

## THE JOHN LEHANE MEMORIAL LECTURE 2004

### DISHONESTY AND UNCONSCIONABLE CONDUCT IN COMMERCIAL LIFE – SOME REFLECTIONS ON ACCESSORY LIABILITY AND KNOWING RECEIPT

ROBERT WALKER

I never had the privilege of meeting John Lehane. I knew him only from his published work, that is his books, articles and judgments. They leave the reader in no doubt as to the depth of his scholarship and the clarity and freshness of his language. In the last few days many of you who knew him have told me of his outstanding human qualities – his warmth, his humour and his generosity of spirit. It is a great honour for me to give this lecture dedicated to his memory.

I am conscious that the title of this lecture covers a wide field. Moreover it is a field which has in recent years been addressed extracurricularly by some very distinguished judges, including Sir Anthony Mason,<sup>1</sup> Lord Millett<sup>2</sup> and Lord Nicholls<sup>3</sup>, as well as by a legion of distinguished academic lawyers<sup>4</sup>. I am not confident of adding anything very significant to this body of learning.

However, the fact is that the treasury of authority keeps getting fuller (without any obvious devaluation of the currency of judicial decision-making). I have in mind (without reference to other parts of the common law world) the recent English decisions in *Akindele*<sup>5</sup> and *Twinsectra*,<sup>6</sup> the decisions of the Court of Appeal of New South Wales in

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<sup>1</sup> The Place of Equity and Equitable Remedies in the Contemporary Common Law World (1994) 110 LQR 238

<sup>2</sup> Equity's Place in the Law of Commerce; Restitution and Constructive Trusts (1998) 114 LQR 214, 399

<sup>3</sup> Knowing Receipt: The Need for a New Landmark in Cornish and others; Restitution Past, Present and Future, Hart Publishing (1998)

<sup>4</sup> In addition to material referred to in other footnotes I gratefully acknowledge indebtedness to Charles Mitchell's contribution to Breach of Trust (eds Birks and Pretto) Hart Publishing (2002)

<sup>5</sup> *BCCI (Overseas) Ltd v Akindele* [2001] Ch 437

<sup>6</sup> *Twinsectra Ltd v Yardley* [2002] 2 AC 164

*Beach Petroleum*<sup>7</sup> and *Evans v European Bank*<sup>8</sup> and (especially so far as it touches on the general topic of what is unconscionable) the decision of the High Court of Australia in *Roxborough*<sup>9</sup>. Some of these cases raise the issue whether unconscionable conduct should be seen as the essential principle underlying receipt-based liability, as well as other occasions for equitable intervention in commercial transactions; and whether the word “unconscionable”, which is not much heard in ordinary conversation, is an appropriate legal touchstone. I shall say something about these and other recent cases, although I am well aware that some recent decisions in this jurisdiction (especially, perhaps *Roxburgh*) may be an area in which angels fear to tread.

So I want to devote most of my time to the way in which the principles of knowing receipt and dishonest assistance have developed and are applied today in commercial cases, both in England and (so far as I can presume to comment on them) in Australia. But I will begin, if I may, with an old case which has nothing to do with commercial life. It is a vignette of family life and family conflict in middle-class mid-Victorian England.

A testator had settled his residuary estate on his four children. Two of the settled shares had been released from the will trust before the story begins and we are concerned with the settled shares of two of the testator’s daughters, Ann and Susan. Both were married: Susan, as it happens, to her cousin, who (following the deaths of his co-trustees) was sole trustee of the will trust. Unfortunately the two brothers-in-law did not get on at all well. Ann’s husband (who was, as most of you will have guessed, Mr Barnes<sup>10</sup>) sued Susan’s husband (Mr Addy) for breach of trust. The proceedings were compromised, and it was proposed that Mr Barnes should be appointed in place of Mr Addy as sole trustee of the settled share of Ann and her six children (this was before the enactment of statutory restrictions on the appointment of a sole individual trustee). Mr Addy’s solicitor (Mr Duffield) advised him against this course, because of the risk of misapplication by a sole trustee. But Mr Addy insisted and Mr Duffield carried out his instructions to prepare a deed of appointment. Mr Barnes’ solicitor (Mr Preston) saw it as his professional duty to write to Ann tactfully expressing his concern, and he did so, but he received an icily polite

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<sup>7</sup> *Beach Petroleum NL v Kennedy* (1999) 48 NSW 1

<sup>8</sup> *Evans v European Bank Ltd* 25 March 2004 [2004] NSW CA 82

<sup>9</sup> *Roxborough v Rothmans of Pall Mall Australia Ltd* (2001) 208 CLR 516

<sup>10</sup> *Barnes v Addy* (1874) 9 Ch App 244

brush-off. So Mr Preston approved the draft deed, and the appointment was completed. On 31 March 1857 a holding of government stock representing Ann's settled share was transferred to Mr Barnes. On the very next day he sold the stock and, in flagrant breach of trust, used the proceeds in his business. Within a year he was bankrupt.

So there were two breaches of trust: an ill-advised but non-fraudulent appointment by Mr Addy and a deliberate fraudulent misapplication by Mr Barnes. But it was Mr Addy, Mr Duffield and Mr Preston whom Ann's six children sued for breach of trust. Mr Addy was held liable, but the solicitors were dismissed from the suit, and in 1874 their exoneration was confirmed by the Court of Appeal in Chancery. That was the context in which the presiding judge, Lord Selborne LC, made his famous statement:<sup>11</sup>

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

For more than a century this statement has been repeatedly cited and analysed throughout the common law world almost as if it were a statutory text. Indeed Professor Charles Harpum<sup>12</sup> has, by reference to this very passage, identified one of what he sees as three serious judicial shortcomings in this area: I will quote all three:

- (i) a willingness to apply authorities on one ground of liability to another that was conceptually discrete;
- (ii) a preference for applying as if they were statutory provisions judicial dicta that were conditioned by the factual context in which they were made; and
- (iii) an obsessive concern with what might be described as the *mens rea* necessary for liability without sufficient consideration of the *actus reus*".

I have gone into the facts of *Barnes v Addy* in a little detail because Lord Selborne's much-cited observation is the foundation of the modern law, and the factual context of the case helps to explain why Lord Selborne did not find it necessary to explore various

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<sup>11</sup> At 251-2

<sup>12</sup> *The Basis of Equitable Liability in the Frontiers of Liability* (ed P B H Birks) OUP 1994 p9

complexities which have since arisen. It was a case of an express trust and the two solicitor defendants knew enough about trusts to be concerned (absolutely correctly, as events turned out) about the risk involved in the appointment of a sole trustee. So far as the case turned on receipt by Mr Duffield (Mr Addy's solicitor, who deducted a modest sum for a share of the costs of the earlier litigation) he was perfectly well aware that it was trust money, but he was acting in a ministerial capacity. The only real issue was whether the solicitors' professional concerns about the general risk of appointing a sole trustee, without any particular apprehension of dishonesty on the part of Mr Barnes, made them liable as accessories.

Most of the other cases that I want to discuss were not concerned with express trusts, but with breaches of fiduciary duty by company directors and their associates. The notion that a company director owes fiduciary duties to the company was already familiar by the time of *Barnes v Addy*.<sup>13</sup> But in England it was for some reason only in the second half of the twentieth century that the full implications of a breach of these duties were subjected to close examination.

I do not propose to attempt any detailed chronological survey of the development of the case law in either England or Australia. I want to concentrate on general principles, including in particular (at the risk of my being treated as having an "obsessive concern") the mental element which has to be proved in these cases, and the degree to which the notion of unconscionable conduct is a principled and useful tool in determining either receipt-based or fault-based liability. I want to suggest that judges have tended to keep asking themselves the question "What sort of knowledge?" – a tendency exemplified by the five-fold *Baden*<sup>14</sup> test – and have not so regularly asked themselves the question "knowledge of what?" In *Barnes v Addy* the solicitors acting for Mr Addy and Mr Barnes knew perfectly well what a breach of trust was. A company director may have (or may plausibly claim to have) a much less clear understanding of what is a breach of fiduciary duty, and the same may be true of bank officials and even, regrettably, accountants and lawyers. That is especially true if a breach consists, not of infringement of a specific statutory duty (such as the prohibition on a company giving financial assistance for the

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<sup>13</sup> See for instance *Re Forest of Dean Coalmining Company* (1878) 10 Ch D450, *Flitcroft's case* (1882) 21 Ch D519, 535 and *Re Lands Allotment Company* [1894] 1 Ch 616, 631, all of which treat the proposition as commonplace.

<sup>14</sup> (1983) [1993] 1 WLR 509, 575-6.

purchase of its own shares) but in the exercise of directors' powers of control for an improper purpose.

This point was very well put by Dixon J (as he then was) as long ago as 1938 in the well-known case of *Mills v Mills*:<sup>15</sup>

“When the law makes the object, view or purpose of a man, or of a body of men, the test of the validity of their acts, it necessarily opens up the possibility of an almost infinite analysis of the fears and desires proximate and remote, which, in truth, form the compound motives usually animating human conduct. But logically possible as such an analysis may seem, it would be impracticable to adopt it as a means of determining the validity of the resolutions arrived at by a body of directors, resolutions which otherwise are ostensibly within their powers. The application of the general equitable principle to the acts of directors managing the affairs of a company cannot be as nice as it is in the case of a trustee exercising a special power of appointment.”

To put much the same point less elegantly and more bluntly, a trustee of an express family trust who steals trust money must assuredly know that he is doing something seriously wrong. A director who is also controlling shareholder of a company may need a lot of persuasion that he is not fully entitled to feather his own nest at the expense of “his” company. Indeed he may find himself serving a custodial sentence before he begins to believe it. That may be what Lord Nicholls had in mind when he said, in *Royal Brunei Airlines v Tan*<sup>16</sup> that the standard of what constitutes honest conduct is not subjective, and honesty is not an optional scale, with higher or lower values according to the moral standards of each individual. But the need for the court to take a realistic view of the exigencies of commercial life, and to be slow to extend fiduciary obligations to commercial relationships, is a recurrent theme throughout the cases: warnings were given, for instance, by the majority of the High Court in the *Hospital Products*<sup>17</sup> case, and by the Privy Council (on appeal from New Zealand) in *Goldcorp*.<sup>18</sup>

Although I am not going to trade the development of the law case by case, it may be useful to have a look at two cases decided in the early 1970's – one in England and one in New South Wales – as snapshots of where the law had got to at that time. *Karak*

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<sup>15</sup> (1938) 60 CLR 120, 185-6.

<sup>16</sup> [1995] 2 AC 378, 389.

<sup>17</sup> *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, 149

<sup>18</sup> *Re Goldcorp Exchange Ltd* [1995] 1 AC 74, 98.

*Rubber*,<sup>19</sup> decided in the English Chancery Division in 1971, was concerned with a company which was almost a natural victim of fraud: like the company in the earlier *Selangor* case,<sup>20</sup> it had a stock exchange listing and cash in the bank but no business, as its plantations in Asia had been sold. By what now seems a fairly simple and old-fashioned fraud, four adventurers used the company's money to enable them to gain control of the company and misappropriate what was left of its funds – apparently a fairly modest amount. The only contested claim was against the company's bank for what was then termed knowing assistance.

Brightman J, following the judge in *Selangor*, applied to the bank officials' conduct a test of constructive knowledge, and by that test, found the bank liable as a constructive trustee (as well as being in breach of its contractual duty to its customer). He reasoned as follows:<sup>21</sup>

“If, as seems to be established by the cases, an objective test of ‘knowledge’ is rightly applied in the context of the first category of constructive trusteeship [*authorities omitted*] I do not myself see any particular logic in denying it a similar role in the context of the second category of constructive trusteeship.”

I fear that this occurs in at least two of Professor Harpum's strictures. There was a very good reason to make the distinction, as was later pointed out, separately but more or less simultaneously, in an article<sup>22</sup> by Professor Birks (whose recent untimely death we all deplore) and by Millett J (as he then was) in *Agip*.<sup>23</sup>

In 1975 *Selangor* and *Karak Rubber* were considered, among many other authorities, by the High Court of Australia on appeal from the Court of Appeal of New South Wales<sup>24</sup> in *Consul Development v DPC Estates*.<sup>25</sup> The facts are probably well known to most of you. In barest outline Mr Walton, a solicitor, carried out property development through his company, DPC. Mr Grey was a director and manager of DPC.

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<sup>19</sup> [1972] 1 WLR 602.

<sup>20</sup> [1968] 1 WLR 1555.

<sup>21</sup> At 639.

<sup>22</sup> *Misdirected Funds: Restitution from the Recipient* [1989] LMCLQ 296,323

<sup>23</sup> *Agip (Africa) Ltd v Jackson* [1990] Ch 265.

<sup>24</sup> *DPC Estates Pty Ltd v Grey* [1974] 1 NSWLR 443.

<sup>25</sup> (1975) 132 CLR 373.

Mr Clowes, Mr Walton's articulated clerk, also engaged in property development through a family company, Consul. Mr Grey made redevelopment opportunities available to Consul, telling Mr Clowes that DPC had insufficient resources to take them up itself. Mr Grey was rewarded with a share of Consul's development profits. DPC's claim against Consul failed at first instance but the Court of Appeal allowed its appeal, Jacobs P dissenting. In the High Court the principal issue was whether Consul's constructive knowledge, if established, was a sufficient basis for liability. McTiernan J dissenting, held that it was; Gibbs J did not, on his view of the facts, find it necessary to express a concluded view; but Barwick CJ (who concurred in the views of Stephen J) and Stephen J held that it was not enough to establish what he called<sup>26</sup> "that species of constructive notice which serves to expose a party to liability because of negligence in failing to make enquiry". Earlier<sup>27</sup> he had quoted from the dissenting judgment of Jacobs P below<sup>28</sup> that where the defendant has not received trust property:

"...something more is required, and that something more appears to me to be the actual knowledge of the fraudulent or dishonest design, so that the person concerned can truly be described as a participant in that fraudulent dishonest activity."

Stephen J was prepared to go a bit farther:<sup>29</sup>

"If a defendant knows of facts which themselves would, to a reasonable man, tell of fraud or breach of trust the case may well be different, as it clearly will be if the defendant has consciously refrained from enquiry for fear lest he learn of fraud."

In England the Chancery Division caught up fourteen years later, with the judgment of Millett J in *Agip*.<sup>30</sup> The judgment gives a vivid account of how the subsidiary of an Italian oil giant, drilling for oil in Tunisia, was systematically defrauded of millions of dollars by its chief accountant, and how the money was laundered through a series of companies, registered in England but run by Isle of Man accountants (who were the defendants in the proceedings), before its final distribution by a French company ostensibly carrying on a jewellery business. Millett J's judgment also contains a

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<sup>26</sup> At 412.

<sup>27</sup> At 410.

<sup>28</sup> [1974] 1 NSWLR 443, 459.

<sup>29</sup> At 412.

<sup>30</sup> *Agip (Africa) Ltd v Jackson* [1990] Ch 265.

penetrating analysis of the law, covering proprietary as well as personal claims. For present purposes the crucial passage comes immediately after a reference to the dissenting judgment of Jacobs P in *DPC*<sup>31</sup>:

“The authorities at first instance are in some disarray on the question whether constructive notice is sufficient to sustain liability under this head. In the *Baden* case Peter Gibson J accepted a concession by counsel that constructive notice is sufficient and that on this point there is no distinction between cases of ‘knowing receipt’ and ‘knowing assistance’. This question was not argued before me but I am unable to agree. In my view the concession was wrong and should not have been made. The basis of liability in the two types of cases is quite different; there is no reason why the degree of knowledge required should be the same, and good reason why it should not. Tracing claims and cases of ‘knowing receipt’ are both concerned with rights of priority in relation to property taken by a legal owner for his own benefit; cases of ‘knowing assistance’ are concerned with the furtherance of fraud.”

A little later in the judgment he said,

“The true distinction is between honesty and dishonesty. It is essentially a jury question.”

There is also a valuable passage about *what* the accountants had to know to found liability. Company minutes signed by one of the accountants suggested that they had been told that the purpose of the money-laundering manoeuvres was to evade Tunisian exchange control. Millett J said,<sup>32</sup>

“It is no answer for a man charged with having knowingly assisted in a fraudulent and dishonest scheme to say that he thought that it was ‘only’ a breach of exchange control or ‘only’ a case of tax evasion. It is not necessary that he should have been aware of the precise nature of the fraud or even of the identity of its victim. A man who consciously assists others by making arrangements which he knows are calculated to conceal what is happening from a third party, takes the risk that they are part of a fraud practised on that party.”

Other English judges have however taken a more cautious view on this point.<sup>33</sup>

This problem can perhaps be posed, in much broader and vaguer terms, as whether you can properly be said to know something unless you can put the right label on it. In

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<sup>31</sup> At 292-3.

<sup>32</sup> At 295.

<sup>33</sup> See *Grupo Torras SA v Al Sabah* [1999] CLC 1469, 1664-5; *Brinks Ltd v Abu-Saleh No. 3* [1996] CLC 133; also the discussion below of *Twinsectra Ltd v Yardley* [2002] 2 AC 164.

Moliere's *Le Bourgeois Gentilhomme* Monsieur Jourdain was aware that he did not normally speak in rhyme, but it came as a revelation to him that he spoke in *prose*. It is a problem which occurs, in different forms, in many other fields of law. To digress with an example from English law, in an action for personal injuries<sup>34</sup> the limitation period runs from a date fixed by the claimant's knowledge of various facts, including the fact that the injury is significant (within the meaning of a rather complex definition). The statute does not in terms require the claimant to know the medical classification of the injury (or that it was caused by negligence). But it is striking how often (on a preliminary issue concerned with limitation) a claimant readily accepts that he or she was well aware of having a serious problem, but did not consider suing until eventually medical diagnosis gave the problem a name – whether it is clinical depression, or PTSD, or dyslexia, or some other disabling condition. A claimant may be held to be statute-barred even though he did not know the right medical label for his trouble. And a defendant may be held to have had enough knowledge to be liable even though he had never heard of the legal label 'breach of fiduciary obligation'.

I have already referred to the five-fold *Baden*<sup>35</sup> test of knowledge. It will be well known to almost all of you, but I had better set it out. It occurs in a judgment delivered in 1983 by Peter Gibson J after a year-long trial arising out of the notorious IOS investment scandal in the 1960's. The judgment is very long and was not reported (except in one specialist series) until 1992. Since it has had (to say the least) a mixed reception it is fair to point out that Peter Gibson J was recording a submission of counsel, and he himself expressed reservations about it. The classification is as follows:<sup>36</sup>

“(i) Actual knowledge, (ii) wilfully shutting one's eyes to the obvious; (iii) wilfully and recklessly failing to make such inquiries as an honest and reasonable man would make; (iv) knowledge of circumstances which would indicate the facts to an honest and reasonable man; (v) knowledge of circumstances which would put an honest and reasonable man on inquiry.”

As I have said, this classification had had a mixed reception in several jurisdictions. It has been called “unhelpful” and “unrememberable” in New Zealand.<sup>37</sup> In England it has led to

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<sup>34</sup> See Limitation Act 1980 sections 11 and 14.

<sup>35</sup> *Baden v Societe Generale* [1993] 1 WLR 509.

<sup>36</sup> At 575-6.

<sup>37</sup> Both by Blanchard J in *Nimmo v Westpac Banking Corp.* [1993] NZLR 218, 228.

warnings against over-refinement<sup>38</sup> and over-elaboration;<sup>39</sup> but it has also been attacked from the other flank as not necessarily comprehensive.<sup>40</sup> In Australia Finn J, writing extra-rially,<sup>41</sup> has described it as “technical to the point of the artificial and the arcane.”

Lord Nicholls might be thought to have administered the *coup de grace*, so far as accessory liability is concerned, in *Royal Brunei*:<sup>42</sup>

“‘knowingly’ is best avoided as a defining ingredient of the principle, and in the context of this principle the Baden scale of knowledge is best forgotten.”

But in *Akindele*<sup>43</sup> Nourse LJ expressed the view that it was ‘often helpful’ in ‘knowing assistance’ cases.

The judgment of Lord Nicholls in *Royal Brunei* is very well known and I shall resist the temptations to cite long passages from it. His conclusions are clear:<sup>44</sup>

“...that dishonesty is a necessary ingredient of accessory liability. It is also a sufficient ingredient.”

I read the judgment as impliedly, if not expressly, approving Millett J’s observations in *Agip*,<sup>45</sup> that whether a defendant should be held liable for dishonest assistance is

“essentially a jury question”.<sup>46</sup>

The prime characteristic of a jury question is the form in which it has to be answered. However imponderable the question, the answer must be short and unambiguous and never has to be backed up by reasons. The abolition of the civil jury, in all but a handful of special cases, has put heavy extra burdens of reasoned decision-making onto the shoulders of trial judges. It is one of the virtues of Lord Nicholls’ judgment in *Royal Brunei* that (once the discussion of the authorities is over) it is expressed in terms

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<sup>38</sup> By Millett J in *Agip* at 293.

<sup>39</sup> By Hirst LJ in *Three Rivers DC v Bank of England (No. 3)* [2003] 2 AC 1, 53.

<sup>40</sup> By the Court of Appeal in *Agip* [1991] Ch 547, 567.

<sup>41</sup> In *Equity, Fiduciaries and Trusts* (ed Waters) Carswell (1993) 195, 196.

<sup>42</sup> At 392.

<sup>43</sup> *BCCI (Overseas) Ltd v Akindele* [2001] Ch 437, 455.

<sup>44</sup> At 392.

<sup>45</sup> Lord Nicholls referred at 388 to p.293 of Millett J’s judgment in *Agip*.

<sup>46</sup> I am not aware of any pithy definition of this expression, but it goes back at latest to *Bell v Kennedy* (1868) LR 1 Sc & Div 307, 324, a case on domicile.

which a jury could be expected to understand. Hard experience in criminal trials shows that there are limits to the degree of refinement with which a jury can sensibly be directed on matters of intention.<sup>47</sup>

There is one point on *Royal Brunei* which I find puzzling, and which seems to have attracted little attention. Mr Tan, who brought about the misappropriation of the airline's money, was the managing director and principal shareholder of a company called Borneo Leisure Travel. That company was, under a formal written agreement, an express trustee of the money which it collected as agent for the airline. The Court of Appeal of Brunei held (allowing the defendant's appeal) that dishonesty on the part of Borneo Leisure Travel had not been established. Lord Nicholls stated the issue<sup>48</sup> as,

“whether the breach of trust which is a prerequisite to accessory liability must itself be a dishonest and fraudulent breach of trust by the trustee”.

(and the Privy Council held<sup>49</sup> that that was not necessary). But at the end of the judgment Lord Nicholls accepted that Mr Tan was the directing mind of Borneo Leisure Travel, and that it must also be treated as having acted dishonestly. So it was hardly necessary to decide the issue in the terms in which he posed it.

The issue of corporate *mens rea* seems to have led to some interesting discussion in Australia as to whether a claimant can “aggregate” knowledge in the minds of different individuals who were officers or senior employees of a company. In *Krakowski*<sup>50</sup> the majority of the High Court of Australia stated that:

“A division of function among officers of a corporation responsible for different aspects of the one transaction does not relieve the corporation from responsibility determined by reference to the knowledge possessed by each of them.”

The Court of Appeal of Victoria<sup>51</sup> has since expressed differing views about how far that goes. The issue has also arisen in New Zealand, in extraordinary circumstances involving the responsibility of government officials and advisers.<sup>52</sup>

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<sup>47</sup> See *R v Woollin* [1999] AC 82.

<sup>48</sup> At 384.

<sup>49</sup> At 392.

<sup>50</sup> *Krakowski v Eurolynx Properties Ltd* (1995) 183 CLR 563, 582-3.

<sup>51</sup> *Macquarie Bank Ltd v Sixty-Fourth Throne Pty Ltd* [1998] 3 VR 133.

<sup>52</sup> *Equiticorp Industries Group Ltd (in stat. man.) v R (No. 47)* [1998] 2 NZLR 481.

The most recent English case on knowing assistance in *Twinsectra*.<sup>53</sup> The facts were unusual. Mr Yardley, an adventurous businessman, had two solicitors. His regular solicitor was Mr Leach but he also had a sort of *ad hoc* solicitor, Mr Sims, who acted because Mr Leach was unwilling to give a personal undertaking to be liable to the proposed lender, Twinsectra, for a loan of £1m. Mr Sims gave this undertaking and also a second undertaking to retain the £1m until it was applied in the acquisition of (unspecified) property. The second undertaking, vague though it was, was held to have created a trust, and Mr Leach knew of it. Mr Sims, in breach of his second undertaking, passed the money to Mr Leach who dispersed it on his client's instructions, and partly not in the acquisition of property. Mr Sims was insolvent and not worth suing.

The trial judge (Carnwath J) found that Mr Leach had not been dishonest although he had "shut his eyes" to the implications of the second undertaking. The Court of Appeal treated these conclusions as contradictory and gave judgment against the solicitor. The majority of the House of Lords thought that the judge's findings (although imperfectly expressed) were not contradictory, and restored his decision.

Lord Hoffmann said<sup>54</sup> that the principles in *Royal Brunei*:

"...require more than a knowledge of the facts which made the conduct wrongful. They require a dishonest state of mind, that is to say, consciousness that one is transgressing ordinary standards of honest behaviour."

He also said:<sup>55</sup>

"I do not suggest that one cannot be dishonest without a full appreciation of the legal analysis of the transaction".

The rest of the House (which did not include Lord Nicholls) took much the same view, except for Millett, whose attitude was sterner. He said,<sup>56</sup>

"There was no need to impute knowledge to Mr Leach, for there was no relevant fact of which he was unaware ... Yet from the very first moment that he received the money he treated it as held to Mr Yardley's order and at Mr Yardley's free disposition. He did not shut his eyes to the facts, but to "the implications", that is to say the impropriety of putting the money at Mr

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<sup>53</sup> *Twinsectra Ltd v Yardley* [2002] 2 AC 164.

<sup>54</sup> At 170.

<sup>55</sup> At 171.

<sup>56</sup> At 203-4, paras 141-4.

Yardley's disposal. His explanation was that this was Mr Sims' problem, not his.

Mr Leach knew that Twinsectra had entrusted the money to Mr Sims with only limited authority to dispose of it; that Twinsectra trusted Mr Sims to ensure that the money was not used except for the acquisition of property; that Mr Sims had betrayed the confidence placed in him by paying the money to him (Mr Leach) without seeing to its further application; and that by putting it at Mr Yardley's free disposal he took the risk that the money would be applied for an unauthorised purpose and place Mr Sims in breach of his undertaking ... In my opinion this is enough to make Mr Leach civilly liable as an accessory."

Or as Stephen J put it more concisely in *DPC*,<sup>57</sup> the defendant's liability arose from his "failure to recognise fraud when he saw it."

I must confess that I am doubtful whether the law as stated in *Royal Brunei* is clearer after *Twinsectra*. Perhaps the time has come to curtail the discussion and just pose the jury question. In a recent case in the English Court of Appeal, Aldous LJ said<sup>58</sup> that whether the defendant was dishonest:

"... may not be an easy question to answer, but it is the sort of question that judges and juries throughout the country answer every day without needing to analyse large numbers of authorities."

In similar vein Lord Hoffman, sitting in the Hong Kong Court of Final Appeal,<sup>59</sup> warned against the concept of the hypothetical decent honest man:

"The danger is that because honest people also tend to behave reasonably, considerately and so forth, there may be a temptation to treat shortcomings in these respects as a failure to comply with the necessary objective standard. It seems to me much safer, at least in the context of an allegation of fraud, to concentrate on the actual defendants and simply ask whether they have been dishonest. Judges and juries seldom have any conceptual difficulty in knowing what is meant by dishonesty."

There has also been a warning in your own Court of Appeal, in *Beach Petroleum*<sup>60</sup>, of the danger of equating imprudent or unreasonable conduct with dishonest conduct.

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<sup>57</sup> (1975) 132 CLR 373, 411.

<sup>58</sup> *Mortgage Express Ltd v Newman & Co.* [2001] PNLR 86, 100.

<sup>59</sup> *Aktiecselskabet Dansk Skibsfinansiering v Brothers* [2001] BCLC 324, 334.

Now I come to *Akindele*.<sup>61</sup> It was argued both as a case of dishonest (or as Nourse LJ preferred to call it, knowing) assistance and as a case of knowing receipt. The latter ground is the important one. The facts were that Chief Akindele, a wealthy Nigerian businessman, had in 1985 paid \$10m to ICIC Overseas, a company associated with BCCI. He did so under a written agreement, the ostensible effect of which was that he bought 250,000 shares in BCCI Overseas at \$40 per share, and ICI Overseas agreed to repurchase them at a price which gave the defendant a return of 15% per annum (compound) on his money. In the meantime the shares were not to be transferred to him. In 1988 ICIC Overseas paid the defendant about \$16.7m under a so-called divestiture agreement. The individuals controlling the BCCI Group entered into these agreements for the purposes of fraud, in an attempt to mislead their auditors. The defendant was not interested in acquiring BCCI Overseas shares. His original, honest intention was to earn an exceptionally high return on his money. By 1988 he had come to have suspicions about the probity of the BCCI Group's management but the conclusion of the trial judge, Carnwath J was that he had no knowledge of the underlying frauds within the BCCI Group, either in general or in relation to the arrangements with him.

The issues at trial were whether the 1985 agreement was a sham (it was not) and whether the defendant was liable as a constructive trustee under the head of dishonest assistance or knowing receipt. Carnwath J held that dishonesty was an essential ingredient under either head, and on his findings of fact he found that the claim failed. In the Court of Appeal the only issue was as to knowing receipt of the defendant's gain of about \$6.7m.

Nourse LJ (with whom Ward and Sedley LJJ agreed) reviewed the English authorities and a small number of Commonwealth authorities. He concluded (especially by reference to *Belmont Finance*<sup>62</sup> and *Re Montagu*<sup>63</sup>) that the only significance of categorising the defendant's knowledge was to determine whether his conscience was affected. He proceeded,<sup>64</sup>

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<sup>60</sup> *Beach Petroleum NL v Kennedy* (1999) 48 NSW 1.

<sup>61</sup> *BCCI (Overseas) Ltd v Akindele* [2001] Ch 437.

<sup>62</sup> *Belmont Finance Corporation Ltd v Williams Furniture Ltd. No. 2* [1980] 1 AER 393, 405

<sup>63</sup> *Re Montagu's Settlement Trusts* [1987] Ch 264, 273.

<sup>64</sup> At 455.

“But if that is the purpose, there is no need for categorisation. All that is necessary is that the recipient's state of knowledge should be such as to make it unconscionable for him to retain the benefit of the receipt.

For these reasons I have come to the view that, just as there is now a single test of dishonesty for knowing assistance, so ought there to be a single test of knowledge for knowing receipt. The recipient's state of knowledge must be such as to make it unconscionable for him to retain the benefit of the receipt.”

On the trial judge's findings, the conduct of the Chief in taking \$16.7m under the divestiture agreement had not been unconscionable, because he neither knew nor ought to have known of the fraud, and the claim had been rightly dismissed.

*Akindede* has, unsurprisingly, caused a good deal of controversy. I am reminded of what Kirby J said about *Breen*<sup>65</sup> in his dissenting judgment in *Pilmer*<sup>66</sup>:

“The comments have ranged from the condemnatory, through the disappointed, to the resigned and accepting, rising to praise and ending just short of unalloyed pleasure. When a judicial decision produces such a wide range of responses, it is fair to assume that the law does not speak with total clarity or that its content is uncontested.”

Lord Nicholls has presciently anticipated the difficulties in *Royal Brunei*:<sup>67</sup>

“Mention, finally, must be made of the suggestion that the test for liability is that of unconscionable conduct. Unconscionable is a word of immediate appeal to an equity lawyer. Equity is rooted historically in the concept of the Lord chancellor, as the keeper of the Royal Conscience, concerning himself with conduct which was contrary to good conscience. It must be recognised, however, that unconscionable is not a word in everyday use by non-lawyers. If it is to be used in this context, and if it is to be the touchstone for liability as an accessory, it is essential to be clear on what, *in this context*, unconscionable means. If unconscionable means no more than dishonesty, then dishonesty is the preferable label. If unconscionable means something different, it must be said that it is not clear what that something different is. Either way, therefore, the term is better avoided in this context.”

Others have made the same point, including Professor Birks<sup>68</sup>:

“‘Unconscionable’ gives no guidance. At one extreme it is unconscionable not to replay what you were not intended to receive. At the other extreme, it is unconscionable to be dishonest. ‘Unconscionable’, indicating unanalysed

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<sup>65</sup> *Breen v Williams* (1994) 35 NSW LR 522.

<sup>66</sup> *Pilmer v Duke Group Ltd (in liquidation)* (2001) 207 CLR 165, 210.

<sup>67</sup> At 392.

<sup>68</sup> *Breach of Trust* (ed Birks & Pretto) Hart Publishing (2002) p226; see also Burrows, *the Law of Restitution*, 2<sup>nd</sup> ed. (2002) p.201.

disapprobation, thus embraces every position in the controversy. If we look at what the court did, rather than at the word in which it summed up the test which it intended to apply, we can see that Chief Akindele held onto his money as a result of a factual inquiry resembling an inquiry into constructive notice: he neither knew nor ought to have known of the improprieties going on inside BCCI. In this inquiry 'unconscionable' seems no more than a fifth wheel on the coach."

In New Zealand, Tipping J has said of unconscionability, that he would prefer "the herald of equity to be wearing more distinctive clothing."<sup>69</sup>

At this point may I take stock? The end of this lecture is now in sight, or at any rate not too far over the horizon. I have not yet mentioned restitution or unjust enrichment. Nor have I made more than the merest mention of the important decision of the High Court in *Roxborough*<sup>70</sup>. I fear that I would be imposing too much on the patience of this very distinguished audience if I were to embark on any lengthy discussion of these difficult and controversial matters. But having got as far as noticing the criticisms of the vagueness of the "unconscionable" test in *Akindele*, and having read with great interest and admiration all the judgements in *Roxborough*, I feel that I would be failing in my duty if I did not, with proper diffidence, say something.

Perhaps I can put it like this. The notion that equity will grant relief in respect of conduct which is against conscience resonates through centuries of legal history. It resonates particularly, I have no doubt, in New South Wales. There are probably many reasons for this, but they must include the particular importance which Australians attach to straightforwardness and fair play. They are reflected in the fact that the administration of equity was separated from the administration of the common law, in your courts, until a time within living memory. They also reflected in the reference in your Commonwealth Trade Practices Act<sup>71</sup> to "conduct that is unconscionable within the meaning of the unwritten law from time to time of the States and Territories."

But as the majority of the High Court said in *Garcia*<sup>72</sup>

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<sup>69</sup> *Marshall Futures Ltd v Marshall* [1992] 1 NZLR 316, 325.

<sup>70</sup> *Roxborough v Rothmans of Pall Mall Australia Ltd* (2001) 208 CLR 516.

<sup>71</sup> Section 51 AA: see *Berbatis Holding Pty Ltd v Australian Competition and Consumer Commission* (2001) 185 ALR 555.

<sup>72</sup> *Garcia v National Australia Bank Ltd* (1998) 194 CLR 395, 409.

“We acknowledge that the statement that enforcement of the transaction would be ‘unconscionable’ is to characterise the result rather than to identify the reasoning that leads to the application of that description.”

The same (or a similar) point was put forcibly, 20 years ago, by Deane J in *Muschinski*<sup>73</sup>:

“Under the law of this country – as, I venture to think, under the present law of England – proprietary rights fall to be governed by principles of law and not by some mix of judicial discretion, subjective views about which party ‘ought to win’ and ‘the formless void of individual moral opinion’”.  
(*References omitted*).

So there is no doubt that equity is alive and well in New South Wales, and it is a thoroughly principled system of equity, not a general liberty for the court to decide cases as it thinks fair. The principles are to be found in that remarkable work of scholarship which still, I am glad to see, bears the names Meagher, Gummow and Lehane.<sup>74</sup> It is just as well that cases are not decided on the court’s general perception of what is fair, since it is striking how the cases throw up facts on which both lawyers and laymen may have very different views as to what would be a fair result. That may be true of *Roxborough* and it is certainly true of *Foskett v McKeown*<sup>75</sup>, an interesting and important decision of the House of Lords which I must leave aside today.

The principle or doctrine of unjust enrichment also forms part of the law of Australia. That has been clear (at least) since 1987 when in *Pavey & Matthews*<sup>76</sup> the High Court exorcised the ghost of implied contract<sup>77</sup> and recognised unjust enrichment as a “unifying legal concept”. In 1988 the High Court unanimously expressed the view<sup>78</sup> that “contemporary legal principles of restitution or unjust enrichment can be equated with seminal equitable notions of good conscience.” And in *David Securities*<sup>79</sup> the High Court gave relief for money paid under a mistake of law, since the doctrine of unjust enrichment

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<sup>73</sup> *Muschinski v Dodds* (1985) 160 CLR 583, 615-6.

<sup>74</sup> 4<sup>th</sup> ed (2002) edited by Meagher, Heydon and Leeming.

<sup>75</sup> [2001] 1 AC 102.

<sup>76</sup> *Pavey & Matthews Pty Ltd v Paul* (1987) 162 CLR 221.

<sup>77</sup> See Kirby J in *Roxborough* at 578-9.

<sup>78</sup> *Australia and New Zealand Banking Group Ltd v Westpac Banking Corporation* (1988) 164 CLR 662, 673; see also *Baltic Shipping Co v Dillon* (1993) 176 CLR 344, 359 (Mason CJ).

<sup>79</sup> *David Securities Pty Ltd v Commonwealth Bank of Australia* (1992) 175 CLR 353.

made meaningless the distinction between mistake of fact and mistake of law. The House of Lords caught up on this point six years later.<sup>80</sup>

In the High Court cases which I have just referred to there is a ready recognition of a degree of kinship between restitutionary and equitable doctrine. The same recognition can be found in some of the old cases which restitution lawyers regard as seminal, including *Moses v Macferlan*<sup>81</sup> (which Gummow J discussed at some length in *Roxborough*) and *Kelly v Solari*.<sup>82</sup> But I sense that there is in this jurisdiction a fairly strong inclination, eloquently expressed by Gummow J in *Roxborough*<sup>83</sup> and by Finn J in an article quoted by Gummow J,<sup>84</sup> to maintain established equitable principles and to be cautious of what his Honour<sup>85</sup> calls “any all-embracing theory of restitutionary rights and remedies founded upon a notion of unjust enrichment.”

I have to say that I share this inclination. It is partly, no doubt, a matter of one’s upbringing and experience in the law, and perhaps to some extent a generational thing, like the way one feels about mobile phones. When I was a law student restitution barely existed as an academic subject in England. The first edition of Goff and Jones lay several years in the future. By training and by temperament, I prefer bottom-up to top-down legal reasoning.

But the fact is that in England the last 15 years have seen some very important changes in this area of the law. Four decisions of the House of Lords have led the way. In *Lipkin Gorman*<sup>86</sup> the House recognised the defence of change of position. In *Westdeutsche*<sup>87</sup> it departed from its venerable but obscure decision in *Sinclair v Brougham*<sup>88</sup>. In the *Lincoln* case<sup>89</sup> it caught up with the High Court of Australia as regards

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<sup>80</sup> *Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 AC 349.

<sup>81</sup> (1760) 2 Burr 1005, 1008-12.

<sup>82</sup> (1841) 9 M & W 54, 58.

<sup>83</sup> At 543-5.

<sup>84</sup> Finn, *Equitable Doctrines and Discretion in Remedies in Cornish, Restitution Past, Present and Future* (1998) 251, 252.

<sup>85</sup> At 544.

<sup>86</sup> *Lipkin Gorman v Karpnale Ltd* [1991] 1 AC 548

<sup>87</sup> *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669

<sup>88</sup> [1914] AC 398.

<sup>89</sup> *Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 AC 349.

mistake of law. And in *Foskett v McKeown*<sup>90</sup> the House expressed the view, not necessary to the decision, that there should in future be a unified theory of tracing, without any need to find an antecedent fiduciary relationship before applying equitable principles.

It is hard to know where we will be going next. but I would venture to predict that the problem of “knowing receipt” highlighted by *Akindele* will not be satisfactorily resolved in England unless we address the potential ambiguities of describing conduct as unconscientious, or unconscionable.

To see to retain property to which the recipient has no proper title may itself be regarded as unconscientious. That thought was expressed by Lord Greene MR in the well-known case of *Re Diplock*,<sup>91</sup> which was concerned with a defective testamentary trust for charitable or benevolent purposes,

“And as regards the conscience of the defendant upon which in this as in other jurisdictions equity is said to act, it is prima facie at least a sufficient circumstance that the defendant, as events have proved, has received some share of the estate to which he was not entitled.”

Another similar passage in Lord Greene’s judgment was recently cited in your own Court of Appeal in *Evans v European Bank Ltd*,<sup>92</sup> a case of enormous interest which time prevents me from discussing. These statements by Lord Greene have echoes of key passages in *Moses v Macferlan* and *Kelly v Solari*. They also find an echo, if I have read the judgments correctly, in the emphasis placed in *Roxburgh*, both by the majority and by Gummow J in his separate concurring judgment, on unjust or unconscientious *retention* of property to which the recipient has no title. It is not necessarily unconscientious to receive another’s property by mistake or accident, but it is unconscientious to hold on to it when you know the facts. The disapprobation implied in characterising conduct as unconscionable, however “unanalysed”<sup>93</sup> and imprecise, suggests a fault-based (rather than a receipt-based) liability. Where does that leave an innocent recipient of misapplied trust money who uses it to pay off his overdraft?<sup>94</sup> There is no proprietary remedy against him,

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<sup>90</sup> [2001] 1 AC 102.

<sup>91</sup> [1948] Ch 465, 503.

<sup>92</sup> [2004] NSWCA 82 para 149.

<sup>93</sup> See footnote 68 above.

<sup>94</sup> This point is discussed in an article by Professor Ross Grantham in *Singapore Journal of Legal Studies* [2002] 388, 398 ff.

and it would be unfair to make him liable as a constructive trustee. But he has not, in the technical sense, changed his position by paying off his overdraft; his net assets have been swollen by the receipt.

The most satisfactory approach to resolving these very difficulties is to my mind put forward in the article by Lord Nicholls, published in 1998, which I have already mentioned.<sup>95</sup> The configuration of personal liability which Lord Nicholls proposes, in the barest outline, is to recognise fiduciary liability for dishonest assistance (or accessory liability) as a fault-based liability founded in dishonesty; fiduciary liability for knowing receipt as a similar fault-based liability requiring actual guilty knowledge; and the personal liability of an innocent or negligent recipient as receipt-based and strict, subject to the defence of change of position. The third of these categories would not make the second redundant, since the defence of change of position is not available to a defendant who is held liable as if he were a trustee (and who is also, therefore, liable to pay compound interest and to account for any profit). At least one judicial voice has been raised in Australia in favour of this way forward.<sup>96</sup> But it is not yet established law, or anywhere close to it, in any jurisdiction. There is still plenty of room for debate.

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<sup>95</sup> Knowing Receipt – The Need for a New Landmark in Cornish, *Restitution Past, Present and Future*, (1998) 231.

<sup>96</sup> *Koorourtang Nominees Pty Ltd v Australia and New Zealand Banking Group Ltd* [1998] 3 ER 16 (Hansen J).