in trust property, rather than the underlying trust property itself. This point has not yet been considered by English courts, although it has been examined in cases from Australia, Canada and Hong Kong. The paper analyses the existing authorities in the context of the wider law relating to knowing receipt and explains the conceptual difficulties and practical problems with allowing liability to be grounded on the receipt of a mere security interest in trust property.

**Keywords:** property and trusts; equity; knowing receipt; constructive trusts

## Introduction

This paper is concerned with whether English law ought to recognise liability in knowing receipt when the third party acquires a mere security interest in respect of trust property instead of obtaining the trust property itself.<sup>1</sup> This is a difficult question for two main (and linked) reasons. First, authority provides that knowing receipt can only be grounded on the receipt of trust property or its traceable proceeds. This property base is important. However, while traditional security interests do involve the transfer or acquisition of proprietary rights, other devices that perform a security function do not. Secondly, the classical formulation of knowing receipt involves the third party receiving ‘some part of the trust property’.<sup>2</sup> The idea is that the trust property, or part of it, is wrongly transferred to a third party. Yet this is not what usually happens when security interests are granted over property: new rights are created, rather than existing ones transferred.<sup>3</sup>

If a trustee wrongly grants a security interest over trust property to a third party, and if that third party knows of the trustee’s lack of authority, then the most straightforward response is to hold the security interest unenforceable. This avoids any question of knowing receipt, and the outcome will be satisfactory if all the claimant seeks is non-enforcement of the security interest. However, such a neat solution will not work in all cases. The claimant may have suffered loss by not being able to

<sup>†</sup>An early version of this work was presented as part of the Global Seminars in Private Law Theory series. I thank Lionel Smith for hosting the seminar and all the participants for their insightful comments. I also thank Matthew Conaglen and two anonymous referees for their helpful comments on more recent drafts.

<sup>1</sup>The term ‘trust property’ is used here in its wide sense, to include property controlled subject to fiduciary obligations. Knowing receipt is available outside the context of strict trusts, although the correctness of this position has been doubted: see eg R Stevens ‘The proper scope of knowing receipt’ (2004) *Lloyd’s Maritime and Commercial Law Quarterly* 421.

<sup>2</sup>*Barnes v Addy* (1874) LR 9 Ch App 244 at 252.

<sup>3</sup>The exception is the general law mortgage, where existing rights are transferred to the mortgagee and new rights (the equity of redemption) are created in the mortgagor.

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deal with the secured property in the meantime, or the defendant may have made a gain through holding the security interest. Also, events may simply have moved on: the security may have been realised and arguments about enforceability become moot. It will be necessary in such cases to decide whether a claim in knowing receipt lay when the security interest was initially granted.

This paper identifies and explains the difficulties with allowing knowing receipt to be grounded on the receipt of a security interest in trust property. The general issue of security interests and knowing receipt has not yet been considered in England and Wales, although it has been examined in Australia, Canada, and Hong Kong. The paper begins in Section 1 by discussing the importance of the receipt of trust property for liability in knowing receipt. It will be seen that the basis of liability in this area is slightly different in Canada, and this is significant because the Supreme Court of Canada is the only ultimate appellate court to have considered the security interest point in depth. Section 2 outlines some conceptual difficulties with knowing receipt being grounded on the acquisition of security interests. Section 3 then discusses the existing authorities on the point. The conclusion in all the current cases is that security interests can indeed ground knowing receipt, but the reasoning is often weak. Section 4 identifies several further problems that arise from security interests being able to ground knowing receipt. The final section concludes that the best option is for the law to permit knowing receipt to be grounded on the traditional security interests, but not on the wider ‘functional’ forms of security. This is the outcome most consonant with the basic tenets of knowing receipt and with other relevant principles of law.

## 1. Trust property

### (a) *The role of property*

Knowing receipt is grounded on the wrongful receipt of trust property with knowledge. Around the end of the twentieth century there were differing views about what level of knowledge (if any) was required,<sup>4</sup> but that issue has now been settled: the recipient’s knowledge must be such as to make it unconscionable for him or her to retain the benefit of the receipt.<sup>5</sup> This paper’s concern is instead with the ‘receipt of trust property’ element of the claim. In *Barnes v Addy* itself, Lord Selborne LC referred to the need for the third party to ‘receive and become chargeable with some part of the trust property’.<sup>6</sup> Much more recently, the Court of Appeal said in the *Novoship* case that ‘receipt of trust property is the gist of the action’.<sup>7</sup> Most cases today involve the receipt of electronic money, but there are also cases involving cheques,<sup>8</sup> land,<sup>9</sup> shares,<sup>10</sup> chattels,<sup>11</sup> and even mining licences<sup>12</sup> and carbon credits.<sup>13</sup>

<sup>4</sup>See S Gardner ‘Knowing assistance and knowing receipt: taking stock’ (1996) 112(1) *Law Quarterly Review* 56. There was also a linked debate about whether knowing receipt ought to be based on unjust enrichment. Important contributions include: P Birks *Restitution – The Future* (Sydney: Federation Press, 1992) ch 2; D Nicholls ‘Knowing receipt: the need for a new landmark’ in W Cornish et al (eds) *Restitution: Past, Present and Future* (Oxford: Hart Publishing, 1998) ch 15; L Smith ‘Unjust enrichment, property and the structure of trusts’ (2000) 116(3) *Law Quarterly Review* 412; P Birks ‘Receipt’ in P Birks and A Pretto (eds) *Breach of Trust* (Oxford: Hart Publishing, 2002) ch 7.

<sup>5</sup>*Bank of Credit and Commerce International (Overseas) Ltd v Akindele* [2001] Ch 437 at 455. It may be that the test as formulated in *Akindele* has survived precisely because it is rather vague.

<sup>6</sup>*Barnes v Addy*, above n 2, at 251–252.

<sup>7</sup>*Novoship (UK) Ltd v Mikhaylyuk* [2014] EWCA Civ 908, [2015] QB 499 at [89]. For full discussion of ‘property’ in this context see J Glister ‘Trust property and knowing receipt’ (2020) 34 *Trust Law International* 3.

<sup>8</sup>*Nelson v Larholt* [1948] 1 KB 339; *Fistar v Riverwood Legion and Community Club Ltd* [2016] NSWCA 81, (2016) 91 NSWLR 732.

<sup>9</sup>*Arthur v AG (Turks and Caicos Islands)* [2012] UKPC 30; *Akita Holdings Ltd v AG (Turks and Caicos Islands)* [2017] UKPC 7, [2017] AC 590. Liability for knowing receipt of land is possible in principle, subject to the effect of legislative postponing and indefeasibility provisions. It remains an open question whether the Land Registration Act 2002 operates to prevent knowing receipt in registered land: see *Byers v Saudi National Bank* [2022] EWCA Civ 43 at [62]–[68], [77], and the sources discussed.

<sup>10</sup>*Thanakharn Kasikhorn Thai Chamkat (Mahachon) v Akai Holdings Ltd (No 2)* [2010] HKCFA 63, (2010) 13 HKCFAR 479.

<sup>11</sup>*Re Montagu’s ST* [1987] 1 Ch 264.

<sup>12</sup>*Diamond Hill Mining Pty Ltd v Huang Jin Mining Pty Ltd* [2011] VSC 288, (2011) 84 ACSR 616.

<sup>13</sup>*Armstrong DLW GmbH v Winnington Networks Ltd* [2012] EWHC 10 (Ch), [2013] Ch 156.

Once receipt with knowledge is established, the defendant becomes liable to account as a constructive trustee. This personal liability to account survives the destruction or transfer away of the original property, and in many cases the knowing receipt claim is valuable precisely because the original property no longer exists. However, even though it is personal relief that is normally sought and ordered, the accountability which yields that personal relief is grounded on a proprietary base.

A further point is that the recipient must *receive trust property* and not merely be benefited by a breach of trust. This is demonstrated by the recent case of *Byers v Saudi National Bank*.<sup>14</sup> A trustee, Mr Al-Sanea, held shares in certain Saudi Arabian banks on trust for the Saad Investments Company Ltd (the trust was governed by Cayman Islands law, which was taken to be relevantly identical to English law). In breach of that trust, Mr Al-Sanea transferred the shares to another Saudi bank, Samba.<sup>15</sup> Saad Investments sought to make Samba liable for knowing receipt of those shares. The problem was that the governing law of the transfer to Samba was Saudi Arabian law, as the *lex situs* of the shares. In findings that were not disturbed on appeal, Fancourt J found that Saudi law recognised an ownership interest in Saad Investments when the shares were held for them by Mr Al-Sanea, but that this ownership interest did not survive the registration of the shares by Samba.<sup>16</sup> This meant Samba acquired unencumbered rights to the shares under Saudi law, and this in turn meant that no claim could be made against Samba in knowing receipt under Cayman/English law. The Court of Appeal held that a claim in knowing receipt requires the beneficiary to have a ‘continuing proprietary interest in the relevant property’,<sup>17</sup> and that this had been lost.

The same principle can be seen in *OJSC Oil Co v Abramovich*,<sup>18</sup> where the value of Mr Abramovich’s shareholding in Sibneft increased when Sibneft acquired other smaller companies. Such acquisition was argued to be in breach of the fiduciary duties owed by the directors of the smaller companies. Christopher Clarke J held that the increased value of Mr Abramovich’s existing shareholding in Sibneft did not involve a receipt of property and so it could not ground knowing receipt.<sup>19</sup> Similarly, in the Australian case of *Quince v Varga*,<sup>20</sup> there was no receipt of property when a trustee wrongly used trust funds to pay off debts owed by a third party, Ms Varga. The trustee paid the money directly to Ms Varga’s creditors, meaning it was never received by Ms Varga herself. However, Ms Varga did knowingly receive other trust money that was paid directly to her, and a car and some electrical goods that were bought with trust money and given to her.

The position is different in Canada, where knowing receipt focuses on the enrichment of the third party rather than on the strict receipt of property by that third party. In *Citadel General Assurance Co v Lloyds Bank Canada*,<sup>21</sup> a bank was liable in knowing receipt when one of its customers used trust money in one account to reduce the same customer’s overdraft on another account. The money was held on trust for Citadel, and the bank received it for the bank’s own benefit when it was used to reduce the customer’s overdraft. This meant there was receipt of trust property on any analysis. But LaForest J, for the Court on the point,<sup>22</sup> stated the principle more widely:<sup>23</sup>

<sup>14</sup>[2021] EWHC 60 (Ch) (Fancourt J); [2022] EWCA Civ 43 (CA). The Supreme Court granted permission to appeal on 3 October 2022.

<sup>15</sup>Samba’s assets and liabilities were transferred to The Saudi National Bank during the litigation.

<sup>16</sup>[2021] EWHC 60 (Ch) at [181], [199], [205]. Not disturbed on appeal: [2022] EWCA Civ 43 at [112].

<sup>17</sup>[2022] EWCA Civ 43 at [79]. ‘A defendant cannot be liable for knowing receipt if he took the property free of any interest of the claimant’: *ibid*.

<sup>18</sup>[2008] EWHC 2613 (Comm).

<sup>19</sup>*Ibid*, at [365]. See also *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch) at [1891] (infringing a design right is not receiving property).

<sup>20</sup>[2008] QCA 376, [2009] 1 Qd R 359.

<sup>21</sup>[1997] 3 SCR 805.

<sup>22</sup>Or at least six members of the Court. Sopinka J agreed with LaForest J but made that agreement subject to what he said in the twin case of *Gold v Rosenberg* [1997] 3 SCR 767. Since, in *Gold*, Sopinka J had thought there was no relevant receipt, he may have taken a stricter view on the requirement for trust property.

<sup>23</sup>[1997] 3 SCR 805 at [30] (citations omitted).

In my view, the receipt requirement for this type of liability is best characterized in restitutionary terms. ... [T]he function of the law of restitution 'is to ensure that where a plaintiff has been deprived of wealth that is either in his possession or would have accrued for his benefit, it is restored to him'. In the present case, the Bank was clearly enriched by the off-setting of debt obligations. As well, the Bank's enrichment deprived Citadel of the insurance premiums collected on its behalf. Moreover, the fact that the insurance premiums were never in Citadel's possession does not preclude Citadel from pursuing a restitutionary claim. After all, the insurance premiums would have accrued to Citadel's benefit. The Bank has been enriched at Citadel's expense. Thus, in restitutionary terms, there can be no doubt that the Bank received trust property for its own use and benefit.

In this way, the Canadian law of knowing receipt is more concerned with unjust enrichment and restitution than is English or Australian law.<sup>24</sup> In Canada the enrichment can occur by receiving trust property, as is required in England and Australia, but it can also occur indirectly. This is important because the only proper ultimate appellate court analysis of the security interests point that is the focus of this paper can be found in another Canadian case, *Gold v Rosenberg*.<sup>25</sup> As we will see in Section 2, a majority in *Gold v Rosenberg* thought that receipt of a mortgage over land could ground knowing receipt. But that was in the context of a particular view being taken of the nature of knowing receipt.

#### (b) Traceable substitutes

Third parties must receive property to be liable in knowing receipt, but the property received need not be the same asset that was originally held on trust. Knowing receipt can also be based on the receipt of traceable substitutes of the original trust property. This has already been seen in *Quince v Varga*,<sup>26</sup> where Ms Varga was not only liable for the trust money she knowingly received but also for a car and some other goods that were bought for her with trust money.

The clearest examples of knowing receipt being based on traceable substitutes involve electronic money. In *El Ajou v Dollar Land Holdings plc*,<sup>27</sup> the proceeds of a fraud were traced through bank accounts in Switzerland, Gibraltar and Panama and eventually into land in London held by the defendant, Dollar Land Holdings. The tracing question was rather difficult, because there were many victims of the fraud, and the notional charge was employed to trace into and through several mixed bank accounts. Ultimately, Mr El Ajou was able to ground his knowing receipt claim on his being entitled in equity to *all* the traceable proceeds of the fraud received by Dollar Land Holdings, even though there were other victims of the same fraud who could have made similar claims.<sup>28</sup>

*Relfo Ltd v Varsani* is a similar case.<sup>29</sup> Mr Varsani was liable for knowing receipt of misdirected funds from a UK company that were traced through bank accounts in Latvia, Lithuania and Singapore. At trial, Sales J was able to identify a sufficient link between a sum of money paid into

<sup>24</sup>See *Gold v Rosenberg* [1997] 3 SCR 767 at [41], per Iacobucci J: 'unjust enrichment is the essence of a claim in knowing receipt'. Iacobucci J was in dissent in *Gold*, but his approach was approved by the Supreme Court in the twin case of *Citadel General Assurance Co v Lloyds Bank Canada* [1997] 3 SCR 805 at [13].

<sup>25</sup>[1997] 3 SCR 767; discussed below, n 42. *Gold* and *Citadel* concern the same principles and were released together. They 'remain the leading decisions on knowing receipt': *Zhu v Zhang* 2021 BCSC 2524 at [124].

<sup>26</sup>[2009] 1 Qd R 359. See also *Dubai Islamic Bank PJSC v PSI Energy Holding Co BSC* [2013] EWHC 3781 (Comm), where misdirected money ended up as shares (though there were other routes to recovery there).

<sup>27</sup>[1993] 3 All ER 717 (Millett J); reversed [1994] 2 All ER 685 (CA). Millett J and the Court of Appeal differed on whether knowledge could be imputed to DLH.

<sup>28</sup>*El Ajou v Dollar Land Holdings plc (No 2)* [1995] 2 All ER 213. All the traceable proceeds, £2.325m, were still less than Mr El Ajou's losses, which exceeded £5m. El Ajou agreed to indemnify DLH if other claims emerged.

<sup>29</sup>[2012] EWHC 2168 (Ch) (Sales J); [2014] EWCA Civ 360, [2015] 1 BCLC 14 (CA). That Mr Varsani was ultimately liable for knowing receipt is clearer from Sales J's judgment.

a Latvian account and a similar sum of money paid out of a Lithuanian account.<sup>30</sup> When Mr Varsani then received the Lithuanian payment into his Singapore account, he had received the traceable substitute of the misdirected UK money. The Court of Appeal agreed.

## 2. Acquiring security interests and receiving trust property

### (a) Security interests

In most knowing receipt cases, the recipient takes legal title to the property in question: there is simply a wrongful transfer of legal title from the trustee to the third party. While this is the usual situation, there is no reason why receiving an equitable interest cannot also ground knowing receipt. For example, consider a trustee holding shares on trust for beneficiaries. The trustee may hold those shares directly and be the legal owner of the shares. Alternatively, the trustee's interest may itself be equitable because legal title to the shares is held by a nominee (such as a bank) rather than by the trustee. In either case, the beneficiaries can bring a claim in knowing receipt if the trustee wrongly transfers the trustee's interest – whether legal or equitable – to a third party. The third party receives the same interest that the trustee had, and the receipt of this interest grounds knowing receipt, assuming knowledge is also present. Receipt of trust property in these cases is clear.

The position is less clear when a trustee wrongly grants a security interest in trust property to a third party, and it is further clouded because the term 'security' can be used in both narrow and broad senses.<sup>31</sup> In the narrow sense, English law recognises mortgages, charges (both equitable charges and statutory land charges), pledges, and contractual liens as security interests.<sup>32</sup> Each involves the secured party acquiring a proprietary interest in the collateral, but the devices differ in their proprietary effects. A mortgagee under a general law mortgage takes a transfer of rights from the mortgagor; this means the mortgagor receives the same property that the mortgagee held, although the mortgagee takes it subject to an equity of redemption rather than absolutely. The orthodox position in respect of charges is that a fixed charge grants an immediate equitable proprietary interest in the charged property.<sup>33</sup> A similar analysis applies to statutory charges over land, although the interest in that case is commonly described as legal. Floating charges are more complicated, but there is still high authority to the effect that the chargee acquires an immediate proprietary interest, subject to the chargor's power to remove assets from the security.<sup>34</sup> Pledges and lienees also acquire a limited proprietary interest in the relevant goods.

<sup>30</sup>[2012] EWHC 2168 (Ch) at [77]. See also *Fistar v Riverwood Legion and Community Club Ltd* (2016) 91 NSWLR 732 at [60]–[63] (tracing trust money into a bank cheque).

<sup>31</sup>See discussion in J McGhee and S Elliott (eds) *Snell's Equity* (London: Sweet & Maxwell, 34th edn, 2020) ch 36.

<sup>32</sup>See *Re Cosslett (Contractors) Ltd* [1998] Ch 495 at 508 (Millett LJ). Note that Millett LJ's list was concerned with the general law and so he did not include statutory land charges. The Cosslett litigation ultimately reached the House of Lords, but nothing was said to undermine Millett LJ's analysis on the security point: *Smith (Administrator of Cosslett (Contractors) Ltd) v Bridgend County Borough Council* [2002] 1 AC 336.

<sup>33</sup>*Société Eram Shipping Co Ltd v Cie Internationale de Navigation* [2004] 1 AC 260 at [87]; *Re Spectrum Plus Ltd (in liq)* [2005] 2 AC 680 at [138]; *Re Lehman Brothers International (Europe) (In Administration)* [2012] EWHC 2997 (Ch) at [43]. The Singapore Court of Appeal has said that the holder of a fixed charge prior to default only has a property interest in a 'narrow' sense: *SCK Serijadi Sdn Bhd v Artison Interior Pte Ltd* [2019] SGCA 05 at [18]; see H Tjio 'Merrill and Smith's intermediate rights lying between contract and property: are Singapore trusts and secured transactions drifting away from English law towards American law?' (2019) *Singapore Journal of Legal Studies* 235 at 253–255.

<sup>34</sup>See *Re Spectrum Plus Ltd (in liq)* [2005] 2 AC 680 at [139] per Lord Walker: 'The chargee has a proprietary interest, but its interest is in a *fund* of circulating capital' (original emphasis); R Nolan 'Property in a fund' (2004) 120(1) *Law Quarterly Review* 108; *Snell's Equity*, above n 31, ch 40. Contrast *Lyford v CBA* (1995) 130 ALR 267 at 273 (Fed Ct Aus); *Diablo Fortune Inc v Duncan* [2018] SGCA 26 at [47]; WJ Gough *Company Charges* (London: Butterworths, 2nd edn, 1996) p 347, taking the view that a proprietary interest only arises on crystallisation. See discussion in S Worthington 'Floating charges: use and abuse of doctrinal analysis' in J Getzler and J Payne (eds), *Company Charges: Spectrum and Beyond* (Oxford: Oxford University Press, 2006) pp 37–44.

The cases discussed later in this paper normally involve mortgages and charges. Few cases genuinely involve pledges,<sup>35</sup> and I am not aware of any involving liens. But ‘security’ can also be used in a broader sense, beyond these traditional forms of security, to include other rights that have the effect of making it more likely that a debt will be paid (and which can therefore be said to secure that debt). These devices, such as guarantees and indemnities, do not involve the acquisition of any proprietary rights by the secured party. However, while such devices do not provide security in the narrow sense, they still perform a security function.

This all means there are several difficulties in saying that a third party receives trust property when they acquire a security interest in respect of trust property. These difficulties are now outlined to provide a background against which the existing cases can be analysed.

### (b) Problems

First, and most obviously, some forms of functional security do not involve the granting of proprietary rights at all. Someone who obtains the benefit of a guarantee or an indemnity will have acquired valuable rights, but these are not property rights. Nonetheless, at least one case has grounded knowing receipt on the acquisition of these personal rights.<sup>36</sup>

Secondly, even where the third party does acquire proprietary rights, these rights are not normally transferred from the trustee to the third party. When an equitable charge is granted, the chargee acquires *newly created* property rights; the chargee does not take a transfer of *existing* rights. The same is true when a secured party takes a statutory land charge, or a pledge or lien: new rights are created, not existing ones transferred. The only exception is the general law mortgage, where the mortgagee does take a transfer of rights from the mortgagor (although the mortgagee holds those rights subject to the mortgagor’s equity of redemption). This important distinction between the creation and transfer of rights was noted by Lord Scott in the *Criterion Properties* case:<sup>37</sup>

The word ‘receipt’ in the expression ‘knowing receipt’ refers to the receipt by one person from another of assets. A person who enters into a binding contract acquires contractual rights that are created by the contract. There may be a ‘receipt’ of assets when the contract is completed and the question whether there is ‘knowing receipt’ may become a relevant question at that stage. But until then there is simply an executory contract which may or may not be enforceable. The creation by the contract of contractual rights does not constitute a ‘receipt’ of assets in the sense that a ‘knowing receipt’ involves a receipt of assets.

*Criterion Properties* concerned a ‘poison pill’ agreement between the claimant and defendant. The claimant argued that, in acquiring rights under this agreement, the defendant had received property for the purposes of knowing receipt. The House of Lords held that this argument was misconceived, and that attention should instead be focused on whether the claimant’s directors had acted within the scope of their authority in entering into the agreement. It will be seen that Lord Scott refers to the creation of *contractual* rights as being distinct from a transfer of assets, and this is understandable given the context of the decision. But the point also has weight in relation to the creation of new proprietary rights.

<sup>35</sup>Arrangements described as pledges are more likely to be legal or equitable mortgages, or at most pledges of share certificates: see *Thanakharn Kasikhorn Thai Chamkat (Mahachon) v Akai Holdings Ltd (No 2)* (2010) 13 HKCFAR 479, discussed below, n 62; *Qilin World Capital Ltd v CPIT Investments Ltd* [2018] SGCA(I) 01 at [4]: ‘The Loan was secured on 25 million shares (“the Pledged Shares”). The expression “Pledged Shares” is a misnomer. The process of pledging applies to choses in possession. A share is a chose in action, not a chose in possession’. The position is different in Canada and the USA: see L Smith *The Law of Tracing* (Oxford: Oxford University Press, 1997) p 97.

<sup>36</sup>*Westpac Banking Corp v The Bell Group Ltd (in liq) (No 3)* [2012] WASC 157, (2012) 44 WAR 1, discussed below, n 55.

<sup>37</sup>*Criterion Properties plc v Stratford UK Properties LLC* [2004] 1 WLR 1846 at [27]. See *Rolled Steel Products (Holdings) Ltd v British Steel Corp* [1986] Ch 246 at 298 (later payments made pursuant to a wrongly given guarantee: the later payments could ground knowing receipt).

Thirdly, these newly created rights do not detract from the original rights held by the trustee – at least in the paradigm case of charges. This is because charges are engrafted on to, not carved out of, the property they encumber.<sup>38</sup> This means both that the charge is a new item of property that did not previously exist (much less was it held on trust) and also that the original property remains in unaltered form.<sup>39</sup> It is therefore difficult to see the security interest as constituting part of the original trust property.

Fourthly, it might be argued that the economic value of the trust property is reduced when security is granted over it, and in this way the secured party receives a traceable substitute of the trust property. However, while superficially attractive, this argument is weak. The mere granting of security over assets does not deplete the value of those assets. Millett J pointed this out in *Re MC Bacon Ltd*,<sup>40</sup> in finding that a company had not entered into a transaction at an undervalue when it granted a charge to a bank. Also, there is an element of circularity to the argument in the knowing receipt context: any diminution in value would only exist to the extent the charge is enforceable, and ex hypothesi a charge will not be enforceable if it can be used to make its holder liable in knowing receipt.

The circularity just mentioned also points to a possible broader issue. If the security interest has not yet been realised, and if the conclusion is that the security interest is not enforceable, then it is not clear that any rights have been received at all (at least outside general law mortgages and legal land charges). This would matter if the claimant sought some remedy beyond the mere non-enforcement of the security interest: for example, compensation for loss suffered because the claimant was unable to sell the secured property in the meantime. Such remedies would be unavailable if it was decided that, in fact, no receipt had ever occurred. That all said, it is doubtful that this point will really trouble judges. It would be very surprising to decide that a wrongly granted security interest was unenforceable because of the knowledge of the recipient, and then to say the recipient's naughtiness operated in his own favour to strip away the basis of the claimant's action.

Finally, Singaporean authority provides that, if property subject to an equitable mortgage is wrongly transferred to a third party, that third party cannot be liable in knowing receipt. This is because the holder of an equitable mortgage in property does not have a sufficient proprietary interest in that property to ground a claim in knowing receipt against a third party.<sup>41</sup> It would seem odd to say that the holder of an equitable mortgage does not have sufficient property rights to ground a *claim* in knowing receipt, yet the person who acquires an equitable mortgage (or other similar security) has received sufficient rights to ground *liability* in knowing receipt.

### 3. Existing authorities

With these considerations in mind, we can turn to the existing authorities on the question. As will be seen, the current authorities all conclude that security interests can ground knowing receipt. However, their reasons for doing so differ and can often be criticised.

<sup>38</sup>Similarly, the holder of legal title in the case of a pledge or lien retains that title, although the loss of possession does mean loss of the right to sue in conversion.

<sup>39</sup>Comments can be found that doubt the correctness of this proposition. In one of the leading works, Gough explains that an equitable charge involves 'some deduction or subtraction from the ownership of the debtor. ... The debtor in creating a charge transfers or abridges from his ownership the full, unfettered right to deal with the charged property in denial of or derogation from the charge agreement': Gough, above n 34, p 38 (references omitted). That the debtor retains the power *at law* to deal with the charged property in denial of the chargee's interest is shown by a wrongful transfer of charged property still being valid at law. And, if the recipient is a bona fide purchaser, they take free of the charge.

<sup>40</sup>[1990] BCC 78 at 92, discussing the Insolvency Act 1986, s 238. See also *Shalson v Russo* [2005] Ch 281 at [176] (same applies to IA 1986, s 423). In *Ultraframe (UK) Ltd v Fielding* [2006] EWHC 1638 (Ch) at [1389], Lewison J thought the same considerations applied to the Companies Act 1985, s 320 ('Substantial property transactions involving directors'; now CA 2006, s 190).

<sup>41</sup>*MKC Associates Co Ltd v Kabushiki Kaisha Honjin* [2017] SGHC 317 at [148]–[157]. Such cases rarely involve knowing receipt because the third party either takes free of the mortgage as a bona fide purchaser or simply takes subject to the equitable mortgage. Here, special circumstances meant it was important to decide if knowing receipt could lie at the point of transfer.

**(a) Canada**

The only full examination of the security interests point by an ultimate appellate court is found in *Gold v Rosenberg*,<sup>42</sup> a case decided by the Supreme Court of Canada. The case concerned a contractual guarantee supported by a mortgage (a legal charge) over certain land in Ontario. A bank made a loan to one company, Trojan, on condition that another company, Primary, guaranteed Trojan's obligations and gave the bank a mortgage over Primary's land to secure that guarantee. The granting by Primary of the guarantee and the mortgage involved a breach of fiduciary duty. Views differed on the question of whether the bank had thereby received trust property for the purposes of knowing receipt. Iacobucci J, with the agreement of LaForest, Cory and Gonthier JJ on the point, thought that the bank had indeed received trust property:<sup>43</sup>

The mortgage, as security for the guarantee, conferred on the Bank a proprietary interest in the trust property. The guarantee provided by Primary, supported by a collateral mortgage over property owned by Primary, in my view, constitutes property which can be made the subject of a knowing receipt claim.

According to Iacobucci J, it was sufficient that the bank received a proprietary interest in the trust property. But Sopinka J, with the agreement of McLachlin and Major JJ, disagreed:<sup>44</sup>

Does the bank receive the trust property into its possession simply because it holds a guarantee supported by a collateral mortgage on that property? I believe it does not. A guarantee is a contract whose performance is contingent on the default of the principal debtor ... If the guarantor supports the guarantee with a mortgage on real property, the creditor only enjoys, at best, a contingent interest in that property. The guarantee supported by the mortgage is no more than a contractual undertaking by the guarantor that, if the principal debtor defaults *and* the guarantor cannot make good the debt from his or her other assets, the creditor *will receive* the trust property.

A majority of the Supreme Court therefore held that the receipt of the guarantee and supporting mortgage could ground knowing receipt.<sup>45</sup> However, a difficulty with *Gold v Rosenberg* is that the judges do not quite engage on the same ground. Iacobucci J focused on the bank's acquisition of a proprietary interest in the relevant land. In contrast, Sopinka J focused on the fact that the bank was several steps away from receiving the land itself. Sopinka J thought the land itself was the relevant trust property, and that the bank had not received that trust property even though it had acquired a mortgage over it. Sopinka J's view is easy to understand: there was simply no transfer of the land. Iacobucci J's view is trickier: it is not clear whether he saw the acquisition of the charge as a form of receipt of the underlying land, or whether he saw the acquisition of the charge as sufficient in itself (that is, whether the proprietary rights granted by the charge were *themselves* seen as part of the trust property). This distinction did not matter in *Gold* itself, because the only question was whether the bank could enforce the mortgage or not. But it may matter in other cases.

In addition to the bank acquiring a proprietary interest in the land, Iacobucci J also gave two alternative reasons for his conclusion that the bank had received trust property. The first was as follows:<sup>46</sup>

<sup>42</sup>[1997] 3 SCR 767.

<sup>43</sup>[1997] 3 SCR 767 at [54].

<sup>44</sup>[1997] 3 SCR 767 at [72] (citations omitted, original emphasis).

<sup>45</sup>The appeal was dismissed by majority and the bank was held not liable in knowing receipt. The majority was Sopinka, Gonthier, McLachlin, and Major JJ. But, on the specific point of whether trust property had been received, Gonthier J agreed with the dissenting judges LaForest, Cory, and Iacobucci JJ. Gonthier J thought the bank acted reasonably and so was not liable in knowing receipt, even though it had received trust property.

<sup>46</sup>[1997] 3 SCR 767 at [54].

Even if one takes the position that the guarantee does not constitute trust property, the giving of the guarantee confers a valuable benefit on the Bank and correspondingly encumbers the estate and detracts from its value. The benefit conferred on the Bank and the resulting loss in value suffered by the estate are sufficient, in my view, to bring the guarantee within the knowing receipt category of liability.

This reasoning does not reflect the current law outside Canada, where the receipt of trust property or its traceable substitutes remains a substantive requirement of liability in knowing receipt.<sup>47</sup> The second alternative was:<sup>48</sup>

Furthermore, in the present action, the Bank has attempted to enforce the guarantee against Primary. If the guarantee is enforced, then the Bank will clearly receive property. For these reasons and on policy grounds, in my opinion, the disputed guarantee can be the subject of a claim in knowing receipt.

This reason can be seen as a form of anticipatory knowing receipt. The analysis makes sense on the particular facts of *Gold v Rosenberg*, where the only question was whether the bank could enforce the security. If, on other facts, the bank had already received direct payments from Primary under the guarantee, or had realised a security over Primary's land and had taken payment out of the proceeds, then there is no doubt that such payments could have grounded knowing receipt in the bank. Such payments would have grounded knowing receipt on the basis that they were wrongly paid away from a company regardless of whether an earlier security interest also grounded knowing receipt at an earlier point in time. It makes obvious practical sense not to require these steps to be taken just so that receipt can be established. But this is only true when the question is about the enforceability of the security interest; that is, when all the plaintiff seeks is the 'return' (ie non-enforcement) of the wrongly granted security. On other facts, such a neat solution will not work.

*Gold v Rosenberg* therefore provides that the acquisition of a wrongly granted legal charge in land can ground knowing receipt in the chargee, assuming the other elements of liability are present. The main reason is that the chargee has thereby received a proprietary interest in the trust property. Although *Gold* concerned legal charges in land, the reasoning would seem to apply equally to equitable charges.

### (b) Australia

The question whether receipt of security interests can ground knowing receipt is also considered in two Australian authorities: the Queensland case of *Doneley v Doneley*,<sup>49</sup> and the Western Australian case of *Westpac v The Bell Group Ltd*.<sup>50</sup>

In *Doneley v Doneley*, a trustee wrongly granted a Torrens mortgage (legal charge) over the freehold reversion of farmland to a bank. The mortgage was to secure the repayment of a loan made to the trustee in her personal capacity. On whether the bank had received trust property for the purposes of knowing receipt, de Jersey J said:<sup>51</sup>

The essential character of a [*Barnes v Addy*] first limb situation is proprietary. Consistently, a claim under that first limb has been likened to a tracing claim. [But the question] does not

<sup>47</sup>See Section 1 above. In addition, we have already seen that granting a charge over property does not diminish the value of that property: above, n 40.

<sup>48</sup>[1997] 3 SCR 767 at [55].

<sup>49</sup>[1998] 1 Qd R 602.

<sup>50</sup>*Westpac Banking Corp v The Bell Group Ltd (in liq) (No 3)* (2012) 44 WAR 1.

<sup>51</sup>[1998] 1 Qd R 602 at 611–612 (original emphasis). The report does not make clear that the mortgage was registered (ie was a legal charge), but this is confirmed in *Tara Shire Council v Garner* [2003] 1 Qd R 556 at [36]. It is not clear why the indefeasibility point was not taken.

rest narrowly on whether the third party received *actual* possession of the trust property, or an *absolute* interest in it: it depends rather on whether the third party was a direct beneficiary of the breach, through having received property identifiable with the trust property the subject of the breach. I conclude that the Bank should be regarded as having ‘received’ some part of the trust property, within the first limb of the test in *Barnes v Addy*.

In addition to the Torrens mortgage over the land, the trustee had also wrongly granted general law mortgages over certain farming plant and equipment. De Jersey J found that the bank had sufficient knowledge of the trustee’s breach of trust and declared that the bank held its interests in all these securities on constructive trust for the beneficiaries.<sup>52</sup>

It is clear the bank received trust property in respect of the general law chattel mortgages. However, the notion of identifiability that de Jersey J employed in relation to the Torrens mortgage is more conclusory than justificatory. Although de Jersey J did require the third party to receive property, and not just be benefited by a breach, beyond this the analysis is rather thin. The essential idea appears to be the same as in *Gold v Rosenberg*: that the chargee has received a proprietary interest (even if not an ‘absolute’ proprietary interest) in the trust property.<sup>53</sup> *Doneley* has been cited with apparent approval on the security interests point in several subsequent Australian cases, but it has never been part of the ratio.<sup>54</sup>

Much fuller discussion of the point can be found in *Westpac v The Bell Group Ltd*,<sup>55</sup> where directors of The Bell Group wrongly granted security interests over the company’s property to various banks. These securities included share mortgages, Torrens mortgages, fixed and floating charges, and various guarantees, indemnities, and subordination agreements. At trial, Owen J considered all these forms of security together, without regard to their underlying legal nature.<sup>56</sup> On the receipt of trust property, he said that ‘where company assets are free of any relevant third party interests and the directors then give security over those assets to the third party, relevant “property” is thereby created and disposed of.’<sup>57</sup> Owen J concluded that the banks were liable in knowing receipt.<sup>58</sup>

On appeal, Drummond AJA discussed the point of receipt of trust property at further length:<sup>59</sup>

Each of those instruments, including the Torrens and share mortgages, the mortgage debentures, the guarantees and indemnities and the main refinancing agreements and the subordination deeds, created choses in action when they were executed (or, at the latest, when they came into effect upon satisfaction of relevant conditions precedent). Property for the purposes of the first limb of *Barnes v Addy* then came into existence.

<sup>52</sup>[1998] 1 Qd R 602 at 614. de Jersey J did not order the securities set aside, although it seems this was sought: 605.

<sup>53</sup>Understandably, neither *Gold* nor *Doneley* refer to each other. *Gold* was argued in May 1997 and judgment delivered in October 1997; *Doneley* was argued in June and July 1997 and judgment delivered at the end of July 1997. *Gold* was argued as a knowing assistance case below the Supreme Court: see *Gold v Toronto-Dominion Bank* (1995) 129 DLR (4<sup>th</sup>) 152 (Ontario CA). It became a knowing receipt case because of the difficulty of establishing dishonesty on the part of the trustee.

<sup>54</sup>*Spangaro v Corporate Investment Australia Funds Management Ltd* [2003] FCA 1025, (2003) 21 ACLC 1948 at [57]; *Cth v Davis Samuel Pty Ltd (No 7)* [2016] ACTSC 146 at [487] (where it is wrongly assumed that the mortgage in *Doneley* was equitable); *Warrington Management Pty Ltd v Kingslane Property Investments Pty Ltd* [2019] WASC 2, (2019) 134 ACSR 8 at [499] (app dismissed [2020] WASCA 8).

<sup>55</sup>*Westpac Banking Corp v The Bell Group Ltd (in liq) (No 3)* (2012) 44 WAR 1 at [2156]–[2164]. *Doneley* was apparently not cited.

<sup>56</sup>*The Bell Group Ltd (in liq) v Westpac Banking Corp (No 9)* [2008] WASC 239 at [8739].

<sup>57</sup>*Ibid.*, at [8736].

<sup>58</sup>*Ibid.*, at [9758].

<sup>59</sup>(2012) 44 WAR 1 at [2158]–[2159]. Lee AJA agreed with Drummond AJA on the knowing receipt issue at [1099]. Carr AJA did not consider the knowing receipt issue, as he held that the directors had not breached their fiduciary duties when they granted security to the banks. Carr AJA felt at [3063] that the matter was adequately dealt with by insolvency law ‘untroubled by 19th century equitable principles derived from the law of trustees’.

Further, all the various interests and rights obtained by the banks under the Transaction instruments, as contractual choses in action, constitute property that are capable of being held in trust, ie, are capable of being subject to the fiduciary obligations of the directors. They therefore satisfy the requirement of ‘trust property’ for the purposes of the first limb of *Barnes v Addy*.

Drummond AJA’s conclusion extended, as had Owen J’s, to all security instruments the banks obtained, regardless of their legal nature.<sup>60</sup> Liability was therefore based on the acquisition of guarantees and indemnities in the same way as it was based upon mortgages and charges. Drummond AJA’s reason was that even contractual choses in action are forms of property that may be held on trust. While this is true, the mere fact that rights may themselves be held on trust does not mean that their acquisition can be seen as receipt of trust property for the purposes of knowing receipt. Indeed, at least in England such reasoning is directly contrary to the House of Lords decision in the *Criterion Properties* case.<sup>61</sup>

### (c) *Hong Kong*

Whether or not security interests can ground knowing receipt was discussed but not decided in the *Akai Holdings* case,<sup>62</sup> a decision of the Hong Kong Court of Final Appeal. Mr Ting, the CEO of Akai Holdings, caused the company to borrow \$30m from a bank. As security, Akai Holdings ‘pledged’<sup>63</sup> shares that it owned in a subsidiary company, Akai Electric. When pledged, the shares were worth \$50m. The value of the shares then fell. When Akai Holdings failed, the bank sold the shares for \$20m and used the proceeds to pay off part of the loan.

The main issue in the case was whether the bank could rely on Mr Ting having apparent authority to bind Akai Holdings to the loan transaction. The Court of Final Appeal held the bank could not rely on such authority, which meant the bank had to repay to Akai’s liquidators the \$20m proceeds of the share sale as damages for conversion.<sup>64</sup>

A secondary point arose concerning knowing receipt. Akai argued that the bank was liable in knowing receipt and that the measure of liability under knowing receipt was the value of the shares when they were pledged, \$50m, and not the value when they were sold, \$20m. Ultimately, Lord Neuberger of Abbotsbury NPJ did not need to decide this point because he held that, even if knowing receipt did lie at the time the shares were pledged, the correct amount of recovery would still be only \$20m.<sup>65</sup>

Although the point did not need to be decided, some interesting comments were still made. Jonathan Sumption QC had argued for the bank that knowing receipt could not lie at the date of pledge because at that point there had been no relevant receipt: ‘no legal or equitable title passed in the share certificates or the shares, when the certificates were received by the bank, because the [loan] transaction was void: accordingly, there is no “receipt” in respect of which a knowing receipt claim can be mounted’.<sup>66</sup> Lord Neuberger did not wish to express a firm view on the issue, but he did comment:<sup>67</sup>

It may well be that the correctness of Mr Sumption’s contention stands or falls on determining whether the Bank had an equitable interest in the Shares at the moment that the share certificates

<sup>60</sup>(2012) 44 WAR 1 at [2169].

<sup>61</sup>[2004] 1 WLR 1846; discussed above, n 37. Drummond AJA considered but rejected Lord Scott’s analysis: (2012) 44 WAR 1 at [2165]–[2167].

<sup>62</sup>*Thanakharn Kasikhorn Thai Chamkat (Mahachon) v Akai Holdings Ltd (No 2)* (2010) 13 HKCFAR 479.

<sup>63</sup>The arrangement was informally described as a pledge of shares, but only the share certificates were pledged. The better view is that the shares themselves were the subject of an equitable mortgage: see below, text to n 70.

<sup>64</sup>The outcome was damages for conversion of the shares, but this ought to be understood as damages for conversion of the share certificates. The shares themselves could not be converted: see *OBG Ltd v Allan* [2007] UKHL 21, [2008] AC 1; A Goymour ‘Conversion of contractual rights’ (2011) Lloyd’s Maritime and Commercial Law Quarterly 67.

<sup>65</sup>This point is discussed in more detail below, text to n 87.

<sup>66</sup>(2010) 13 HKCFAR 479 at [138].

<sup>67</sup>*Ibid.*, at [141]–[143].

were pledged. That in turn may be resolved by construing the pledge agreement (and possibly other documents). If the Bank merely had a contractual right to sell the Shares, which right was protected by the pledging of the certificates, then, at least until the Shares were sold and the proceeds of sale retained by the Bank, there may have been no asset or money in the possession of the Bank on which a claim for knowing receipt could bite.

[There is a] need for ‘beneficial receipt’ of an asset or money by a defendant in a knowing receipt claim. It is true that, by holding the certificates, the Bank did receive a benefit, but it was merely a protection of its alleged right to sell the Shares, and Akai’s claim relates to the Shares. (There is, I suppose, an argument, which, even for the purpose of this hypothesis, need not be considered, that when the Bank actually purported to exercise its right of sale of the Shares, there was a scintilla temporis before sale when it was exercising sufficient degree of control over the Shares to have beneficial ownership of them.)

Several points emerge from these comments. First, and although it was not the subject of argument, it seems that Hong Kong law has the same requirement of receipt of trust property as do English law and Australian law.<sup>68</sup> Secondly, Lord Neuberger thought that a mere contractual right to sell the shares would not itself be sufficient to ground knowing receipt, although retaining the proceeds of a subsequent sale would be. As we have seen, the Court of Appeal of Western Australia took a different view in *Westpac v The Bell Group*.<sup>69</sup> Thirdly, the additional protection of a pledge of share certificates would not be enough to elevate a mere contractual right to sell the shares. Instead, Lord Neuberger thought the point may turn on whether the bank had a proprietary interest in the shares themselves at the time the share certificates were pledged. It appears that the bank did indeed have such an interest, in that the shares were the subject of an equitable mortgage in the bank’s favour. The Court of Final Appeal did not specifically deal with the point, but the arrangement had been treated as an equitable mortgage of the shares by Cheung JA in the Court of Appeal below,<sup>70</sup> and this seems correct in that the bank was able to sell the shares without further recourse to Akai Holdings. It must be remembered, though, that this was all subject to the difficult qualification that the underlying loan transaction was found to be void.<sup>71</sup>

The subsequent case of *Pacific Electric Wire & Cable Co Ltd v Texan Management Ltd* also considered security interests and knowing receipt, although the *Akai Holdings* case was not cited.<sup>72</sup> Reyes J at trial had found Mr Ma liable in knowing receipt when legal charges were wrongly granted over land beneficially owned by Pacific Electric. Those charges secured a large credit facility provided to Mr Ma’s company, Town Sky, by a German bank, HSH. The security interests were therefore granted to HSH, although Mr Ma and Town Sky benefited from the arrangement in that HSH was then willing to lend money to Town Sky. The security was never called upon, but Reyes J found Mr Ma liable to account to Pacific Electric ‘for all benefits (including monies and preferential borrowing rates) received by him or Town Sky’ from the HSH loan facility.<sup>73</sup>

The difficulty with this analysis, as noted by Kwan JA in the Court of Appeal,<sup>74</sup> is that neither Mr Ma nor Town Sky received the charge. In this way the case could be distinguished from *Gold v Rosenberg*. The lender, HSH, received the charge, and Town Sky received loan monies from HSH.

<sup>68</sup>Contrast the position in Canada, discussed above, n 21.

<sup>69</sup>See above, n 60.

<sup>70</sup>[2009] HKCA 286 at [255]–[257]. The Court of Appeal held that liability in knowing receipt existed at the date of mortgage/pledge, although still only for around \$20m.

<sup>71</sup>Payments made under void arrangements can be recovered: see eg *Rolled Steel Products (Holdings) Ltd v British Steel Corp* [1986] Ch 246. But here the question is whether cognisance can be taken of the arrangements of a void transaction in determining the extent of the rights granted to the ‘secured’ party.

<sup>72</sup>[2012] HKCFI 502 (Reyes J); [2013] HKCA 496 (CA). I thank Lusina Ho for bringing this case to my attention.

<sup>73</sup>[2012] HKCFI 502 at [564], [616].

<sup>74</sup>[2013] HKCA 496 at [169]–[171]. Kwan JA did comment, obiter, that in a general law mortgage the mortgagee would receive trust property: [169].

Town Sky certainly benefited from the charge being granted to HSH, in that HSH then lent money to Town Sky. But it could not be said that Town Sky received property belonging to Pacific Electric. This would be true even if the security was eventually realised: enforcement of the security by HSH could not convert Pacific Electric's interest in the land into an interest in the loan funds that HSH had previously advanced to Town Sky.<sup>75</sup> The Court of Appeal therefore overturned the finding of knowing receipt: neither Mr Ma nor Town Sky had received the assets of Pacific Electric, or their traceable proceeds.

#### (d) *England and Wales*

There appears to be no English authority on the point of whether security interests can ground knowing receipt. Perhaps the closest case is *Shalson v Russo*,<sup>76</sup> where Mr Mimran was defrauded into lending money to Westland. He later rescinded those loan contracts, acquiring a property right sufficient to trace the loan funds into Westland's bank account. Mr Mimran was then able to trace into certain further loans made by Westland's controller, Mr Russo, with funds from the Westland account.<sup>77</sup> But those further loans had already been charged with debts due to another innocent victim of the fraud, Mr Shalson, before Mr Mimran rescinded his original loans. Rimer J held that Mr Shalson took those charges innocently and for value, and so Mr Mimran's tracing claim in respect of the further loans failed.<sup>78</sup>

At the time the charge was granted to Mr Shalson, Mr Mimran had not yet rescinded his original loans. This means the case cannot provide direct assistance on the main point being discussed, because at the time of the charging Mr Mimran was not the equitable owner of the further loans (so there was no relevant trust property). If the original loans had already been rescinded, the question would concern the effect of Mr Russo's attempted charging of Mr Mimran's property in favour of Mr Shalson. It could be said that such charging had no effect, on the grounds that Mr Russo was simply not competent to charge property owned in equity by Mr Mimran. Alternatively, it could be said that Mr Shalson's charge was valid, but that it ranked behind Mr Mimran's interest, and since Mr Mimran's interest amounted to full beneficial ownership there would never be anything left for Mr Shalson.<sup>79</sup>

The tenor of Rimer J's judgment suggests that the latter is more likely. Rimer J thought it important that Mr Shalson had no notice and had given value for the charge, even though the charge had been granted before Mr Mimran rescinded the original loan. This suggests that Mr Shalson's charge defeated what was, at the time, Mr Mimran's mere equity. It seems Rimer J would still have viewed the matter as a priority dispute even if Mr Mimran had had a full equitable interest when Mr Shalson acquired the charges, and not as a situation where Mr Shalson's charges were simply invalid. But the point was not directly addressed, and, since there was no question of Mr Shalson having knowledge of any wrongdoing, knowing receipt was not discussed.

#### (e) *Discussion*

All the cases that directly address the point conclude that security interests can ground knowing receipt. However, they do so for different reasons. Both *Gold v Rosenberg* and *Akai Holdings* suggest

<sup>75</sup>[2013] HKCA 496 at [171].

<sup>76</sup>[2005] Ch 281. The transferred shares in *Byers v Saudi National Bank* [2022] EWCA Civ 4 were referred to as 'disputed securities', but 'securities' was being used as a synonym for 'shares'.

<sup>77</sup>[2005] Ch 281 at [160]. Tracing was possible in respect of these specific loans, but much of Mr Mimran's claim failed as the relevant funds had passed through an overdrawn account.

<sup>78</sup>*Ibid.*, at [165]–[167]. See also at [126]: 'Until rescission, the property is vested in the representor; and if it is disposed of to a good faith purchaser, that purchaser will obtain a title which will be unimpeachable after any rescission. Such purchasers would include the representor's chargees.'

<sup>79</sup>See D Fox 'Relativity of title at law and in equity' (2006) 65(2) *Cambridge Law Journal* 330 at 355–357.

that the point turns on whether the third party has received a proprietary interest in trust property. *Doneley v Doneley* is similar in that it focuses on the acquisition of property rights, but it only needs these rights to be ‘identifiable with’ the trust property. In contrast, *Westpac v The Bell Group* apparently only requires that whatever rights the third party acquires – whether they be personal or proprietary – are capable of being held on trust. Guarantees, indemnities, and subordination agreements were therefore able to ground knowing receipt in *Westpac v The Bell Group* but would not have done so according to the reasoning in the other cases.

Allowing knowing receipt when a third party acquires a proprietary right in the trust assets is consistent with the basic nature of knowing receipt as a claim based on the receipt of property. However, many of the difficulties identified in Section 2 remain. For example, apart from the case of general law mortgages, the proprietary rights acquired by the third parties have been created and not transferred. Of the authorities discussed above, only *Westpac v The Bell Group* addresses this point. There, Drummond AJA simply disagreed with Lord Scott’s comments in *Criterion Properties* and thought that even personal rights created by contract could ground knowing receipt.<sup>80</sup> This is not the position in England and Wales.

Not only has the third party’s interest been created and not transferred, but when a security interest is granted the original trust property still exists in the trustee’s hands in unaltered form.<sup>81</sup> In *El Ajou v Dollar Land Holdings plc*, Hoffmann LJ laid out the elements of knowing receipt in a passage regularly followed by English courts:<sup>82</sup>

[T]he 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.

That the trust property still exists in unaltered form makes it difficult to argue: (i) that there has been a disposal of trust assets in breach of fiduciary duty; and (ii) that the security interest is a traceable product of the original trust property. Finally, at this point it is also helpful to remember that strictly trustees hold their *rights to* trust property on trust. Such precision is not often necessary, and it is normally fine to speak of the property itself being held on trust. But here it is helpful to illustrate the point that trust property itself has not been transferred to anyone or received by anyone.

For these reasons it is possible that an English court would take a different view on the question of security interests grounding knowing receipt. Nonetheless, the unanimity in the existing authorities (on the outcome if not the reasoning) suggests that the English courts may adopt the same position as those authorities. The next section discusses some further difficulties that would then be encountered.

#### 4. Further difficulties

The point made in this section is that, if courts decide that knowing receipt can be grounded on security interests, further difficulties will follow. Section 4 is therefore concerned with different issues than Section 2, which concerned conceptual problems with the idea in the first place.

These further difficulties are chiefly caused by the fact that the grant of a security interest may be followed by its realisation: that is, a security interest in trust property may eventually yield the actual trust property. This can be seen in the *Akai Holdings* case, where the defendant eventually sold the

<sup>80</sup>(2012) 44 WAR 1 at [2165]–[2167].

<sup>81</sup>Again, this excepts the general law mortgage.

<sup>82</sup>[1994] 2 All ER 685 at 700. This passage was recently restated and approved in *Byers v Saudi National Bank* [2022] EWCA Civ 43 at [17]–[18], subject to the qualification to the knowledge requirement imposed by *Bank of Credit and Commerce International (Overseas) Ltd v Akindele* [2001] Ch 437.

pledged shares and purported to keep the proceeds.<sup>83</sup> On realisation, the third party would undoubtedly receive trust property. However, it may still be necessary to decide whether liability in knowing receipt had in fact existed earlier, at the time the third party acquired the initial security interest.

First, timing is important for limitation purposes. *Williams v Central Bank of Nigeria* confirms that claims against knowing recipients are subject to a six-year limitation period,<sup>84</sup> so it is important to identify the date of the original claim. While it would normally be the *beneficiaries* who would argue that knowing receipt could be grounded on the acquisition of a security interest, here the *third party* might contend that any knowing receipt claim was based on an earlier security interest (so that the limitation clock started to run at that point). It may be possible to see two actions accruing: the first on the acquisition of the security interest and the second on its realisation. Yet this does seem rather artificial, and, in any case, it may still be appropriate to stop the limitation clock at six years from the accrual of the initial action.<sup>85</sup>

Secondly, there is a difficult question whether the acquisition of a security interest in property is treated as sufficient receipt of the underlying property itself, or as merely the acquisition of a security interest in that property.<sup>86</sup> The values will often be different, if only because under the latter analysis the value could not be more than the debt secured. The values being different would mean that the quantum of relief would also vary. Also, to the extent that the acquisition of a security interest is seen as a form of receipt of the underlying property, it would seem impossible to argue that the defendant has received the property again on realisation. It would then follow that there could not be two claims, one on acquisition of the security interest and one on realisation.

Thirdly, the value of the underlying property itself may shift over time. In *Akai Holdings*, the value of the shares when they were pledged was \$50m and the value when they were finally sold was only \$20m. The claimants sought recovery in the higher amount on the basis that knowing receipt had occurred at the date of pledge, and so \$50m was the appropriate relief. However, even if knowing receipt had occurred at pledge, the Court of Final Appeal thought that \$20m would still be the appropriate quantum. Applying *Target Holdings Ltd v Redferns*,<sup>87</sup> Lord Neuberger commented on the need for a causal connection between breach and loss and considered what Akai would have done with the shares if they had been returned. Importantly, he did not think they would have been sold at a higher price. Lord Neuberger therefore concluded that, even if knowing receipt had existed at pledge (which was assumed for these purposes, but not decided), when the shares were worth \$50m, the appropriate relief would still only have been \$20m.<sup>88</sup> This means the point ultimately did not matter in *Akai Holdings*, although it could have done on other facts. More generally, the proper approach to equitable compensation in this area is still being worked out. In *Byers v Saudi National Bank*,<sup>89</sup> for example, Fancourt J would have reduced the amount of equitable compensation payable for knowing receipt by applying a ‘block discount’ taking into account the difficulty of selling a large parcel of shares in a company on a single day. On appeal, the Court of Appeal doubted that this approach was correct.<sup>90</sup>

Fourthly, the third party may have used the security interest for its own purposes, thus making a potentially disgorgeable gain, before eventually realising that interest. In such cases it will be important to know whether knowing receipt can be grounded on the receipt of the security interest, and not on

<sup>83</sup>*Thanakharn Kasikhorn Thai Chamkat (Mahachon) v Akai Holdings Ltd (No 2)* (2010) 13 HKCFAR 479.

<sup>84</sup>[2014] UKSC 10, [2014] AC 1189, interpreting the Limitation Act 1980, s 21.

<sup>85</sup>Compare successive conversions of the same goods, where the limitation period ends at six years from the original conversion: Limitation Act 1980, s 3 (though this directed at successive conversions by different people).

<sup>86</sup>See J Dietrich and P Ridge *Accessories in Private Law* (Cambridge: Cambridge University Press, 2015) p 245.

<sup>87</sup>[1996] AC 421.

<sup>88</sup>*Thanakharn Kasikhorn Thai Chamkat (Mahachon) v Akai Holdings Ltd (No 2)* (2010) 13 HKCFAR 479 at [153]–[155]. Cf *Snell's Equity*, above n 31, at paras [30-071], [30-074], suggesting that recovery should be based on the value at receipt.

<sup>89</sup>[2021] EWHC 60 (Ch). The discussion was obiter because liability in knowing receipt was not established.

<sup>90</sup>[2022] EWCA Civ 43 at [135]–[137]. Again, the point was obiter. The Court of Appeal's approach is supported in A Georgiou ‘Knowing receipt: continuing trusts and conscionability *Byers v Saudi National Bank*’ (2023) 86(1) *Modern Law Review* 276.

its later realisation. It has been argued elsewhere that the authority for knowing recipients being liable to disgorge discrete profits is rather thin,<sup>91</sup> but it is at least possible that such liability does exist.<sup>92</sup>

## Conclusion

It is perhaps surprising that the question of security interests and knowing receipt has not yet been considered by courts in England and Wales. One reason why it has not been considered may be the availability of alternative claims that do the same work without having to tackle this exact point. Such claims might include conversion, dishonest assistance, and the strict liability claim available to a principal when assets are transferred away without authority by their agent.<sup>93</sup> However, it is still important to decide whether knowing receipt is available. First, these other claims do not cover quite the same ground: for example, conversion is not possible in respect of intangible property,<sup>94</sup> and it is doubtful that an action in conversion is available to a trust beneficiary.<sup>95</sup> Neither is the strict liability claim available to a trust beneficiary *as* beneficiary. Secondly, knowing receipt might be more attractive: it has a lower fault level than dishonest assistance, and it may allow for more extensive remedies than the strict liability claim.

Normative debates in the area of knowing receipt have generally turned on whether the law ought to focus on the protection of the beneficiary's property rights or on the wrongdoing of the third party.<sup>96</sup> This question has been addressed through the prism of the knowledge requirement: to the extent liability is about protecting property, a lesser degree of fault ought to be required; to the extent it is about wrongdoing, less blameworthy (and less knowledgeable) people ought to be protected. Yet the current state of the law seems to involve sitting on a slightly uncomfortable fence: knowing receipt clearly requires fault, yet it also insists on the receipt of trust property. The latter requirement does lead to some stark results: as we have seen, the defendant in *Quince v Varga* was liable in knowing receipt for money given to her, but not for money used for her benefit to pay off debts that she owed.<sup>97</sup> Nonetheless, the receipt of trust property requirement is part of the current law, and it is in this context that the security interests question needs to be decided.

While knowing receipt is firmly rooted in the transfer of property rights, we have seen that security interests vary greatly in their underlying mechanics and proprietary effects. In addition, a trustee's wrongful granting of any type of security, regardless of its legal form, can harm the interests of the trust beneficiary. This means there is an understandable attraction to treating all forms of security in the same way,<sup>98</sup> but doing so would create significant tensions in the law of knowing receipt.

<sup>91</sup>See J Glister 'Knowing receipt' in W Day and S Worthington (eds) *Challenging Private Law – Lord Sumption on the Supreme Court* (Oxford: Hart Publishing, 2020) pp 223–225.

<sup>92</sup>See *The Bell Group Ltd (in liq) v Westpac Banking Corp (No 9)* [2008] WASC 239 at [8738], per Owen J: '[M]y statement that the "property" is the basket of rights arising from the securities should not be taken as an indication that I regard the later exercise by the third party of those rights, for example, by appointing a receiver or by selling the secured assets, as irrelevant to the process. However, the exercise of rights is more directly connected with the gain to the third party (and any consequent loss to the beneficiary) than to the initial receipt of property to which a fiduciary obligation attaches.'

<sup>93</sup>*Criterion Properties plc v Stratford UK Properties LLC* [2004] 1 WLR 1846 at [4], per Lord Nicholls (Lord Scott did not consider the point directly in his leading speech); *Great Investments Ltd v Warner* [2016] FCAFC 85, (2016) 243 FCR 516 at [59], [69]; M Yip 'Third parties' liability for receipt of misapplied corporate assets: the relevance of knowing receipt?' (2017) 11 *Journal of Equity* 293.

<sup>94</sup>*OBG Ltd v Allan* [2008] AC 1; see above n 63.

<sup>95</sup>Beneficiaries can sue third parties for conversion using the *Vandepitte* procedure (from *Vandepitte v Preferred Accident Ins Corp of New York* [1933] AC 70), but the proper claimant is the trustee, whose right to possession grounds the claim. Yet it is the trustee who wrongfully transferred the trust property to the third party. See A Tettenborn 'Trust property and conversion: an equitable confusion' (1996) 55(1) *Cambridge Law Journal* 36.

<sup>96</sup>For discussion see J Dietrich and P Ridge 'The receipt of what? Questions concerning third party recipient liability in equity and unjust enrichment' (2007) 31 *Melbourne University Law Review* 47 at 57–62.

<sup>97</sup>[2009] 1 Qd R 359, discussed above n 20. Ms Varga was liable for the money used to pay off her debts on the footing of knowing assistance, but not knowing receipt.

<sup>98</sup>As was done, eg, in *Westpac Banking Corp v The Bell Group Ltd (in liq) (No 3)* (2012) 44 WAR 1.

On the current state of English law, it seems clear that *Criterion Properties* prevents purely personal rights such as guarantees and indemnities from grounding liability in knowing receipt.<sup>99</sup> Beyond that, the question is difficult. It can be argued that, on principle, only the general law mortgage could involve the receipt of trust property sufficient for liability in knowing receipt. The legal mortgage is the only device whereby existing rights are transferred: this accords with the fundamentals of *Barnes v Addy* liability and recognises the important distinction between the creation and the transfer of rights. The practical problems identified in Section 4 are also lessened with general law mortgages: for example, it is not necessary to decide whether the security interest counts as a form of receipt of the underlying property, or as merely receipt of the security interest.

On the other hand, it can be argued that grounding knowing receipt upon all the traditional security interests is appropriate even if it is not wholly consistent with other aspects of the law in the area. These security interests – most importantly mortgages and charges – each involve the acquisition of proprietary rights by the secured party. Outside the general law mortgage, these rights are newly created rather than transferred, and we have also seen that allowing such interests to ground liability does bring further practical problems. However, permitting claims to be based on these security interests would still allow knowing receipt to be recognised as a claim based on the acquisition of *property rights*, if not strictly on the acquisition of *trust property*. It would also keep English law generally consistent with the overseas authorities on the point.<sup>100</sup> The arguments are finely balanced, but they tip more towards reasonable pragmatism than analytical purity: a third party's wrongful acquisition of a security interest in trust property should be able to ground knowing receipt, assuming the other elements of liability are also present.

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<sup>99</sup>*Criterion Properties plc v Stratford UK Properties LLC* [2004] 1 WLR 1846.

<sup>100</sup>On the desirability of consistency between common law jurisdictions see *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2015] AC 250 at [45].