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IS THE REQUIREMENT OF DISHONESTY ALWAYS THE
BEST POLICY TO ESTABLISH LIABILITY AGAINST
THOSE WHO ASSIST IN A BREACH OF TRUST?

Philip J Drake

A dissertation submitted for the award of the degree of
Master of Laws (LLM)

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Declarations

I, Philip Drake, confirm that the material contained in this dissertation has not been used in any other submission for an academic award and that there is full attribution of the work of any other authors.

The word count for this dissertation (to the nearest 500 words) is 25,000

The dissertation supervisor is Dr Paul H Richards

Summary

This dissertation considered the history of the equitable liability for assisting in a breach of trust. The position in equity was compared with the position in the criminal law and the common law. The aim was to establish if liability in equity should be founded on the dishonesty or knowledge of an intermeddling stranger and to consider if the appropriate test was being applied.

Liability in equity was historically based on objective knowledge, with a requirement that the trustee was also dishonest. However, whilst the requirement that the trustee was dishonest was removed, this was replaced with a requirement that the stranger should be dishonest. This led to the imposition of a *Ghosh* style test for objective and subjective dishonesty, which has been heavily criticised. The Privy Council and Court of Appeal have sought to re-define the test as being objective, however the position remains somewhat uncertain. The use of a criminal test for an equitable liability is not appropriate. The criminal law has encountered enough problems in trying to define dishonesty. The common law has encountered problems due to the 'privity of contract' rule. However, the common law has evolved to allow for the beneficiaries of a will to sue in the tort of negligence and it may also be possible for the equitable owner of goods to sue in negligence.

The requirement of dishonesty in equity should be removed altogether and equity should return to a requirement of actual knowledge or constructive knowledge ascertained by an objective test. There should also be an additional requirement that in the circumstances, it is 'just and reasonable' to impose liability. Equity and the common law should remain separate. Reference to negligence is best avoided, even if the test is similar to this common law tort.

CHAPTER 1

INTRODUCTION

The position for legal or equitable recovery against trustees who breach their duty is well settled in law¹. A constructive trust will be imposed upon a trustee who receives remuneration to which he is not entitled², enters a transaction on his own behalf which he should have done on his principal's behalf³, uses confidential information for his own ends⁴ or receives a bribe⁵. However, the position becomes far more complex if the trustee has dissipated the funds or has insufficient assets to satisfy the beneficiaries' claims. In such circumstances it is necessary for the beneficiaries to cast their net wider in the hope of recovering lost funds and consider where the trust property is or if anybody assisted with the breach of duty. This dissertation will concentrate on the latter of the two scenarios, where the beneficiaries' sole remaining hope for recovery of the lost funds is against an intermeddling stranger who assisted in the breach of trust. Quite often the intermeddling stranger ("the stranger") will be an institution such as a bank⁶ or professionals, such as a solicitor⁷ or accountant⁸. Whilst they will generally have the funds or insurance available to compensate the beneficiaries, the courts have been traditionally reluctant to impose liability upon them, particularly since the introduction of the requirement of dishonesty⁹.

1.1 Knowledge and dishonesty

Both the knowledge and dishonesty of the stranger and trustee have been acknowledged, by the courts, as two fundamental areas in the development of this area of law.

Historically, the courts had limited the requirement of dishonesty to the trustee, who must have had a fraudulent design when he breached the trust. The stranger did not need to be

¹ *Bray v Ford* [1896] AC 44 HL.

² *Sugden v Crossland* (1856) 3 Sm & G 192; *Erlanger v New Sombrero Phosphate Co* (1877-78) LR 3 App Cas 1218 HL; *Williams v Barton* [1927] 2 Ch 9 Ch D; *Re Macadam* (1946) Ch 73; [1945] 2 All ER 664 Ch D; *Guinness plc v Saunders* [1990] 2 AC 663.

³ *Keech v Sandford* 25 ER 223; (1726) 1 Sel Cas Ch 61 Ct of Chancery; *Re Biss* [1903] 2 Ch 40 CA; *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134; [1942] 1 All ER 378 HL.

⁴ *Boardman v Phipps* [1967] 2 AC 46.

⁵ *Attorney General of Hong Kong v Reid* [1994] 1 AC 324; *Crown Resources AG v Vinogradsky and others* [2001] All ER.

⁶ *Selangor United Rubber Estates Ltd v Cradock (a bankrupt) and others (No. 4)* [1969] 3 All ER 965 Ch D.

⁷ *Fyler v Fyler* (1841) 3 Beav 550, 49 ER 216; *Barnes v Addy* (1873-74) LR 9 Ch App 244.

⁸ *Agip (Africa) Ltd v Jackson* [1991] Ch 547.

⁹ *Twinsectra Ltd v Yardley* [2002] UKHL 12 [35]; JE Penner, 'Dishonest assistance revisited: Barlow Clowes International Ltd (in liquidation) and others v Eurotrust International Ltd' [2006] Tru LI 122, 134.

dishonest, but had to have knowledge of this fraudulent design. Whilst knowing of a fraudulent design may imply dishonesty, there was no express requirement of dishonesty on the part of the stranger. Therefore this form of liability was previously known as knowing assistance. However, the law has moved away from knowledge being the most important consideration. The position now is that there must be a breach of trust and the stranger must have dishonestly assisted in the breach of trust. This has further led to confusion over whether it is the stranger's mind or conduct that is dishonest, whether conduct alone can be dishonest, without the mind being dishonest and whether the test to decide whether the stranger is dishonest should be subjective, objective or a combination of the two.

This area will be examined further in detail, with particular attention given to objective and subjective dishonesty and knowledge, whether the stranger should be dishonest or simply have knowledge of the breach of trust and whether dishonesty is the same as acting 'unconscionably' or with 'want of probity'.

1.2 Consequences of being found liable in equity

The reason why the courts have increased the evidential burden to one of dishonesty could be the remedy which is provided to the victim and the severe financial consequences of this remedy. This may also be the reason why many beneficiaries, who have been the victim of a fraud, find this remedy to be very attractive.

In the case of *Gruppo Torras SA v Al-Sabah*¹⁰ the Privy Council confirmed that the normal rules of causation do not apply to strangers found liable for dishonest assistance. The stranger in such circumstances will be jointly and severally liable with the trustee, by way of a secondary liability, for the whole loss resulting from the breach of trust. The stranger's liability is only secondary as the action will only arise if there has been a primary breach of trust by a trustee. If the trustee does not breach the trust then the stranger cannot be liable. However, as the stranger is jointly and severally liable, he may potentially be liable for all the loss suffered by the trust regardless as to whether he caused it or not. This flies in the face of the normal rules of causation, where the defendant is only liable for the consequences of his own actions. Effectively, in equity, the stranger is liable for the exact

¹⁰ [2001] Lloyd's Rep 36.

same losses as the trustee¹¹. This is a very wide and far reaching liability upon the stranger and consequently is likely to result in higher and more substantial damages than a remedy under the common law would provide. Essentially, the stranger may be liable in equity for all the losses suffered by the beneficiaries, whereas in the common law he would only be liable for those losses he had caused.

1.3 The dissertation

This dissertation will examine the early and foundation cases on knowing assistance, the development of this area of law over the years, including the key case of *Twinsectra Ltd v Yardley*¹². It will examine and compare the requirement of dishonesty and knowledge in the criminal law, the common law torts of misrepresentation, interference with a contract and negligence and the problems created by the privity of contract rule. Consideration will be given to the attempts by the Privy Council¹³ and Court of Appeal¹⁴ to clarify the law following the case of *Twinsectra*¹⁵ and the Court of Appeal's suggestion of the possibility of a claim under the equitable remedy of restitution. The dissertation will end with an evaluation of the requisite knowledge and dishonesty required in order to establish liability upon an intermeddling stranger, a comparison with the position in other areas of law and a recommendation whether the requirement of dishonesty on the part of the stranger, who assists in a breach of trust, is still appropriate and what the appropriate test should be in the future.

¹¹ *MacDonald v Hauer* (1976) 72 DLR (3d) 110 [129]; *Re Bell's Indenture* [1980] 1 WLR 1217 [1231]-[1233]; *NCR Australia Pty Ltd v Credit Connection Pty Ltd (in liq.)* [2004] NSWSC1 [150].

¹² [2002] UKHL 12.

¹³ *Barlow Clowes International Ltd (In Liquidation) v Eurotrust International Ltd* [2005] UKPC 37.

¹⁴ *Abou-Rahmah v Abacha* [2006] EWCA Civ 1492.

¹⁵ *Twinsectra* (n 12).

CHAPTER 2

THE EARLY CASES

The earliest cases in the area of knowing assistance focused on the knowledge of the stranger.

2.1 The cases of *Fyler v Fyler*¹⁶ and *A-G v Leicester Corp*¹⁷

In *Fyler v Fyler*¹⁸, the strangers who assisted in a breach of trust were solicitors. The solicitors had induced a trustee to invest in an unauthorised investment. They had knowledge that the money involved was trust money and constructive notice of the terms of the trust. Upon this basis, the court found that they must have known that a breach of trust was being committed and Lord Langdale confirmed that they 'ought to be considered as partakers in the breach of trust'.

In the case of *A-G v Leicester Corp*¹⁹ Lord Langdale considered the position of an agent who acted on the instructions of trustees, with knowledge that this would interfere or assist in a breach of trust. Lord Langdale was clear that even if the agent was following the instructions of his principal, he would still be personally answerable. The key point was the knowledge of the agent. If he had knowledge that a breach of trust was being committed and then interfered or assisted in the breach of trust, he would be liable.

In *Fyler* the stranger procured the breach of trust with knowledge that a breach of trust was being committed. In *Leicester Corp* the stranger complied with instructions from trustees, when he knew a breach of trust was being committed. In both cases the knowledge of the strangers was important in the finding of liability and there was no requirement that either the stranger or trustee were dishonest.

¹⁶ (1841) 3 Beav 550, 49 ER 216.

¹⁷ (1844) 7 Beav 176, 49 ER 1031.

¹⁸ *Fyler* (n 16).

¹⁹ *Leicester Corp* (n 17) [1032].

2.2 *Eaves v Hickson*²⁰

In the case of *Eaves v Hickson*²¹, Sir John Romilly considered the position where honest trustees had been tricked into breaching a trust by a stranger. The stranger in this case was a father who had forged a marriage document to entitle his children who had been born out of wedlock, to be paid trust monies. Unsurprisingly, the stranger was found liable for sending a forged certificate to the trustees that he had known was false. Whilst he had forged the document himself, he was found liable upon the basis that he knew the document was false, so again the knowledge of the stranger was vital to the question of liability. The stranger in this case clearly knew that by sending the forged document he would be assisting in the breach of a trust.

The court held that the father would be liable for all monies that the children no longer had in their possession and could not return. The trustees would only be liable for the difference which had not been paid by the father and children. This was a somewhat controversial structure, perhaps reflecting the court's views on the culpability of each party. However, nevertheless it did seem inherently fair and just.

2.3 Summary

Ridge and Dietrich²² and Andrews²³ pointed out that all three of these cases were drawn upon by Lord Nicholls in *Royal Brunei Airlines Sdn Bhd v Tan*²⁴ to support his contention that focus should be on the dishonesty of the stranger. It is submitted however, that these cases do not support a case for the requirement of dishonesty. The courts primary concern in all three cases was the knowledge of the stranger. The courts did not indicate any requirement that either the trustee or stranger should have to act dishonestly. Ridge and Dietrich pointed out that in contrast to Lord Nicholls approach, the High Court of Australia in the case of *Farah Constructions Pty Ltd v Say-Dee Pty Ltd*²⁵ had considered the same nineteenth century cases and taken the opposite approach²⁶.

²⁰ [1861] 30 Beav 136, 54 ER 840.

²¹ *ibid.*

²² Pauline Ridge & Joachim Dietrich, 'Equitable third party liability' [2008] LQR 26, 29-30.

²³ Georgina Andrews, 'The Redundancy of dishonest assistance' [2003] Conv 398, 400.

²⁴ [1995] 2 AC 378.

²⁵ [2007] HCA 22.

²⁶ Ridge & Dietrich (n22) 29.

Whilst all three of these cases were groundbreaking cases of their time, they were unfortunately not considered in the subsequent and leading case of *Barnes v Addy*²⁷, which will be looked at in the next chapter.

²⁷ (1873-74) LR 9 Ch App 244.

CHAPTER 3

CONSIDERATION OF *BARNES v ADDY*²⁸

The principle arising from this case is credited by Martin²⁹ as creating the category of knowing assistance. It was described by Oakley³⁰ as the starting point for every discussion on knowing/dishonest assistance and Hudson³¹ set out the case as providing the foundations for modern law on the area of knowing/dishonest assistance.

3.1 The liability of strangers

The strangers in this case were solicitors who had acted injudiciously on the instructions of trustees³², but not dishonestly³³, and had inadvertently assisted in the misapplication of trust property.

It was acknowledged by the court that liability could be:-

‘extended in equity to others who were not properly trustees’.³⁴

However, the court was clear that for liability to attach to the stranger, he must be:-

‘cognisant of a dishonest design on the part of the trustee’.³⁵

This created a primary requirement that the trustee had a dishonest design. This was a principle which Martin described as becoming subsequently entrenched in the law³⁶. It unfortunately did not take into account the *Eaves v Hickson*³⁷ situation where the trustees

²⁸ *Barnes* (n27).

²⁹ Jill E Martin, *Modern Equity* (18th edn, Sweet & Maxwell 2009) 12-010.

³⁰ AJ Oakley, *Parker and Mellows: The Modern Law of Trusts* (9th edn, Sweet & Maxwell 2008) para 10-165.

³¹ Alastair Hudson, *Equity and Trusts* (6th edn, Routledge Cavendish 2010) 878.

³² Oakley (n 30) para 10-166.

³³ *Barnes* (n 27) [255].

³⁴ *ibid* [252].

³⁵ *ibid* [244].

³⁶ Martin (n 29) para 12-012.

³⁷ *Eaves* (n 20).

could be honest. As recognised by Halliwell and Prochaska³⁸, Lord Nicholls in *Royal Brunei Airlines Sdn Bhd v Tan*³⁹ described this as the law having gone wrong.⁴⁰

3.2 'Cognisant of a dishonest design'

The dictionary definition of being cognisant is 'to have knowledge, awareness or to have cognition'⁴¹. Cognition is 'an action or faculty of knowing, perceiving, conceiving, as opposed to emotion and volition; a perception, sensation, notion or intuition'⁴².

Therefore the dictionary definition suggests that the stranger must have knowledge of or awareness of the dishonest design. It also indicates that 'cognition' or a perception, sensation, notion or intuition of the trustee's dishonest design may also be sufficient.

Lord Selborne LC clarified what was meant by 'cognisant' and confirmed that this would include knowledge of or a suspicion of a fraudulent design⁴³. A view which both Harpum⁴⁴ and Oakley⁴⁵ share.

In the original trial hearing of this action, the stranger gave evidence that he was aware that as a general rule what he had done was 'not a safe thing...' to do⁴⁶. However, the appeal court applied an objective test to decide whether the stranger had knowledge of the 'dishonest design'. The test was:-

'whether the solicitor ought or ought not from the circumstances of the case, be held to have been aware that something wrong was intended'⁴⁷.

The court concluded upon the basis of 'evidence, justice and reason' that they could not disbelieve the stranger when he said he did not know nor suspect a dishonest purpose and was not liable. Therefore, the court will consider the evidence given and upon the

³⁸ Margaret Halliwell & Elizabeth Prochaska, 'Assistance and dishonesty: ring-a-ring o'roses' [2006] Conv 465, 466.

³⁹ *Royal Brunei* (n 24).

⁴⁰ *ibid* [386].

⁴¹ *The Concise Oxford Dictionary* (9th edn, OUP 1995).

⁴² *ibid*.

⁴³ *Barnes* (n 27) [245], [252].

⁴⁴ Charles Harpum, 'The stranger as constructive trustee: Part 1' [1986] LQR 114, 120.

⁴⁵ Oakley (n 30) para 10-173.

⁴⁶ *Barnes* (n 27) [253].

⁴⁷ *ibid* [254].

basis of this evidence decide if the stranger should have known or suspected a dishonest purpose and decide his liability accordingly.

At the time of this judgment, the common law had its own objective test known as the 'reasonable man' test⁴⁸. This test was whether the defendant had done, or failed to do, something which 'a prudent and reasonable man' would have done or not done. The 'reasonable man' test was later adopted and applied in some equity cases, but the decision in *Barnes v Addy*⁴⁹ was a decision of the Chancery Court of Appeal and pre-dated the fusion of equity and law courts by the Judicature Acts of 1873 and 1875. Therefore the legal jurisprudence between the courts of equity and the common law courts remained very much separate.⁵⁰

3.3 Public policy and commercial reality

The court made clear in this case that it would not take lightly the imposition of liability on strangers⁵¹ and the doctrine of trusts should not be 'strained' by allowing liability where the stranger had no knowledge or suspicion of the improper conduct⁵². It was feared by Lord Selborne that the consequences of not applying an appropriate test would be that solicitors, bankers or other agents would be unable to act for trusts if they had any doubts over the transaction⁵³. He did not want this area of law to impede upon commercial affairs. Benjamin recognised *Barnes v Addy*⁵⁴ as one of the first cases to recognise there is a powerful argument to restrict the role of equitable remedies⁵⁵.

Sir W M James considered that some cases had gone to the 'very verge of justice' in trying to make good to beneficiaries at the expense of honest, but injudicious strangers. He concluded:-

⁴⁸ *Blyth v Birmingham Waterworks Co* (1856) 11 Ex 781.

⁴⁹ *Barnes* (n27).

⁵⁰ Daniel J Carr, 'Equity rising? Commonwealth Oil & Gas Co Ltd v Baxter [2010] Edin LR 273, 276.

⁵¹ *Barnes* (n27) [251].

⁵² *ibid* [252].

⁵³ *ibid* [252].

⁵⁴ *ibid*.

⁵⁵ Joanna Benjamin, 'Cukurova in the Court of Appeal' [2008] *Insol Int* 105, 105.

'I do not think it is for the good of the cestuie que trust, or the good of the world, that those cases should be extended'⁵⁶.

3.4 Summary

When delivering the decision, commercial realities and public policy weighed heavily on the judges minds. They considered that the imposition of liability on honest professionals could have grave consequences on the commercial practicality of trusts, by creating unnecessary burdens upon those who deal with them. The court therefore created a test that would limit the situations of liability for these professionals. A stranger would only be liable if the trustee had been dishonest and the stranger had knowledge of the trustee's dishonest design. The knowledge would be objective and upon the basis of what the stranger should have known or suspected.

Delaney and Ryan⁵⁷ described the decision as a distinct doctrinal basis for the imposition of liability. However, it arguably led to a very mechanical application to this area of law, which had previously been very flexible. Tey⁵⁸ pointed out the irony that Lord Selborne had stated in this very judgment that:-

'[there is] no better mode of undermining the sound doctrines of Equity than to make unreasonable and inequitable applications of them'.⁵⁹

It is suggested that whilst this mechanical application of the law may have been equitable to strangers who unknowingly assist in a breach of trust, its limited nature may have had the effect of restricting the growth of this particular doctrine.

⁵⁶ *ibid* [256].

⁵⁷ Hilary Delany & Desmond Ryan, 'Unconscionability: a unifying theme in equity' [2008] Conv 401, 435.

⁵⁸ Tsun Hang Tey, 'Fiduciaries, third parties and remedies – Singapore's perspectives and contribution' [2010] Tru LI 234, 237.

⁵⁹ *Barnes* (n27) [251].

CHAPTER 4

THE CASES FOLLOWING BARNES V ADDY

The law following *Barnes v Addy*⁶⁰ was settled for almost a century. It was not until the late 1960s, and particularly the early 1990s, when a number of large commercial insolvency disputes came before the courts, that the test for the liability of an intermeddling stranger was further analysed and developed.

4.1 Can liability be established on negligence?

The case of *Selangor United Rubber Estates Ltd v Cradock (a bankrupt) and others (No. 4)*⁶¹ extended liability to those strangers who assist in a breach of a fiduciary relationship⁶², but was specifically criticised by Lord Nicholls in *Royal Brunei Airlines v Tan*⁶³ for creating the tendency of the courts to cite Lord Selborne's formulation in *Barnes v Addy*⁶⁴, as though it were a statute.

The case involved the dishonest misapplication of company funds through an elaborate scheme where the purchaser of a company had effectively used the company's own money to buy it.

The stranger was a bank which had transferred money into the purchaser's account and assisted the purchaser in using this money to buy the company. The court claim made out against the bank was that it ought to have known that the payment would be a misapplication of company funds⁶⁵. The court applied an objective test and confirmed:-

‘The plaintiff company's claim in equity against the District Bank depended on the question whether the District Bank should have known, from the facts apparent to its

⁶⁰ *Barnes* (n 27).

⁶¹ [1969] 3 All ER 965 Ch D.

⁶² Robert Pearce, John Stevens & Warren Barr, *The Law of Trusts and Equitable Obligations* (5th edn, OUP, 2010) 971.

⁶³ *Royal Brunei* (n 24) [103].

⁶⁴ *Barnes* (n27).

⁶⁵ *Selangor* (n 61) [968].

branch officials, that the plaintiff company's £232,500 was being used in part to cover the purchase by Mr Cradock of shares in the plaintiff company'.⁶⁶

The court concluded:-

'... a reasonable banker would have concluded that the payment was to finance purchase by Mr Cradock of shares of the plaintiff company'.⁶⁷

The court was solely concerned with what the stranger knew as a matter of fact and if this would have indicated to a 'reasonable banker' that a breach of duty was being committed or put him on inquiry.

The requirement of honesty or dishonesty was not considered at all in *Selangor*⁶⁸. The bank may have acted honestly, but it was liable because it should have known or at least suspected the transaction may result in a misapplication of funds. Neither public policy nor commercial realities were considered by the court, which may reflect a change in attitude by the court or, more likely, a failure by the parties to raise it as an issue.

The *Selangor*⁶⁹ case was followed by *Karak Rubber Co Ltd v Burden (No 2)*⁷⁰. The case again applied an objective test, as in *Selangor*⁷¹, focusing on the knowledge of the stranger and did not consider dishonesty on the part of the stranger.

It was recognised by Ulph and Allen and Pearce, Stevens and Barr that both *Selangor* and *Karak* demonstrated that liability could exist upon the basis of constructive notice⁷² where the stranger had been negligent in not realising or discovering that he was assisting in a breach of trust⁷³.

⁶⁶ *ibid.*

⁶⁷ *ibid.*

⁶⁸ *ibid.*

⁶⁹ *ibid.*

⁷⁰ [1972] 1 All ER 1210.

⁷¹ *Selangor* (n 61).

⁷² Janet Ulph & Tom Allen, 'Transactions at an undervalue, purchasers & the impact of the Human Rights Act 1998' [2004] JBL 1, 11.

⁷³ Pearce, Stevens & Barr (n 62) 973.

In the case of *Baden v Societe Generale pour favoriser le Developpement du Commerce et de l'Industrie en France SA Note*⁷⁴, the court again considered the focus should be on the knowledge of the stranger. In this case Peter Gibson J adopted a fivefold classification of knowledge, incorporating the possibility of liability for the stranger who negligently failed to realise he was assisting in a breach of trust. The levels of knowledge were:-

- '(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; and
 - (v) knowledge of circumstances which would put an honest and reasonable man on inquiry.'
- ⁷⁵

The first three categories related to actual knowledge and what the stranger knew or did. The final two categories were termed constructive knowledge and allowed for a negligence scenario where the stranger did not have knowledge, but was aware of facts or circumstances that should have indicated the facts to him or put him on notice or inquiry, as had been the basis of liability in both *Selangor*⁷⁶ and *Karak*⁷⁷.

4.2 Unconscionable conduct

In addition to the question of knowledge, cases in this area started to examine the conduct of the stranger, in light of what he knew. In the New Zealand case of *Powell v Thompson*⁷⁸ Thomas J observed that if the stranger's conduct was unconscionable then the trustee's conduct would not be relevant and the stranger would be liable to the beneficiary as if he was a trustee. This was contrary to the principle that had been established in *Barnes v Addy*⁷⁹ and would appear to be an attempt to replace the requirement that the trustee was dishonest, with a requirement that the stranger was unconscionable.

⁷⁴ [1993] 1 WLR 509.

⁷⁵ *ibid* [575]-[576].

⁷⁶ *Selangor* (n 61).

⁷⁷ *Karak* (n 70).

⁷⁸ [1991] 1 NZLR 597.

⁷⁹ *Barnes* (n27).

This approach did raise the question what is unconscionable conduct? Unfortunately this has not been satisfactorily defined. Hayton suggested:-

‘Unconscionable behaviour includes, but is not limited to, dishonest behaviour since it encompasses “commercially unacceptable conduct”’.⁸⁰

Hayton is correct in that unconscionable conduct should not be limited to dishonest behaviour only and it is submitted should include generally unacceptable conduct as well as commercially unacceptable. The word unconscionable would seemingly relate to a person’s conscience. The definition of conscience is ‘a moral sense of right and wrong esp. [sic] as felt by a person and affecting behaviour’⁸¹. Therefore acting unconscionably is behaviour falling below the moral and acceptable standards of the ordinary, reasonable and honest person.

In the case of *Equiticorp Industries Group Ltd v Hawkins*⁸², Wylie J agreed that the stranger’s conduct should be unconscionable. However, he confirmed ‘unconscionability’ should be measured in accordance with the concept of ‘want of probity’.⁸³ Unfortunately, he also did not definitively clarify what this meant. Lord Nicholls suggested that acting with lack of probity is ‘simply not acting as an honest person would in the circumstances’.⁸⁴ The dictionary definition of probity is ‘acting with integrity and uprightness’⁸⁵. Acting with ‘want of probity’, it is suggested is acting without integrity and without morality, which does seem a more appropriate description. Petch referring to the dictionary definition confirms that:-

‘Probity means moral excellence, integrity, rectitude, uprightness; conscientious, honesty, sincerity. A lack of probity is the opposite’.⁸⁶

The requirement that the stranger must act with ‘want of probity’ was supported by both Vinelott J in *Eagle Trust plc v SBC securities Ltd*⁸⁷ and Scott LJ in *Polly Peck International plc v Nadir (No 2)*⁸⁸.

⁸⁰ David Hayton, ‘The interrelated liability in equity of financial institutions used in the furtherance of fraud: three bases for liability in equity’ [2010] Comp Law 103, 103.

⁸¹ *The Concise Oxford dictionary* (9th edn, OUP 1995).

⁸² [1991] 3 NZLR 700.

⁸³ *ibid* [728].

⁸⁴ *Royal Brunei* (n 24) [105]; Sukhinder Panesar, ‘A loan subject to a trust and dishonest assistance by a third party’ [2003] JIBL 9, 13.

⁸⁵ *Collins English Dictionary - Complete & Unabridged* (10th edn, HarperCollins 2009).

⁸⁶ Tolek Petch, ‘The investment adviser as constructive trustee’ [2006] JIBLR 377, 378.

The judge at first instance in the Court of Appeal case of *Agip (Africa) Ltd v Jackson*⁸⁹ was Millet J who later delivered the much applauded dissenting judgment in the House of Lords case of *Twinsectra*⁹⁰. In *Agip*⁹¹, an accountant had fraudulently altered the payee names on 28 payment orders and diverted these payments to 'dummy' companies. The dummy companies were controlled by two of the accountant's partners and an employee. They were all held at first instance to be liable.

This judgment was appealed to the Court of Appeal which upheld the decision and confirmed that a stranger would be liable where he 'knowingly assisted in a fraudulent design'.⁹² The Court of Appeal confirmed:-

'the degree of knowledge required was described by Ungood-Thomas J. in *Selangor United Rubber Estates Ltd. v. Cradock (No. 3)* [1968] 1 W.L.R. 1555, 1590 as circumstances which would indicate to an honest and reasonable man that such a design was being committed, or would put him on inquiry whether it was being committed. Peter Gibson J. in *Baden, Delvaux and Lecuit v Societe General pour Favoriser le Developpement du Commerce et de l'Industrie en France S.A.* [1983] B.C.L.C 325, 407 gave a more expanded description of the circumstances constituting the necessary knowledge under five heads... I accept that formulation. It is however, only an explanation of the general principle and is not necessarily comprehensive'.⁹³

In this case, the strangers were put on inquiry⁹⁴ and failed to make any inquiries at all⁹⁵. The Court of Appeal confirmed that having been made aware of the possibility of fraud, a person acting honestly would have made inquiries to satisfy themselves that there was no fraud and were therefore liable.⁹⁶

⁸⁷ [1992] 4 All ER 488, 499.

⁸⁸ [1992] 4 All ER 769, 777.

⁸⁹ [1991] Ch 547.

⁹⁰ *Twinsectra* (n 12).

⁹¹ *Agip* (n 89).

⁹² *ibid* [567].

⁹³ *ibid* [567].

⁹⁴ *ibid* [569].

⁹⁵ *ibid* [570].

⁹⁶ *ibid* [570].

In the case of *Re Montagu Settlement trusts*⁹⁷ Megarry VC confirmed that the conscience of the recipient must be affected for liability to arise. He referred to the levels of knowledge in *Baden* and considered what level of knowledge that must be established to find that the stranger acted with 'want of probity'. He confirmed that the stranger would need actual knowledge and that constructive knowledge would not be sufficient.

Therefore, the position prior to *Barnes v Addy*⁹⁸ was that the stranger should have knowledge that he is assisting with a breach of trust. *Barnes v Addy*⁹⁹ stated the knowledge must be of a fraudulent design on the part of the trustee. *Selangor*¹⁰⁰, *Karak*¹⁰¹, *Baden*¹⁰² and *Agip*¹⁰³ stated liability could be imposed for negligence where the stranger had knowledge which would indicate to an honest, reasonable man that a breach was being committed or would put him on inquiry. The law developed to examining the stranger's conduct, in light of what he knew¹⁰⁴ and requiring that the stranger's conduct be unconscionable¹⁰⁵ or lack probity¹⁰⁶. This move towards the additional consideration of the stranger's conduct, in light of what he knew, resulted in Megarry VC stating in *Re Montagu*¹⁰⁷ that the knowledge must be actual and effectively closed the door to liability for constructive or negligent knowledge. However, the courts then went on to consider creating an even higher evidential burden and looking at whether the stranger's conduct should be dishonest.

4.3 Does the stranger need to be dishonest?

The issue of knowledge and dishonesty was initially considered by the Australian court in *DPC Estates Pty Ltd v Grey*¹⁰⁸. In this case, Jacob P expressed doubts over the focus of the previous cases being on knowledge, as opposed to dishonesty. These doubts were

⁹⁷ [1992] 4 All ER 308.

⁹⁸ *Barnes* (n27).

⁹⁹ *ibid.*

¹⁰⁰ *Selangor* (n 61).

¹⁰¹ *Karak* (n 70).

¹⁰² *Baden* (n 74).

¹⁰³ *Agip* (n 89).

¹⁰⁴ *Powell* (n 78).

¹⁰⁵ *Equiticorp Industries Group Ltd v Hawkins* [1991] 3 NZLR 700 [728].

¹⁰⁶ *ibid.*; *Eagle Trust* (n 88); *Polly Peck* (n 88).

¹⁰⁷ *Re Montagu* (n 89).

¹⁰⁸ [1974] 1 NSWLR 443 [459].

further echoed by Barwick CJ, Gibbs J and Stephen JJ when the case reached the High Court of Australia¹⁰⁹.

The doubts over the focus on knowledge, as opposed to dishonesty, were raised in the English courts by Buckley and Goff LJ in the case of *Belmont Finance Corporation Ltd v Williams Furniture Ltd*¹¹⁰. Support for a greater focus on dishonesty was also given by Sir Clifford Richmond in *Westpac Banking Corp v Savin*¹¹¹ and Tompkins J in *Marr v Arabco Traders Ltd*¹¹².

The stranger had historically not had to be dishonest and the requirement of dishonesty had the effect of increasing the evidential burden upon a claimant in proving their claim. In any event, the relatively new requirement of unconscionable conduct, introduced in *Powell v Thompson*¹¹³, is not the same as a requirement of dishonest conduct. Dishonesty has criminal connotations, whereas unconscionable conduct is concerned with morality and integrity. These are two entirely different concepts, so there were effectively two different approaches running concurrently.

In *Marshall Futures Ltd v Marshall*¹¹⁴, Tipping J recognised that ‘unconscionable conduct’ was less blameworthy than dishonest conduct, but considered that dishonest conduct was more identifiable than ‘unconscionable conduct’. Tipping J confirmed that he would ‘prefer the herald of equity to be wearing more distinctive clothing’ and therefore a test for dishonesty would provide a more identifiable and presumably therefore more certain test for the courts to apply. However, whilst it may be argued that with a more certain test there is less ambiguity, it could equally be argued that this leads to more rigidity in the law, less flexibility and consequently increased prospects of injustice.

There was much confusion arising from the different approaches and the Privy Council sought to review and clarify the law in the case of *Royal Brunei Airlines Sdn Bhd v Tan*¹¹⁵.

¹⁰⁹ *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373 at 376.

¹¹⁰ [1979] Ch 250 [267], [275].

¹¹¹ [1985] 2 NZLR 41 [70].

¹¹² (1987) 1 NZBLC 732 [762].

¹¹³ *Powell* (n 78).

¹¹⁴ [1992] 1 NZLR 316 [325].

¹¹⁵ *Royal Brunei* (n 24).

CHAPTER 5

CONSIDERATION OF *ROYAL BRUNEI AIRLINES SDN BHD V TAN*¹¹⁶

Lord Nicholls, sitting in the Privy Council, reviewed the case of *Barnes v Addy*¹¹⁷ and the existing case law relating to knowing assistance and sought to clarify the position in this area of law.

The circumstances of the case were that an airline had appointed a travel company to act as its agent. The travel company agreed it would sell the airline tickets and hold all money received for the tickets in trust for the airline. The travel company breached the trust, by failing to use a separate bank account and later became insolvent.

An action was brought against the travel company's principal director and shareholder alleging that he was liable for knowingly assisting in a fraudulent design on the part of the trustee.

At first instance, in the High Court of Brunei, Mr Tan was found to have known that there was an express trust of money, the trust money was being used in breach of this trust and that he had authorised the use of the money for these purposes. This was sufficient to make Mr Tan liable as a stranger for assisting in the breach of trust.¹¹⁸ This decision was appealed to the Court of Appeal of Brunei and then to the Privy Council.

One of the key questions addressed by the Privy Council was whether liability of strangers who assisted in a breach of trust should be founded on the knowledge or dishonesty of the stranger.

5.1 Strict liability

Lord Nicholls considered if knowledge should be required at all and looked at the possibility of strict liability. However, he rejected this possibility completely¹¹⁹ and

¹¹⁶ *Royal Brunei* (n 24).

¹¹⁷ *Barnes* (n27).

¹¹⁸ *Royal Brunei* (n 24) [97].

¹¹⁹ *ibid* [104].

confirmed that a stranger should not be liable if he did not know or have reason to suspect that the person he was dealing with was a trustee. He also confirmed that a stranger would not be liable if he was aware that he was dealing with a trustee, but had no reason to know or suspect that the transaction was inconsistent with the terms of the trust.

5.2 Negligence

At the opposite end of the liability spectrum, Lord Nicholls also considered the question of whether strangers could be liable where they were negligent. He looked at the situation where the stranger would have been aware of the likely breach of trust had he exercised reasonable diligence¹²⁰. It was recognised that strangers were usually advisers, consultants, bankers and agents or officers and employees of companies¹²¹ who already had a duty to exercise reasonable care and skill to the trustees and Lord Nicholls thought there was no compelling reason why the strangers should owe a duty to the beneficiaries, in addition to the duty they already owed to the trustees. He stated:-

‘as a general proposition... beneficiaries cannot reasonably expect that all the world dealing with their trustees should owe them a duty to take care lest the trustees are behaving dishonestly’¹²².

This view was clarified by Gardner as indicating that liability for knowing assistance involving negligence is either unnecessary or inappropriate and there should not be a duty of care from the stranger¹²³. Simple negligence will not therefore suffice. As surmised in Snells Equity:-

‘A negligent or incompetent failure to realise that the transaction was unlawful is not enough’.¹²⁴

However, Lord Nicholls did concede that a stranger may recklessly assist to such an extent that this may call into question the honesty of the stranger, especially if the

¹²⁰ *ibid* [108].

¹²¹ *ibid*.

¹²² *ibid*.

¹²³ Simon Gardner, ‘Knowing assistance & knowing receipt: taking stock’ [1996] LQR 56, 74.

¹²⁴ John McGhee QC, *Snell's Equity* (32nd edn, Sweet & Maxwell 2010) para 30-078.

assistance served to benefit his own interest.¹²⁵ This had been recognised in *Cowan de Groot Properties Ltd v Eagle Trust plc*¹²⁶ where Knox J had confirmed that a person can be dishonest for reckless actions as well as deliberate actions, if this involved disregarding other people's rights or possible rights.¹²⁷

5.3 Dishonesty

Martins¹²⁸ recognised that opinions have differed as to whether dishonesty is required or if it would be sufficient to demonstrate that the stranger ought to have known of the breach. Lord Nicholls' was clear that the assistance in the breach of trust must be dishonest and held that:-

a person who dishonestly procures or assists in a breach of trust or fiduciary obligation will be liable in equity;
the stranger's dishonesty is both a necessary and sufficient ingredient to establish liability; and
whilst there must be a breach of trust, in order to establish liability on the part of a stranger, this need not itself be a dishonest and fraudulent breach of trust by the trustee¹²⁹.

This represented a partial return to the position prior to *Barnes v Addy*¹³⁰ in that the trustee did not need to be dishonest, to impose liability on the stranger. A stranger can procure¹³¹ a breach of trust, as well as assist in one, but there must be some breach of trust in order for liability to arise¹³². However, unlike the position prior to *Barnes v Addy*¹³³, Lord Nicholls was clear the stranger must be dishonest and this was both a 'necessary and sufficient ingredient' in order to satisfy liability.

¹²⁵ *Royal Brunei* (n 24) [106].

¹²⁶ [1992] 4 All ER 700.

¹²⁷ *ibid* [761].

¹²⁸ Martin (n 29) para 12-013.

¹²⁹ *Royal Brunei* (n 24) [109].

¹³⁰ *Barnes* (n27).

¹³¹ *Fyler* (n 16); *Leicester Corp* (n 17); *Harpum* (n 44) 105.

¹³² *Royal Brunei* (n 24) [100].

¹³³ *Barnes* (n27).

5.4 Knowledge and unconscionable conduct

Lord Nicholls sought to justify his departure from the requirement of knowledge and unconscionable conduct. He argued that the word 'unconscionable' was not an everyday word, and had its roots in equity, dating back to the concept of the Lord Chancellor as the keeper of the royal conscience¹³⁴. Whilst not directly stating that unconscionability had the same meaning as dishonesty, he stated that if they were the same, this is the description that should be provided and the word 'unconscionable' was best avoided.

Lord Nicholls went on to impose a test of dishonesty, so presumably believed that they were the same. The justification for replacing the word 'unconscionable' with 'dishonest' was because the meaning of dishonesty is easier to understand and recognise. However, it is contended that 'unconscionable' conduct is both a modern and recognisable term. The Times Newspaper¹³⁵ recently printed on the front page a letter from three world leaders, Barack Obama, David Cameron and Nicolas Sarkozy confirming that:-

'the world will be guilty of an "unconscionable betrayal" if the Libyan Leader is left in place... '.

It is clear that this quote is suggesting that conscience and morality demand that the world intervenes. As considered in the last chapter, just because a person fails to follow generally accepted moral standards or act with integrity does not make him dishonest. Dishonesty has its roots in criminal behaviour and deception and whilst it may be easier to identify, the purpose of the court of equity is to do justice and what is right. 'Equity regards as done that which ought to be done'. This maxim cannot be served best by an overly restrictive test which does not allow for recovery against professionals who have acted without morality or conscience but nevertheless were not deemed to be dishonest.

5.5 A state of mind

Lord Nicholls stated that what mattered was the state of mind of the stranger¹³⁶. This was problematic and it is submitted that it is the conduct of the stranger and not his state of

¹³⁴ *Royal Brunei* (n 24) [108].

¹³⁵ *The Times* (London, 15 April 2011).

¹³⁶ *Royal Brunei* (n 24) [102].

mind that is important. The majority of prior case law¹³⁷, academic opinion¹³⁸, the Brunei Court of Appeal¹³⁹ and Lord Nicholls' himself in this judgment¹⁴⁰ had previously indicated that that focus should be on the conduct of the stranger. This reference to a 'dishonest state of mind' was regrettably later seized upon by the House of Lords in the case of *Twinsectra v Yardley* to justify a subjective test.

5.6 Objective and/or subjective test

It was recognised by Lord Nicholls that dishonesty was a word with criminal connotations. He sought to distinguish the civil position from the criminal position on dishonesty as referred to in the case of *R v Ghosh*¹⁴¹ where a defendant must be dishonest by the ordinary standards of reasonable and honest people and must also realise this. He explained acting dishonestly was 'synonymous' with acting with a lack of probity¹⁴² and a person acting dishonestly was someone not acting as an honest person would in the circumstances. It is submitted that this is an admirable attempt to re-define the word to justify the imposition of an objective test, which was his intention, but dishonesty is far more than failing to act as an honest person would in the circumstances. Nevertheless, Lord Nicholls stated this was an objective standard¹⁴³, but recognised that honesty had a strong subjective element¹⁴⁴. He described honesty as:-

'a description of a type of conduct assessed in the light of what a person actually knew at the time, as distinct from what a reasonable person would have known or appreciated'¹⁴⁵.

The conduct would mostly be advertent, not inadvertent conduct¹⁴⁶ and the stranger should therefore be judged on his conduct, in light of what was known to him at the time.

¹³⁷ *Barnes* (n 27); *Belmont Finance* (n 110); *Agip* (n 89); *Marshall Futures* (n 114); *Powell* (n 78); *Equiticorp Industries* (n 82); *Eagle Trust* (n 88).

¹³⁸ Harpum (n 44) 128, 147, 152, 154; Johanna Vroegop, 'Constructive trusteeship and the bank' [1988] JBL 437, 437; Charles Harpum, 'Accessory liability for procuring or assisting in a breach of trust' 1995 LQR 545, 547, 548; Nicholas Clark, 'The impact of recent money laundering legislation on financial intermediaries' 1995 JFL 388, 138, 139, 140; Martin (n 29) para 12-014; McGhee (n 124) para 30-078.

¹³⁹ *Royal Brunei* (n 24) [101].

¹⁴⁰ *ibid* [105], [106].

¹⁴¹ [1982] QB 1053.

¹⁴² *Royal Brunei* (n 24) [105].

¹⁴³ *Ibid*.

¹⁴⁴ *ibid* [106].

¹⁴⁵ *ibid*.

¹⁴⁶ *ibid*.

However, Lord Nicholls description of dishonest conduct as 'conscious impropriety'¹⁴⁷, has created difficulties in that this term has subjective connotations and suggests some level of awareness of doing something wrong.

Pearce Stevens and Barr considered the question whether the stranger must have been consciously aware that he was acting wrongly and were firmly of the opinion that at least in the context of *Royal Brunei*, Lord Nicholls was at pains to explain that dishonesty provided an objective criterion for assessment of the stranger's conduct¹⁴⁸. Lord Nicholls made clear that the test to be applied should not be subjective. He confirmed that:-

'individuals are [not] free to set their own standards of honesty in particular circumstances'; and

'the standard of what constitutes honest conduct is not subjective'¹⁴⁹.

Honesty cannot be optional. A stranger would not have a defence by simply stating that he did not realise he was acting dishonestly or had different moral standards to other people. Dishonesty was viewed as not acting as an honest person would in the circumstances and intentionally engaging in improper behaviour. Lord Nicholls reiterated that when considering honesty, it is impossible to be more specific other than to say that:-

'honesty is an objective standard. The individual is expected to attain the standard which would be observed by an honest person placed in those circumstances'¹⁵⁰

The circumstances that the court would have regard to included:-

'the nature and importance of the proposed transaction;

the nature and importance of his role;

the ordinary course of business;

the degree of doubt;

the practicability of the trustee or the third party proceeding otherwise; and

the seriousness of the adverse consequences to the beneficiaries'¹⁵¹.

¹⁴⁷ *ibid.*

¹⁴⁸ Pearce, Stevens & Barr (n 62) 975.

¹⁴⁹ *Royal Brunei* (n 24) [106].

¹⁵⁰ *ibid* [107].

¹⁵¹ *ibid* [107].

Therefore, the court would consider from the evidence given what the defendant knew and take all of the above circumstances into account to decide if the stranger did what an honest person would have done in those circumstances.¹⁵²

The court will also not only consider what the stranger has done, but what he has failed to do. Lord Nicholls considered the courses of action an honest person would take, which included:-

‘flatly decline to become involved... ask further questions... seek advice, or insist on further advice being obtained’¹⁵³.

It is clear, as confirmed by Lord Nicholls, that an honest person would not deliberately close his eyes or ears, or deliberately not ask questions.

5.7 Public policy and commercial reality

Lord Nicholls recognised that equity was increasingly being used in commercial transactions as a remedy and typically where companies had become insolvent. Claimants were using equity to seek relief from directors of companies or their bankers or their legal or other advisers, with a view to holding them personally liable for assisting in breaches of trust or fiduciary obligations.

Lord Nicholls confirmed the purpose of the principle in his judgment was twofold:-

- (1) ‘making good the beneficiary’s loss should the trustee lack financial means; and
- (2) imposing a liability which will discourage others from behaving in a similar fashion’¹⁵⁴.

He thus recognised that the beneficiaries may not always be able to recover their loss from the trustees and introduced a public policy argument in favour of the imposition of liability

¹⁵² Harpum, ‘Accessory liability for procuring or assisting in a breach of trust’ (n 138) 547; Martin (n 29) para 12-014; McGhee (n 124) para 30-078.

¹⁵³ *Royal Brunei* (n 24) [106].

¹⁵⁴ *ibid* [103].

on strangers. The further argument for the imposition of liability as a deterrent represented a complete 'volte-face' to traditional judicial opinion¹⁵⁵. It is clear by suggesting that the imposition of liability may act as a deterrent the court is beginning to acknowledge that relatively modern day professionals are far more aware of their legal obligations and able to adapt their practices accordingly and indeed may only adapt their practices if there is a threat of liability.

However, having stated that this judgment was a deterrent, Lord Nicholls added that liability should be limited to those strangers who acted dishonestly and with knowledge of the breach as:-

'... ordinary everyday business would become impossible if third parties were to be held liable for unknowingly interfering in the due performance of such personal obligations'¹⁵⁶.

Lord Nicholls thus appeared to be attempting to strike a balance between imposing liability as a deterrent and ensuring that ordinary everyday business continued, which was a welcome step in the right direction.

The main difficulties from this judgment arose from Lord Nicholls' attempt to redefine dishonesty, his suggestion that the stranger's state of mind should be dishonest and the need for 'conscious impropriety'.

Acting dishonestly is not the same as failing to act honestly and represent two very different degrees of candour. Failing to act honestly is far closer to acting unconscionably or without probity, despite Lord Nicholls desire to move away from this description.

The reference to a dishonest state of mind and a need for 'conscious impropriety' is unfortunate and has created subsequent problems for lawyers and academics alike when interpreting this judgment, as will be seen in the consideration of the case of *Twinsectra*¹⁵⁷.

¹⁵⁵ *Barnes* (n 27).

¹⁵⁶ *Royal Brunei* (n 24) [104].

¹⁵⁷ *Twinsectra* (n 12).

CHAPTER 6

CONSIDERATION OF *TWINSECTRA LTD V YARDLEY AND OTHERS*¹⁵⁸

Twinsectra Limited loaned £1 million to an individual upon the basis of an undertaking, given by solicitors. The undertaking confirmed that the loan money would only be used for the acquisition of property and no other purpose. Upon the basis of the undertaking, the loan money was paid over to the solicitors, who then paid the money over to another solicitor acting for the borrower, called Mr Leach. Mr Leach was aware of the undertaking given by the previous solicitor and the terms of the loan. However, despite this Mr Leach subsequently paid the money over to his client, without taking any steps to ensure the money would only be used for the acquisition of property. As a consequence, over £357,000 was used by the client for purposes other than the acquisition of property¹⁵⁹, in breach of the original solicitor's undertaking.¹⁶⁰

At first instance it was held that the undertaking did not create a trust and that Mr Leach had not acted dishonestly. However, the Court of Appeal found that there was a trust and Mr Leach had acted dishonestly and was consequently liable. The case was then appealed to the House of Lords.

6.1 Accessorial liability

In the House of Lords, Lord Millett provided a succinct overview of the law relating to accessorial liability. He stated that for this type of liability there must be some fault on the part of the stranger¹⁶¹ and whilst accessorial liability is not based upon receipt of the trust property, it will apply if a stranger receives trust property and holds the trust property without any beneficial interest in it¹⁶².

¹⁵⁸ *Twinsectra* (n 12).

¹⁵⁹ *ibid* [10].

¹⁶⁰ *ibid* [11].

¹⁶¹ *ibid* [107].

¹⁶² *ibid* [105].

Lord Millet confirmed that the stranger does not have to assist in the original breach and will include strangers who assist later on in the breach with 'covering up' or helping to launder the money¹⁶³ which represents an important extension of the liability.

6.2 Knowledge

In his dissenting judgment Lord Millett reviewed the case of *Barnes v Addy*, noting that liability would rest where 'the defendant assisted (i) with knowledge, (ii) in a fraudulent breach of trust'.¹⁶⁴ Lord Millett stated that as the second condition had been discarded in *Royal Brunei*¹⁶⁵, it was only necessary to demonstrate that the defendant had assisted with actual knowledge, which meant that he:-

'... knew all the relevant facts, in particular the fact that the principal was not entitled to deal with the funds entrusted to him as he had done or was proposing to do'¹⁶⁶.

In Lord Millett's opinion this meant that the accessory must be guilty of intentional wrongdoing¹⁶⁷. This was because an honest man would not knowingly participate in a transaction which caused the misapplication of funds¹⁶⁸. However, Lord Millett had to grudgingly accept that Lord Nicholls in *Royal Brunei*¹⁶⁹ had not applied the requirement of intentional wrongdoing, as the condition of liability, and had instead moved away from a requirement of knowledge to the requirement of dishonesty¹⁷⁰.

Both Lord Hoffman and Lord Hutton agreed with Lord Nicholls and stated that:-

'... those principles require more than mere knowledge of the facts which make the conduct wrongful.'¹⁷¹

Lord Millett's dissenting opinion was in complete contrast to the opinion of the majority and will be examined later.

¹⁶³ *ibid* [107].

¹⁶⁴ *ibid* [109].

¹⁶⁵ *ibid* [109].

¹⁶⁶ *ibid* [110].

¹⁶⁷ *ibid* [113].

¹⁶⁸ *ibid* [120].

¹⁶⁹ *Royal Brunei* (n24).

¹⁷⁰ *Twinsectra* (n 12) [113].

¹⁷¹ *ibid* [20].

6.3 The dishonesty test

Lord Hoffman and Lord Hutton confirmed that strangers:-

‘require a dishonest state of mind, that is to say, consciousness that one is transgressing ordinary standards of honest behaviour’¹⁷².

6.4 Objective and/or subjective test

Lord Hutton identified three possible standards to determine whether a person was acting dishonestly:-

the purely subjective standard¹⁷³;
the purely objective standard¹⁷⁴; and
a combined objective and subjective standard

Whilst an objective approach may be more harsh towards the stranger, Lord Millet was of the opinion that this type of approach should be taken and referred to a number of cases and practitioner and academic opinions, including Stafford who had invited the Lords to:-

‘reiterate that honesty is an objective standard and that individuals are not free to set their own standards of proper conduct’.¹⁷⁵

However, Lord Hutton seized upon Lord Nicholls’ references in *Royal Brunei*¹⁷⁶ to ‘conscious impropriety’¹⁷⁷, the need for advertent conduct and his statement that dishonesty had a subjective element¹⁷⁸. He confirmed that these references to subjectivity all supported his view that Lord Nicholls had embraced a subjective, as well as objective

¹⁷² *ibid* [20].

¹⁷³ *ibid* [27].

¹⁷⁴ *ibid* [27].

¹⁷⁵ Andrew Stafford, ‘Solicitors liability for knowing receipt and dishonest assistance in breach of trust’ (2001) PN 3.

¹⁷⁶ *Royal Brunei* (n24).

¹⁷⁷ *Twinsectra* (n 12) [37]; *Grupo Torras SA v Al-Sabah* [1999] CLC 1469; William Blair QC, ‘Secondary Liability of Financial Institutions for the Fraud of Third Parties’ (2000) Hong Kong Law Journal 74; Jeremy Chan, ‘Dishonesty and Knowledge’ (2001) Hong Kong Law Journal 283; Andrew Stafford QC, ‘Solicitors liability for knowing receipt and dishonest assistance in breach of trust’ (2001) PN 3.

¹⁷⁸ *Twinsectra* (n 12) [28].

approach. With this in mind, both Lord Hutton and Lord Hoffman went on to deliver a judgment confirming their preference for a combined test, incorporating both objective and subjective elements.

It is questionable, given Lord Nicholl's clear statement that an objective standard should be applied, whether his reference to the need for 'conscious impropriety' was an error. Lord Hutton and Lord Hoffman's interpretation was not so much blinkered when it came to the clear statements in *Royal Brunei* that the standard for dishonesty was an objective one, but seemingly blind to all the other references that Lord Nicholls had made to the test being objective.

However, upon the basis that the majority in the House of Lords supported his view regarding the need for a combined test, Lord Hutton went on to explain what 'the combined test'¹⁷⁹ would require:-

'the stranger's conduct was dishonest by the ordinary standards of reasonable and honest people; and
that the stranger himself realised that by those standards his conduct was dishonest.'

Thornton¹⁸⁰ recognised that this was an almost identical test for dishonesty to that applied in the criminal case of *R v Ghosh*¹⁸¹, which created a further problem as Lord Nicholls had clearly stated in *Royal Brunei*¹⁸² that there should be a distinction between the position in criminal law and the position in equity.

Lord Hutton suggested that rather than look at specific words, the sentences should be read in the context of what else had been written. Lord Nicholls had confirmed in *Royal Brunei*¹⁸³ that when considering the honesty of an individual, the court should look at the circumstances known to the third party and the personal attributes of the third party, such as his experience and intelligence¹⁸⁴. However, Lord Hutton suggested that this meant that

¹⁷⁹ *ibid* [27].

¹⁸⁰ Rosy Thornton, 'Dishonest Assistance: guilty conduct or a guilty mind?' 2002 CLJ, 61(3) 524, 526.

¹⁸¹ [1982] QB 1053.

¹⁸² *Royal Brunei* (n24).

¹⁸³ *ibid*.

¹⁸⁴ *Twinsectra* (n 12). [31].

the test should not be objective alone and the stranger would 'have to be aware that his conduct was dishonest by the ordinary standards of reasonable and honest people'¹⁸⁵. It is questionable that Lord Nicholls had represented or intended this. Whilst there may have been a subjective element, this was because all the circumstances of the defendant would be taken into consideration when applying the objective test. The test in *Royal Brunei*¹⁸⁶ did not require that the defendant knew himself that he was acting dishonestly and, as identified by Lord Nicholls in *Royal Brunei*¹⁸⁷, it is wrong to apply a criminal test to a claim in equity¹⁸⁸.

This judgment has attracted a great deal of academic criticism. Oakley considered that whilst Lord Hutton's statement was consistent with the combined test, it overlooked the possibility that the accessory might fail to realise that his conduct was dishonest by the ordinary standards of reasonable and honest people¹⁸⁹. Kiri described the second limb of the majority's combined test requiring subjective dishonesty as 'unnecessary and unhelpful'¹⁹⁰. Thompson suggested Lord Hutton was equating civil liability with a need for guilt, which it is suggested is too high a standard on which to make the stranger liable¹⁹¹. Panesar went further and submitted that:-

'the majority, although purporting to apply the test of dishonesty, did so incorrectly and confused it with the test of dishonesty in the context of criminal liability'¹⁹².

Further confusion arose as a consequence of Lord Hutton's contention that a defendant could not be dishonest, if he did not know that that what he was doing would be regarded as dishonest¹⁹³. This was because Lord Hutton confirmed later in his judgment that:-

'he [the stranger] should not escape a finding of dishonesty because he sets his own standards of honesty, and does not regard as dishonest what he knows would offend the normally accepted standards of honest conduct'¹⁹⁴.

¹⁸⁵ Martin (n 29) para 12-014.

¹⁸⁶ *Royal Brunei* (n24).

¹⁸⁷ *ibid*.

¹⁸⁸ *Royal Brunei* (n24) [105].

¹⁸⁹ Oakley (n 30).

¹⁹⁰ Nikunj Kiri, 'Dishonest assistance: the latest perspective from the Court of Appeal' 2007 JIBLR 305, 307.

¹⁹¹ M P Thompson, 'Criminal Law and Property Law: An Unhappy Combination' [2002] Con 387, 399.

¹⁹² Panesar, *Exploring Equity and Trusts* (Pearson 2010) 433.

¹⁹³ *Twinsectra* (n 12) [32].

¹⁹⁴ *ibid* [36].

As confirmed by Martin this would appear to contradict everything that Lord Hutton had said earlier about the need for 'self-conscious dishonesty'.¹⁹⁵

6.5 Lord Millett's dissenting opinion

Lord Millett also did not agree and his powerful dissenting speech attracted a great deal of academic support¹⁹⁶. He was of the opinion that in civil matters, liability is usually dependent on the defendant's conduct rather than his state of mind¹⁹⁷ and therefore the test of dishonesty should relate to the stranger's conduct and not his state of mind.¹⁹⁸

Lord Millett stated that Lord Nicholls had not employed the concept of dishonesty as understood in criminal cases¹⁹⁹ and had not suggested that the defendant need realise that honest people would regard his conduct as dishonest²⁰⁰.

It was clear to Lord Millett, and the majority of academics reviewing the case, that Lord Nichols had adopted an objective standard of dishonesty, by which the defendant was expected to attain the standard which would be observed by an honest person placed in similar circumstances²⁰¹. Subjective considerations must be taken into account, such as the defendant's experience and intelligence and his actual state of knowledge at the relevant time²⁰², but nevertheless this was still an objective approach and recognised by academics as acceptable²⁰³.

In relation to the assertion that a stranger had to appreciate that he was acting dishonestly, Lord Millett confirmed that:-

¹⁹⁵ Charles Mitchell, *Commentary and cases on the Law of Trusts and Equitable Remedies* (13th edn, Sweet & Maxwell 2010) para 12-72.

¹⁹⁶ Charles Rickett, 'Quistclose trusts and dishonest assistance' [2002] RLR 112; Thornton (n 180); Phillip H Kenny, 'Helping to break an undertaking' [2002] Conv 202; Thompson (n 191); Kiri (n 190).

¹⁹⁷ *Twinsectra* (n 12) [116].

¹⁹⁸ *ibid* [118].

¹⁹⁹ *ibid* [114].

²⁰⁰ *ibid* [120].

²⁰¹ *ibid* [121].

²⁰² *ibid* [121].

²⁰³ Martin (n 29) para 12-014.

‘the question is whether an honest person would appreciate that what he was doing was wrong or improper, not whether the defendant himself actually appreciated this’²⁰⁴.

Lord Millett was clear that any test should be made from an objective perspective.

6.6 State of mind or conduct

Lord Millett suggested that as it was the defendant’s conduct that was important, the question that should be asked is not whether Lord Nicholls was using the word dishonesty in a subjective or objective sense, but whether it was necessary to prove that the stranger had a dishonest state of mind or whether proving he acted with the requisite knowledge would be sufficient²⁰⁵. Lord Millett was clear that in his opinion acting with the requisite knowledge and judging this on an objective basis should be sufficient. He provided a number of detailed reasons for this view²⁰⁶:-

- (1) Consciousness of wrongdoing is an aspect of *mens rea* which is an appropriate condition of criminal liability: it is not an appropriate condition of civil liability;
- (2) The objective approach is in accordance with Lord Selborne’s statement in *Barnes v Addy*²⁰⁷ and traditional doctrine... that a person who knowingly participates in the misdirection of money is liable to compensate the injured party; and
- (3) The claim for “knowing assistance” is the equitable counterpart of the economic torts.

The economic torts will be examined later in this dissertation.

6.7 Does shutting one’s eyes to the problems amount to dishonesty?

Oakley identified that difficulty had arisen in this case because of:-

²⁰⁴ *Twinsectra* (n 12) [122].

²⁰⁵ *ibid* [126].

²⁰⁶ *ibid* [127].

²⁰⁷ *Barnes* (n 27).

‘the apparent mutual inconsistency of the statements of Carnwath J that Leach, on the one hand, had not been dishonest but, on the other hand, had wilfully shut his eyes; the difficulty arose because everyone else has always regarded a wilful shutting of eyes as amounting to dishonesty’.²⁰⁸

Lord Hoffman and Lord Hutton described it as unfortunate that the judge had referred to Leach wilfully shutting his eyes to the details, problems or implications and attempted to explain this anomaly²⁰⁹. They both considered that as Mr Leach was aware of all the facts, he could not have possibly shut his eyes and therefore the judge had used the wrong terminology. Leach would have been better described as having taken a ‘blinkered approach’ or having ‘buried his head in the sand’. It is not entirely clear why taking a blinkered approach or burying one’s head in the sand should be treated any different to deliberately closing one’s eyes and ears or deliberately not asking questions. Turning a blind eye is probably better or more reflective of what he had done. Leach had knowledge, but ignored it rather than failed to see it.

Lord Millett confirmed that if a man deliberately shut his eyes to facts which he would prefer not to know then this would amount to actual knowledge or ‘Nelsonian knowledge’²¹⁰. Such knowledge in his opinion was intentional behaviour. He believed it important to consider what the honest man would do, if the propriety of the transaction was doubtful. He concluded that:-

‘... an honest man... would make appropriate enquiries before going ahead’²¹¹.

However, Lord Millett did not think this was a case of ‘Nelsonian knowledge’ or wilful blindness²¹². Mr Leach could not have shut his eyes to the facts as he knew all of them. The only thing that he did not know was that the terms of the undertaking had created a trust. Mr Leach had shut his eyes to the implications of his actions²¹³ and in Lord Millett’s opinion this was sufficient enough to impose liability. The approach laid out by Lord Millett does seem more logical.

²⁰⁸ Oakley (n 30) para 10-178.

²⁰⁹ *Twinsectra* (n 12) [22].

²¹⁰ *ibid* [112].

²¹¹ *ibid* [120].

²¹² *ibid* [141].

²¹³ *ibid* [142].

6.8 Public Policy and Commercial considerations

Lord Hutton, when delivering his judgment, confirmed that a finding by a judge that a stranger had been dishonest was a 'grave finding', and was particularly grave against a professional man, such as a solicitor²¹⁴. This consideration has been recognised by Pearce, Stevens and Barr²¹⁵ as weighing heavily on Lord Hutton's mind when reaching his decision. This was also recognised by Lord Millett who stated that:-

'many judges would be reluctant to brand a professional man as dishonest where he was unaware that honest people would consider his conduct to be so'²¹⁶.

6.9 Did the possibility of a retrial influence the court?

The possibility of a re-trial also influenced Lord Hutton in his considerations, hanging over him like the mythical 'sword of Damocles'. In his final deliberations, Lord Hutton considered whether a new trial should be ordered and accepted that there was an argument of some force to suggest there should be a retrial²¹⁷. The important point for consideration was that the judge had not defined the test for dishonesty and so there was doubt as to whether he had applied the correct test²¹⁸. If he had not applied the correct test, then a re-trial may have been necessary.

Lord Hutton concluded that he believed that it was 'probable', that the judge at first instance had applied the right test. To reinforce this opinion, it was necessary for Lord Hutton to explain how the trial judge had found that Leach was not dishonest, given that he had also made a finding that Leach had deliberately closed his eyes to the problems. Deliberately closing one's eyes to the problems would be sufficient to impose liability on the basis of an objective test alone. The judge could not therefore have only applied an objective test, as if he had, he should have found the solicitor to be dishonest. He also could not have applied a purely subjective test, as this approach had been rejected by the

²¹⁴ *ibid* [35].

²¹⁵ Pearce, Stevens & Barr (n 62) 976.

²¹⁶ *Twinsectra* (n 12) [134].

²¹⁷ *ibid* [50].

²¹⁸ *ibid* [50].

courts.²¹⁹ It was incumbent therefore for Lord Hutton to give a creditable alternative. By suggesting that the trial judge had applied a combined test, Lord Hutton could provide a plausible explanation as to why the trial judge did not find Mr Leach to have acted dishonestly. This consequently meant that it would not be necessary to order a retrial. As identified by Oakley:-

‘faced with the consequential choice between ordering a new trial and allowing Leach’s appeal, they [the majority] opted for the latter’²²⁰.

6.10 A return to knowing assistance

Lord Millet confirmed that he disagreed with treating words such as ‘fraud’ and ‘dishonesty’ as being the same as ‘moral turpitude’ or ‘conduct which is morally reprehensible’²²¹. He felt:-

‘there is nothing to be said for retaining the language and giving it the meaning it has in criminal cases so as to alter the incidents of equitable liability’²²².

Lord Millett considered whether the law should return to the traditional description of ‘knowing assistance’²²³ where actual knowledge would be sufficient, or alternatively, to adopt Lord Nicholls’ description of ‘dishonest assistance’ and apply an objective test²²⁴. He described the introduction of dishonesty as ‘an unnecessary distraction and conducive to error’ and preferred a return to the traditional position of liability arising from ‘knowing assistance’²²⁵

6.11 Summary of the judgment

Liability for dishonest assistance will arise where a stranger assists by procuring, covering up or helping with a breach of trust and will also include those who hold property for a client or customer, without a beneficial interest in that property.

²¹⁹ *ibid* [27].

²²⁰ Oakley (n 30) para 10-165.

²²¹ *Twinsectra* (n 12) [125].

²²² *ibid* [125].

²²³ *ibid* [133].

²²⁴ *ibid* [133].

²²⁵ *ibid* [134].

The dissenting judge, Lord Millett, was of the opinion that knowledge was important and liability could be established upon the basis that the stranger must realise that the person he was assisting was not entitled to deal with the funds as he was doing or proposing to do. He called this 'intentional wrongdoing'. He did not agree that the stranger must be dishonest, but if a test for dishonesty was to be applied this should relate to the stranger's conduct and should be judged objectively. The question was whether an honest person with the defendant's experience, intelligence and knowledge would appreciate that what he was doing was wrong or improper.

Lord Hutton and Lord Hoffman considered that the stranger required more than mere knowledge of the facts which made the conduct wrongful. The stranger must have a dishonest state of mind, that is to say, consciousness that he was transgressing ordinary standards of honest behaviour, otherwise known as 'self-conscious dishonesty'. The combined objective and subjective test was applied and the stranger would be liable if his conduct was dishonest by the ordinary standards of reasonable and honest people and if he himself realised that by those standards his conduct was dishonest.

It would seem a major consideration in this case that the majority in the House of Lords were reluctant to find that the solicitor had acted dishonestly and overturn the trial judge's finding or alternatively, find that the trial judge had erred in law which would have required a retrial.

Lord Hutton and Lord Hoffman were wrong to equate civil liability with a need for guilt²²⁶ and the correct test should be objective, taking into consideration the stranger's characteristics as submitted by Lord Millett.

As Lord Millett also stated, dishonesty is not the same as want of probity, acting unconscionably or acting without honesty. The use of the word dishonesty is also unsatisfactory due to its implied subjectivity and association with criminal activities. This has resulted in confusion and misapplication of the law. A return to a focus on the stranger's knowledge and whether his conduct lacked probity or was unconscionable would be preferable, even if this may be more difficult to ascertain.

²²⁶ Thompson (n 191) 398.

However, the irony of Lord Millett suggesting a return to the position of 'knowing assistance' has not been lost. Pearce, Stevens and Barr pointed out that it was Lord Millett himself in *Agip (Africa) Ltd v Jackson* who had begun the task of cutting the Gordian knot of knowledge and replacing it with dishonesty²²⁷.

What *Twinsectra* did was highlight the dangers of linking the criminal law too closely to the civil law. The position of dishonesty in the criminal law will be examined further in the next chapter.

²²⁷ Pearce, Stevens & Barr (n 62) 983.

CHAPTER 7

AN ANALYSIS OF DISHONESTY IN THE CRIMINAL LAW

Whilst liability for dishonest assistance is a matter for the civil courts, use of language from the criminal courts has crept into the civil judgments. In *Royal Brunei*²²⁸ Lord Nicholls confirmed it had not been established that the trustee was 'guilty' of fraud or dishonesty.²²⁹ In *Twinsectra*²³⁰ Lord Slynn noted the trial judge had 'acquitted' the stranger of dishonesty.²³¹ There may be a number of reasons for this, including the introduction of dishonesty as a criterion in the liability of strangers who assist. This subsequently may have resulted in the line between the civil and criminal law becoming blurred and will be considered further within this chapter.

The requirement of dishonesty in the criminal law for theft, fraud and handling stolen goods will be analysed with consideration of how the position in the criminal law compares to the position in equity.

7.1 Theft and dishonesty

7.1.1 Is acting fraudulently the same as acting dishonestly?

Surprisingly, prior to 1916 there was no requirement in the offence of theft that the offender be dishonest. The requirement of dishonesty replaced the requirement that the offender should be 'fraudulent and without a claim of right in good faith'. The reason for this change was that it was considered easier for a jury to identify with what was meant by dishonesty, than what was meant by fraud²³². This is not dissimilar to the argument put forward by Lord Nicholls in *Royal Brunei*²³³, for replacing the description of unconscionable conduct with dishonesty²³⁴.

²²⁸ *Royal Brunei* (n24).

²²⁹ *ibid* [101].

²³⁰ *Twinsectra* (n 12).

²³¹ *ibid* [3].

²³² Michael Allen & Simon Cooper, *Elliott and Wood's Cases and Materials on Criminal Law* (10th edn, Sweet & Maxwell 2010).

²³³ *Royal Brunei* (n24).

²³⁴ *ibid* [108].

It is submitted that the burden prior to 1916 of acting fraudulently was a higher evidential burden than the requirement after 1916 to prove that a person had acted dishonestly. Dishonesty is an element of fraudulent behaviour²³⁵. A person can be dishonest without being fraudulent, but a person cannot be fraudulent without also being dishonest. Therefore, whether deliberate or not the change from the requirement of fraud to one of dishonesty had the effect of lowering the burden for proving criminal liability. Comparatively, the change from a requirement of unconscionable conduct to dishonesty achieved the exact opposite effect and increased the evidential burden on the claimant to prove liability, as can be seen from the test applied in *Twinsectra*²³⁶.

Dishonesty is now the essential element to the offence of theft and a person will be guilty of theft if he dishonestly appropriates property belonging to another, with the intention of permanently depriving the other of it²³⁷.

7.1.2 The exclusion of trustees and personal representatives

The Theft Act 1968, s2(1) provides specific circumstances when the appropriation of property may not be dishonest. However, in relation to s2(1)(c) trustees or personal representatives are exclusively excluded. This section relates to the position where a person has an honest belief that should he take reasonable steps he would not be able to find the owner. As a consequence, the trustees or personal relatives will never be entitled to the property beneficially, as there will always be someone else who will have a prior interest in the property. For example, if the beneficiary of a will cannot be found then the trustees may seek a Benjamin order²³⁸ from the court to allow them to distribute to the beneficiaries. When preparing the statute Parliament clearly recognised that despite the trustees having legal ownership of the property, the true owners of the property are the beneficiaries of the trust.

²³⁵ Fraud Act 2006.

²³⁶ *Twinsectra* (n 12).

²³⁷ Theft Act 1968, s 1.

²³⁸ *Re Benjamin* [1902] 1 Ch 723.

7.1.3 Is the test for dishonesty objective, subjective or both?

Lawton LJ stated in *R v Feely*²³⁹ that liability could be founded on a purely objective test for dishonesty. He stated that jurors when deciding if the accused had acted dishonestly should apply the current standards of ordinary decent people and they would have to decide from their own lives what is or is not dishonest. Ormerod suggested that an imposition of an objective approach has some academic support and would have the advantage of consistency with the civil law²⁴⁰. However, Griew identified that the objective approach had many defects²⁴¹.

The question of whether dishonesty characterised a state of conduct or a state of mind was further examined by Lord Lane CJ in the key case of *R v Ghosh*²⁴², which established the test for dishonesty in the criminal law. Whilst he accepted that if dishonesty was based on conduct then it could be established independently of the knowledge or belief of the accused, he concluded that criminal dishonesty is based on an accused's state of mind. The jury should therefore decide if:-

- (1) according to the ordinary standards of reasonable and honest people what the defendant did was dishonest and if it was dishonest by these standards (conduct); and
- (2) did the defendant himself realise that what he was doing was by those standards dishonest (state of mind).

The clear point arising from *Ghosh*²⁴³ is that in criminal law dishonesty is based on the accused's state of mind, rather than his conduct and therefore a subjective test is necessary in addition to the objective test.

The question of whether civil dishonesty is based on a defendant's conduct or state of mind was also addressed by Lord Millett in the civil courts²⁴⁴. It was argued by Lord Millett that dishonesty in the civil courts is based on conduct and not the defendant's state of

²³⁹ [1973] QB 530.

²⁴⁰ David C Ormerod, 'A bit of a con? The Law Commission's consultation paper on fraud' 1999 Crim LR 789, 798.

²⁴¹ Griew, 'Dishonesty: Objections to Feely & Ghosh (1985)' Crim LR 341.

²⁴² *Ghosh* (n 181).

²⁴³ *Ghosh* (n 181).

²⁴⁴ *Twinsectra* at Para [115].

mind. If Lord Millett is correct, then following Lane CJ's directions in *Ghosh*²⁴⁵ that liability for conduct could be established independently of the knowledge or belief of the accused, it would seem that the correct test to be applied must be an objective one. The difficulty in equity has therefore arisen from Lord Hutton and Lord Hoffman's assertion in *Twinsectra*²⁴⁶ that dishonesty should be adjudged by the defendant's state of mind.

Mantell LJ considered in *R v Rostron and Collinson*²⁴⁷ what the prosecution must prove that the accused knew in order to find him to be dishonest. The trial judge in this case had directed the jury that the accused would have the dishonest state of mind if:-

'he had known that he was not entitled to do what he was doing'.

Mantell LJ upheld this as a correct direction to apply to establish dishonesty. It is questionable whether knowing that you should not have done something is the same as knowing you are acting dishonestly, but this does demonstrate that the criminal courts have applied a degree of flexibility in the application of this test and that the knowledge of the accused is a key factor to establishing dishonesty.

7.1.4 Should there be a general dishonesty offence?

In 1999, the Law Commission examined the requirement of dishonesty and the associated problems in requiring a jury to set a moral standard of honesty and then decide if the defendant's conduct fell below that standard.²⁴⁸ Criminal offences consist of objectively defined conduct and mental states, but dishonesty is somewhat an enigma as it is necessary for the jury to characterise the existing facts and then make a moral judgment. The requirement that the jury make their judgment upon the basis of an undefined moral standard is very unusual²⁴⁹ and has resulted in endemic inconsistency with decisions²⁵⁰. Whilst dishonesty is an ordinary word used in the English language, there is no guarantee that everybody would agree as to its application, particularly in cases which are not 'clear

²⁴⁵ *Ghosh* (n 181).

²⁴⁶ *Twinsectra* (n 12).

²⁴⁷ [2003] EWCA Crim 2206.

²⁴⁸ Law Commission, *Legislating the Criminal Code: Fraud and Deception* (Law Com No 155, 1999).

²⁴⁹ *ibid* para 5.11.

²⁵⁰ *ibid* 5.15.

cut'²⁵¹. This has not been helped by the inability to conduct jury research, as recognised by Ormerod²⁵², although Smith was of the opinion that it may not necessarily be a good thing knowing how many errors juries make²⁵³.

As confirmed by the Law Commission, the problem is that the dishonesty test is based upon a unified conception of honesty and it is unrealistic for a single standard of dishonesty to be discernible by twelve random people of varying different ages and background. This has led to some jury verdicts being described as 'anarchic'.²⁵⁴ It may be for this reason that the Law Commission were wholly opposed to a general dishonesty offence and stated that this would extend the reach of the criminal law too far and render criminal that which should not be. Ormerod suggested that it might prove difficult to produce a satisfactory legal definition of dishonesty for the simple reason that there is such 'plurality of opinion' on the underlying moral conditions and limits of dishonesty²⁵⁵

It is submitted that Lord Nicholl's requirement of dishonesty for strangers who assist in *Royal Brunei*²⁵⁶ and the imposition of the combined test in *Twinsectra*²⁵⁷ had the effect of almost rendering criminal that which should not be. It is not appropriate to apply a criminal test for dishonesty to a civil claim. The two matters are very different and the courts that hear the matters are very different. In a criminal matter, the case is brought on behalf of the Crown against an individual, who will be judged by his peers and more often than not will have his liberty at stake. This is not the situation in a civil case. A claim will have been brought by a beneficiary of a trust or a person in a fiduciary relationship who has usually suffered severe financial losses as a consequence of a fraud or breach of trust. If the defendant is found liable, there will be financial consequences, but the defendant will not lose his liberty. It is also very rare for a civil judge to suggest that a witness is telling a lie and rarer still for the judge to make a finding that the defendant is dishonest or fraudulent. A civil judge will often go to great lengths to avoid calling a witness or defendant a liar, using such phrases as "I think the witness may have been mistaken on this point". The criminal courts very purpose is to establish if a crime has taken place and if so, to punish and/or rehabilitate the offender.

²⁵¹ ibid 5.16.

²⁵² Ormerod (n240) 791.

²⁵³ J C Smith, 'Is Ignorance bliss? Could jury trial survive investigation?' (1998) *Med Sci Law* 98.

²⁵⁴ Law Commission, *Legislating the Criminal Code: Fraud and Deception* (n 248) para 5.17.

²⁵⁵ Ormerod (n 240). 799.

²⁵⁶ *Royal Brunei* (n24).

²⁵⁷ *Twinsectra* (n 12).

Therefore, it is submitted that to apply an identical test to civil and criminal matters, is incorrect and unduly unfair and prejudicial to a completely innocent civil claimant who has suffered significant financial losses, as a consequence of the breach of trust or fiduciary position, in which the stranger has assisted.

7.2 The Fraud Act 2006 and dishonesty

The Fraud Act 2006 is described in legal guidance to the Crown Prosecution Service as on the borderline between criminal and civil liability.²⁵⁸ Ormerod and Williams cautioned that considerable care by prosecutors was therefore needed to avoid over-criminalisation of this area²⁵⁹. This section will consider the different forms of fraud introduced by the Fraud Act 2006 and compare them with the position in equity.

7.2.1 Fraud by false representation

Under the Fraud Act 2006, s2(1) a person will be guilty of fraud if he dishonestly makes a false representation and intends by making the representation to make a gain for himself or another, or to cause loss to another or to expose another to a risk of loss. This section is described by Ormerod as the broadest form of the fraud offences and likely to be most frequently charged²⁶⁰.

The *Ghosh* test is applied to establish if the accused is dishonest²⁶¹. Dishonesty is described by Williams as the 'fundamental *mens rea* element in this offence²⁶². In addition to establishing dishonesty, the prosecution must also establish that the representation was false. A representation will be false if it is untrue or misleading, which is described in the explanatory notes as something 'less than wholly true and capable of an interpretation to the detriment of the victim'.²⁶³ In addition to the representation being false, the person

²⁵⁸ The Crown Prosecution Service, 'Fraud Act: Legal Guidance: The Crown Prosecution Service' (updated 12 December 2006 – confirmed up to date 4 February 2008) <http://www.cps.gov.uk/legal/d_to_g/fraud_act> accessed 12 May 2011.

²⁵⁹ David Ormerod and David Huw Williams, 'The Fraud Act 2006' [2007] Arch News 6, 9.

²⁶⁰ David Ormerod, 'The Fraud Act 2006 – criminalising lying?' [2007] Crim LR 193, 196.

²⁶¹ Ormerod & Williams, 'The Fraud Act 2006' (n 259) 7.

²⁶² *ibid* 7.

²⁶³ Fraud Act 2006 *Explanatory Notes*, para 19.

making it must know that it is, or might be, untrue or misleading²⁶⁴ and intend to gain or cause loss. These form part of the *mens rea* of the offence with dishonesty.

The requirement of *Ghosh* dishonesty is the key element of the Fraud Act 2006, as identified by Ormerod and Williams²⁶⁵. However, the Government were also clear in their consultation paper that the test for knowledge is important which should be considered subjectively. The court will look at what the accused subjectively knew and then only if the accused subjectively knew that it might be untrue, apply the *Ghosh*²⁶⁶ test, to establish if the accused was dishonest. The two tests are entirely separate, however it is suggested that they are both extrinsically linked given that if it is proven that the accused subjectively knew that the representation was untrue or misleading this would act as evidence towards dishonesty.

Whilst it is not suggested that the test for knowledge in the civil courts should be subjective, Lord Millett did suggest that subjective considerations should be taken into account in *Twinsectra*²⁶⁷ such as the defendant's experience and intelligence when applying the objective test for dishonesty²⁶⁸. It is interesting therefore that Lord Nicholls in *Royal Brunei* and the majority in *Twinsectra*²⁶⁹ suggested that the requirements of knowledge are best avoided. It is submitted that there is a link between knowledge and dishonesty, especially when establishing dishonesty. A dishonest person will usually have knowledge of the transaction and surrounding circumstances that make his assistance dishonest. However, it does not necessarily follow that if a person has knowledge that they will always be dishonest. This subtle difference indicates that if dishonesty is required then knowledge will be relevant, but if only knowledge is required then dishonesty is not essential.

7.2.2 Fraud by failing to disclose information

A person will be guilty of this form of fraud if he dishonestly fails to disclose information that he is under a legal duty to disclose and intends thereby to make a gain for himself or

²⁶⁴ Fraud Act 2006, s 2(2).

²⁶⁵ Ormerod & Williams, 'The Fraud Act 2006' (n 259) 7.

²⁶⁶ *Ghosh* (n 181).

²⁶⁷ *Twinsectra* (n 12).

²⁶⁸ *ibid* [121].

²⁶⁹ *ibid*.

another or to cause loss to another or to expose another to a risk of loss. This form of fraud shares the concept of dishonesty and an intention to gain or cause loss with fraud by false representation²⁷⁰.

7.2.3 Fraud by abuse of position

This form of fraud was described by Ormerod and Williams as ‘the most controversial’²⁷¹. A person will be in breach of the Fraud Act 2006, s4 if he:-

- (a) occupies a position in which he is expected to safeguard, or not to act against, the financial interests of another person;
- (b) dishonestly abuses that position; and
- (c) intends by means of the abuse of that position:-
 - i. to make a gain for himself or another; or
 - ii. to cause loss to another or to expose another to a risk of loss.

The difficulty in this offence was confirmed by Ormerod and Williams as identifying whether the defendant occupies a relevant financial position²⁷². The Law Commission explained the meaning of ‘position’ as:-

‘The necessary relationship will be present between trustee and beneficiary, director and company, professional person and client, agent and principal, employee and employer, or between partners. It may arise otherwise, for example within a family, or in the context of voluntary work, or in any context where the parties are not at arm’s length. In nearly all cases where it arises, it will be recognised by the civil law as importing fiduciary duties, and any relationship that is so recognised will suffice. We see no reason, however, why the existence of such duties should be essential. This does not, of course, mean that it would be entirely a matter for the fact finders whether the necessary relationship exists. The question whether the particular facts alleged can properly be described as giving rise to that

²⁷⁰ Ormerod & Williams, ‘The Fraud Act 2006’ (n 259) 7.

²⁷¹ Ormerod & Williams, ‘The Fraud Act 2006’ (n 259) 8.

²⁷² *ibid* 8.

relationship will be an issue capable of being ruled on by the judge and, if the case goes to the jury, of being the subject of directions²⁷³.

The position is not therefore restricted to circumstances where a fiduciary duty is owed and was described by the Crown Prosecution Service as relating to 'a position of trust' and 'something more than a moral obligation'.²⁷⁴ It is submitted that solicitors, accountants or banks who assist in a breach of trust occupy such a position where they would be liable if they dishonestly abused that position and intended to make a gain or cause loss.

This section was criticised by Ormerod and Williams as allowing civil law disputes on issues such as family or employment to become issues of criminal law²⁷⁵. Because of this, they considered that the element of dishonesty would prove crucial.²⁷⁶

7.2.4 Obtaining services dishonestly

Before the Fraud Act 2006, this offence was obtaining services by deception²⁷⁷, rather than dishonestly. Prior to the change, the requirement of deception alone had the unfortunate consequence that a person could obtain a service dishonestly and escape punishment if he had not actually deceived anyone²⁷⁸. Whilst it was recognised by the Government that one of the purposes of this section of the Fraud Act 2006 was to deal with the problems raised by 'deception' from automated services²⁷⁹, they also recognised that it had the effect of redirecting the focus away from deception towards 'misrepresentation'²⁸⁰.

As with the other sections, the mental elements of this offence are dishonesty and knowledge by the accused that he should pay for the services, with an intention not to pay.

²⁷³ Law Commission, *Fraud* (Law Com No 276, 2002) para 7.38.

²⁷⁴ The Crown Prosecution Service, 'Fraud Act: Legal Guidance: The Crown Prosecution Service' (n 258).

²⁷⁵ Ormerod & Williams, 'The Fraud Act 2006' (n 259) 8.

²⁷⁶ *ibid* 8.

²⁷⁷ Theft Act 1978, s 1

²⁷⁸ Law Commission, *Fraud* (n 273) para 8.1.

²⁷⁹ Nehaluddin Ahmed, 'E-Commerce and legal issues surrounding credit cards: emerging issues and implications' [2009] CTLR 114, 120.

²⁸⁰ Home Office consultation paper, 'Fraud Law Reform: Government Response to Consultations' 2005 para 35.

7.2.5 Possession of articles for use in fraud and making or supplying articles for use in fraud

Under the Fraud Act 2006, s 6(1), a person will be guilty of the offence of possession of articles for use in a fraud if he has in his possession or under his control any article for use in the course of or in connection with any fraud. Whilst this section does not appear to contain any *mens rea*²⁸¹, according to the Government the accused will have a general intention (rather than specific intention) that the article is used for some future fraud²⁸². Interestingly, there is no requirement of express dishonesty.

In accordance with the Fraud Act 2006, s7(1) a person will be guilty of the offence of making or supplying articles for use in fraud if he makes, adapts, supplies or offers to supply any article:-

- (a) knowing that it is designed or adapted for use in the course of or in connection with fraud; or
- (b) intending it to be used to commit, or assist in the commission of, fraud.

Again, with this offence, there is no express requirement of dishonesty. Guilt will depend if the accused had the requisite knowledge or intention. However, establishing that the accused had knowledge that the property would be used in connection with a fraud or an intention of it to be used to commit or assist a fraud would seem to imply dishonesty.

All the previously considered changes in the Fraud Act 2006 relate to where the accused is the primary offender. But, the most interesting introduction from the Fraud Act 2006 related to the change in law where a person assists in a fraud. It is submitted these offences are more closely related to those carried out by the stranger in equity. Notably, both the offences of possession of articles for use in fraud and making or supplying articles for use in fraud do not have any express requirement of dishonesty. There is no requirement that the accused has been dishonest or fraudulent. Knowledge or intention are the two key areas to establish liability.

²⁸¹ Ormerod & Williams, 'The Fraud Act 2006' (n 259) 8.

²⁸² Home Office consultation paper, 'Fraud Law Reform: Government Response to Consultations' (n 280) para 46.

The position in *Twinsectra*²⁸³, in applying *Ghosh*²⁸⁴ dishonesty to secondary liability, meant that the test being applied in the civil courts was actually higher than the test now being applied in the criminal courts for assisting in a fraud. For the offences of possession and supplying articles for use in a fraud, only evidence of an intention or knowledge is required. This, it is submitted, simply cannot be right.

Scanlan and Kiernan highlighted that the effect of incorporating a requirement of dishonesty into an offence, is that it can predominate all of the issues to be considered by the court and stated:-

‘In pursuing such cases, the amount of evidence devoted to establishing that the conduct of the defendants is dishonest is disproportionate (if one takes an academic view) compared to the other limbs of the offences charged. This is because it is rare for a jury to contemplate convicting a defendant unless they are satisfied that his conduct was thoroughly dishonest. Indeed, in many cases, the *actus reus* aspects of the offence are often largely or wholly admitted and it is upon the issue of dishonesty that the trial concentrates.’²⁸⁵

This may have been a reason that the offence of dishonesty was omitted from these two offences. It is submitted by the writer that the introduction of a requirement of dishonesty in equity has had a similar effect to that in the criminal law and has led to an over emphasis on the dishonesty element of the liability and less focus on what the stranger has actually done or failed to do. It may be time to consider returning to a liability without the need for dishonesty and the criminal connotations that are associated with it.

7.3 Handling stolen goods

Under the Theft Act 1968, s22(1) a person will handle stolen goods if knowing or believing them to be stolen goods, he dishonestly receives the goods, or dishonestly undertakes or assists in their retention, removal, disposal or realisation by or for the benefit of another person, or if he arranges to do so.

²⁸³ *Twinsectra* (n 12).

²⁸⁴ *Ghosh* (n 181).

²⁸⁵ Gary Scanlan & Peter Kiernan, ‘Fraud and the Law Commission: the future of dishonesty’ [2003] *Comp Law* 4, 6.

The accused must therefore know or believe the goods to be stolen and dishonestly receive or undertake or assist in handling the goods.

The *Ghosh*²⁸⁶ test is applied and according to *R v Smith*²⁸⁷ the dishonesty must be *vis a vis* the owner of the goods or someone who has a proprietary interest in the goods that have been stolen.

7.3.1 Knowing or believing the goods to be stolen

Whilst the question of dishonesty when handling stolen goods is at least in theory, relatively straightforward, the test to be applied for 'knowing' or 'belief' was not. Bramwell B in *R v White*²⁸⁸ stated that the accused would have the requisite knowledge if:-,

'with regard to the circumstances of the transaction, he believed that the goods had been stolen'.

However, in the absence of statutory assistance, this test evolved into one requiring actual knowledge alone. The Criminal Law Revision Committee ("CLRC") recognised the requirement of actual knowledge to be a serious defect of the criminal law and quite often the circumstances were such that the receiver ought to be found guilty, but guilty knowledge did not exist²⁸⁹. The CLRC gave an example of the person who bought goods at a ridiculously low price in a public house. He might not know the goods were stolen, but it may be clear that he believed the goods were stolen. The statutory addition of 'belief', as an alternative to knowledge was therefore welcomed²⁹⁰. However, the CLRC were at pains to distinguish this situation from the person who was merely careless, in that he had not made sufficient inquiry, and who would not be found guilty, under section 22(1).

When considering the knowledge or belief of the accused, it is necessary to demonstrate that the accused had the requisite knowledge or belief at the time he handled the goods²⁹¹

²⁸⁶ *Ghosh* (n 181).

²⁸⁷ [1986] Crim LR 123.

²⁸⁸ (1859) 1 F & F 665.

²⁸⁹ Criminal Law Revision Committee, *Eighth Report, Theft and Related Offences* (1966) Cmnd 2977 134.

²⁹⁰ *Haughton v Smith* [1975] AC 485 [503].

²⁹¹ *R v Williams* [1994] Crim LR 934.

and it will be sufficient if he had a knowledge or belief of the general nature of the goods, without having a specific knowledge of what the goods are.²⁹² The court will also take into consideration the circumstances upon which the goods were obtained when considering if the accused knew or believed that they were stolen.²⁹³

The case of *R v Forsyth*²⁹⁴ related to a defendant who had been accused of handling £400,000 which had been stolen by Asil Nadir, the Chairman and Chief Executive of Polly Peck International. Fraud involving Asil Nadir and Polly Peck International had also been subject to a claim in equity²⁹⁵. The judge at first instance in *R v Forsyth* described belief as:-

‘the state of mind of a person who says to himself I cannot say I know for certain that this money is stolen, but there can be no other reasonable conclusion in the light of all the circumstances, in the light of all that I have heard and seen.’

He also considered that the accused will still be guilty if he shut his eyes to the obvious. The appellant in this case criticised the direction upon the basis that ‘belief’ does not import an objective test and is not the same as ‘shutting one’s eyes to the obvious’. It was indicated that ‘belief’ could be constituted by unreasonable uncertainty and a refusal to believe the obvious.

The Court of Appeal reviewed the law in respect of knowledge and belief. In *Atwal v Massey*²⁹⁶ Lord Widgery CJ emphasised that the question was a subjective one:-

‘whether the accused suspecting the goods to be stolen, deliberately shut his eyes to the consequences?’

However, James LJ stated in *R v Griffiths*²⁹⁷ the question is:-

²⁹² *R v McCullum* (1973) 57 Cr App R 645.

²⁹³ *R v Hulbert* (1979) 69 Cr App R 243.

²⁹⁴ [1997] 2 Cr App R 299.

²⁹⁵ *Polly Peck* (n 88).

²⁹⁶ [1971] 56 Cr App R 6.

²⁹⁷ (1974) 60 Cr App R 14.

‘whether the defendant knew or believed the goods to be stolen because he deliberately closed his eyes to the circumstances’.

Therefore the action of deliberately closing his eyes is a matter of evidence from which the jury could infer belief.

In the case of *R v Moys*²⁹⁸, the Court of Appeal considered that:-

‘a very strong suspicion that the property was stolen, coupled with the accused shutting his eyes to this possibility was insufficient to establish belief.’

Lord Lane CJ suggested in *R v Grainge*²⁹⁹ that the question is subjective and whilst suspicion and shutting one’s eyes to the circumstances is not enough, it may be taken into account by the jury when deciding if the accused had the necessary knowledge or belief.

In *R v Hall*³⁰⁰, Boreham J considered that belief is something short of knowledge. This state of mind may arise where the accused cannot say for certain that the goods are stolen, but there can be no other reasonable conclusion in the light of all the circumstances and all that the accused has heard and seen. He also confirmed the accused would still have sufficient ‘belief’ if he refused to believe all that he had seen and heard and what his brain tells him is obvious.

The Court of Appeal considered all of these cases in *R v Forsyth*³⁰¹ and the direction given by the judge at first instance. It was held that the judge had misdirected the jury. The ordinary meaning of belief is:-

‘the mental acceptance of a fact as true or existing’.

It was accepted that between suspicion and actual belief there may be a range of awareness, but the jury must be satisfied that the accused actually believed that the goods were stolen. Bedlam LJ then went on to refer to the guidance provided in *R v Moys*³⁰² as

²⁹⁸ (1984) 79 Cr App R 72 [74].

²⁹⁹ (1973) 59 Cr App R 3 [6].

³⁰⁰ (1985) 81 Cr App R 260.

³⁰¹ Forsyth (n 294).

³⁰² Moys (n 298) [74].

being the appropriate guidance to be given. His reason was that it is more readily understandable to juries and there is therefore less chance of confusion which would arise from guidance such as that provided in *R v Hall*³⁰³.

The technical legal debate over the interpretation of what suspicion and actual belief is can be understood in the context of criminal law, where a person's liberty may be at stake. However, this does highlight how difficult it can be to ascertain if an individual has sufficient knowledge of the criminal offence. It would be extremely difficult in a complex fraud case to prove that a stranger had more than a very strong suspicion of fraud, if he denied he had any suspicion. However, as considered earlier, this does demonstrate that focus in civil cases should be on the conduct of the stranger and not his state of mind, as confirmed by Lord Millett³⁰⁴. A stranger's state of mind should not be considered and subjective knowledge should remain the preserve of the criminal courts. As confirmed by Lord Millett:-

‘Consciousness of wrongdoing is an aspect of *mens rea* which is an appropriate condition of criminal liability: it is not an appropriate condition of civil liability’³⁰⁵.

7.4 Negligence in the criminal law

The criminal courts have understandably always had difficulty in imposing punishment for negligence. The possibility of imposing a criminal punishment for negligence was considered by Spencer and Brajeux³⁰⁶. They identified that the reason for such reluctance in the criminal courts has traditionally been for two reasons:-

- (i) ‘the threat of punishment only works in respect of deliberate and conscious behaviour, so ‘punishing negligence is cruelty without purpose’ (“the utilitarian reason”); and
- (ii) it punishes those who ‘couldn’t help it’ (“the unfairness reason”).³⁰⁷

³⁰³ Hall (n 300).

³⁰⁴ *Twinsectra* (n 12) [116].

³⁰⁵ *ibid* [127].

³⁰⁶ JR Spencer & Marie-Aimee Brajeux, ‘Criminal liability for negligence – a lesson from across the Channel?’ 2010 ICLQ. 1.

³⁰⁷ *ibid* 19.

Spencer and Brajeux argued that the legal philosopher Herbert Hart justified the imposition of criminal liability for negligence upon the basis that the risk of incurring punishment makes a person stop and think. Herbert Hart stated:-

‘[T]he threat of punishment is something which causes him to exert his faculties, rather than something which enters as a reason for conforming to the law when he is deliberating whether to break it or not. It is perhaps more like a goad than a guide’.³⁰⁸

In relation to the issue of unfairness, Spencer and Brajeux argued that as long as the person could have complied with the law by trying a little harder, then punishment would not be unfair.³⁰⁹

7.4.1 Comparison with equity

It is submitted that the imposition of a criminal punishment for an act of negligence is very harsh, due to the possibility of a person losing his liberty. However, whilst it is conceded that a finding of dishonesty in the civil court will likely have adverse consequences to a professional’s reputation and career, the civil court does not have the power to imprison a defendant. In such circumstances, Spencer and Brajeux’s comments may be far more appropriate as in civil law the consequence of being found liable is only financial.

There needs to be a balancing act between the rights of the professional and the rights of the beneficiaries of a trust. As has been considered already far too much weight has been given to the rights of the professional, due to fear of some commercial and financial breakdown if they are to be found liable. However, it should be remembered that these cases are heard in a civil and not criminal context and if the threat of liability could make professional strangers stop and think about the beneficiaries and try a little harder to protect the beneficiaries’ interests, then this must be for the benefit of not only the beneficiaries, but the future of trusts as a financially secure means of protecting financial interests. Why should a negligent professional’s interests be more important than those of an innocent beneficiary who has suffered loss? The common law torts will be considered

³⁰⁸ HLA Hart, *Intention and Punishment* (2nd edn, Clarendon Press 2008) 134.

³⁰⁹ JR Spencer & Marie-Aimee Brajeux (n 306).

further and the next chapter will consider the position of misrepresentation which can be either fraudulent or negligent.

CHAPTER 8

AN ANALYSIS OF THE TORT OF MISREPRESENTATION

8.1 Fraudulent misrepresentation

A fraudulent misrepresentation is a statement of existing fact, opinion or of the law³¹⁰ and will usually be a belief or opinion that the person who makes it does not hold³¹¹ or a statement of an intention to do something when he has no such intention.

8.1.1 Dishonesty

The key element of fraudulent misrepresentation is dishonesty, as confirmed in *Henry Ansbacher & Co Ltd v Binks Stern*³¹². The maker of a false ambiguous statement will be liable for fraud if he intends it to have a meaning that he knows is not true. This will even be the case if the statement turned out to be true³¹³.

It is therefore important to establish if the person who makes the statement believes that it is true. If he believes the statement to be true, he will not be liable for fraud³¹⁴. This would suggest that liability has a subjective requirement and was considered by Lord Jenkins in the case of *Akerhielm v De Mare*³¹⁵. He believed fraud had a subjective requirement. He stated the question is not whether the defendant honestly believed the representation to be true on an objective basis, but whether he honestly believed the representation to be true in the sense in which he understood it, albeit erroneously when it was made. The test according to Lord Jenkins was therefore a subjective one.

In *Gross v Lewis Hillman Ltd*³¹⁶ the Court of Appeal conceded that it would be possible to infer fraud from very clear undisputed documents, but made clear it is really the role of the trial judge to decide if the defendant is liable or not. In order to establish liability for a fraudulent misrepresentation the representation must be false and it must be intended to

³¹⁰ Edwin Peel, *The Law of Contract* (12th edn Sweet & Maxwell 2007) para 9-002.

³¹¹ *ibid* para 9-004.

³¹² The Times, June 26 1997.

³¹³ *The Sibeon and the Sibotre* [1976] 1 Lloyd's Rep 293 [318].

³¹⁴ *Akerhielm v De Mare* [1959] AC 789; *Gross v Lewis Hillman Ltd* [1970] Ch 445.

³¹⁵ [1959] AC 789.

³¹⁶ [1970] Ch 445.

be fraudulent. However, the Court of Appeal did not specify if the test to be applied would be objective or subjective.

It should be noted that in both cases the trial judge had acquitted the defendants of fraud after seeing and hearing their evidence, and certainly in *Gross v Lewis Hillman*³¹⁷ a re-trial would have been necessary if the trial judge's finding had been reversed. It was confirmed in *Akerheilm v De Mare*³¹⁸ that the trial judge's decision should not be displaced on appeal except on the clearest grounds, which may explain the reluctance of the appeal courts to go behind the trial judge's decision.

8.1.2 Agents

It is common in commercial transactions for agents to be involved and acting on behalf of one of the parties. The position where an agent acting within the scope of his instructions, makes a statement that he knows is false, is that both the agent³¹⁹ and the principal³²⁰ will be liable for fraud. An agent will not however, generally be liable for the fraud of the principal if he has no knowledge that the statement is false³²¹. The key element with agents is therefore knowledge.

8.1.3 Is there a criminal or civil burden of proof?

It has long been accepted that 'fraud' has criminal connotations and the Court of Appeal considered in *Hornal v Neuberger Products*³²² whether the burden of proof in these cases should be 'beyond a reasonable doubt' or 'on the balance of probabilities'. Denning LJ stated that the standard of proof will depend on the nature of the issue and the more serious the allegation, the higher the degree of probability that will be required. Hodson LJ confirmed there were degrees of probability, which would depend on the subject matter. For an allegation of fraud, a civil court would require a far higher degree of probability than for an allegation of negligence. It was conceded however, by both Denning LJ and Hodson

³¹⁷ *Gross* (n 316).

³¹⁸ *Akerheilm* (n 314).

³¹⁹ *Standard Chartered Bank v Pakistan National Shipping Co* [2002] UKHL 43.

³²⁰ *S Pearson & Son Ltd v Dublin Corp* [1907] AC 351; *Briess v Woolley* [1954] AC 333; *Rignal Developments Ltd v Halil* [1988] Ch 190 [198]; *Man Nutzfahrzeuge AG v Freightliner Ltd* [2005] EWHC 2347; *Clapp v Enron (Thrace) Exploration & Production BV* [2005] EWCA Civ 1511 [29].

³²¹ *Cornfoot v Fowke* (1840) 6 M & W 358; *Gordon Hill Trust Ltd v Segall* [1941] 2 All ER 379; *Armstrong v Strain* [1952] 1 KB 232.

³²² [1957] 1 QB 267.

LJ that the civil court would not adopt so high a degree of proof as a criminal court. Therefore, whilst it is not necessary to prove liability beyond a reasonable doubt, it is clear that the burden of proof in civil fraud cases is far higher than the usual burden applied in the civil courts of the balance of probabilities.

8.1.4 What must the claimant prove?

In the case of *Wallingford v Mutual Society*³²³ the House of Lords confirmed that the common law rule when making an allegation of fraud, is that general and vague allegations will be insufficient to establish fraud. However, whilst requiring allegations of fraud to be specific, the House of Lords did state that fraud can be implied from an actual fact or circumstance.

Lord Selborne who had been sitting in the House of Lords in *Wallingford*³²⁴ confirmed in *Smith v Chadwick*³²⁵ that the claimant must prove there was an actual fraud and that the fraud induced the contract. He stated that the knowledge and intention of the defendant were the important factors when considering if an actual fraud had taken place.

The House of Lords in the leading case of *Derry v Peek*³²⁶ stated that the claimant must prove that the defendant made the statement knowingly or without belief in its truth. The defendant could be reckless in making the statement without belief in its truth, but mere carelessness was not sufficient. In order to establish liability, the claimant must demonstrate that the defendant had a dishonest intention and this was an objective test. The claimant must show that an honest man would not have done as the defendant did. When applying this objective test, the court would consider if the defendant had reasonable grounds for believing the statement and look at the defendant's knowledge and means of knowledge.

Whilst the courts will look at the defendant's knowledge and means of knowledge, it is not necessary that the maker of a false statement is 'dishonest' as that word is used in the criminal law³²⁷. In *Standard Chartered Bank v Pakistan National Shipping Corp (No.2)*³²⁸

³²³ [1880] 5 App Cas 685.

³²⁴ *ibid.*

³²⁵ (1883-84) L.R. 9 App. Cas. 187 [190].

³²⁶ (1889) 14 App Cas 337 [374].

³²⁷ Qi Zhou, 'Economic analysis of the legal standard for deceit in English tort law' [2009] EJL&E 83, 94

Evans LJ confirmed that if the false statement is made knowingly and the maker of the statement has the intention that his statement shall be acted upon by the person to whom it is addressed, then this will be sufficient for liability to be established.

8.1.5 Should a failure to take reasonable care be fraudulent?

Lord Herschell had expressed the opinion in *Derry v Peek*³²⁹ that when representations are made in a commercial context there is a moral duty to take reasonable care and that this moral duty should be converted into a legal obligation. He did concede however, that this would be a matter where the legislature must intervene and the law should not be strained to make a failure to take reasonable care, fraudulent.

8.1.6 Comparison with the position in equity

As with the position in equity for dishonest strangers, in the case of fraudulent misrepresentation the key issue is honesty. If the person making a false statement is honest, then he will not be liable for fraud, just as in equity if the stranger is honest, he will not be liable for assisting in a breach of trust. There are other similarities in the approach taken in *Twinsectra*³³⁰ and *Akerheilm v De Mare*³³¹. In both cases, the subjective knowledge of the defendant was important to ascertaining if the defendant was dishonest/fraudulent. It is suggested that it is more than just coincidence that in both *Twinsectra*³³² and *Akerheilm*³³³, a failure to allow a subjective test would have resulted in a retrial.

The decision however to apply a subjective test has led to uncertainty and confusion. It is submitted that the correct test to be applied is an objective test which concentrates on the knowledge and intention of the defendant, as confirmed in *Smith v Chadwick*³³⁴, *Derry v Peek*³³⁵ and *Standard Chartered Bank v Pakistan National Shipping Corp (No.2)*³³⁶. The approach of concentrating on the knowledge and intention of the defendant bears many

³²⁸ [2000] 1 Lloyds Rep 218 [27].

³²⁹ *Derry* (n 326).

³³⁰ *Twinsectra* (n 12).

³³¹ *Akerheilm* (n 314).

³³² *Twinsectra* (n 12).

³³³ *Akerheilm* (n 314).

³³⁴ *Smith* (n 325).

³³⁵ *Derry* (n 326).

³³⁶ *Standard Chartered Bank* (n 328).

similarities with the position in equity prior to the introduction of the requirement of dishonesty in *Royal Brunei*³³⁷.

Interestingly, Lord Selborne who delivered the judgment in the leading case in equity of *Barnes v Addy*³³⁸ was also involved in both the cases of *Wallingford v Mutual Society*³³⁹ and *Smith v Chadwick*³⁴⁰. In both areas of law the defendant's knowledge was the essential component of liability, which was established objectively.

In *Derry v Peek*³⁴¹, Lord Herschell considered that at least in a commercial context, makers of representations to induce contracts had a moral duty to take reasonable care and that this moral duty should be converted into a legal obligation. This is commendable and there should be no reason why banks, solicitors, accountants and other professionals when entering into contracts with trustees should not have to take reasonable care and be found liable in negligence where they fail to do so. Professionals who contract with trustees have an even greater moral duty towards the beneficiaries of a trust.

The requirement of dishonesty was only introduced by *Royal Brunei*³⁴² relatively recently. Did its introduction result in the law taking another wrong turn? As recognised in *Hornal v Neuberger Products*³⁴³ an allegation of fraud or dishonesty requires a higher degree of proof than is normal in the civil courts. It is therefore suggested that the problems that have arisen in equity from all the confusion over what the correct test is to apply, whether the test should be subjective, the difficulty for beneficiaries to succeed in such a claim and the potential consequences to the reputation and career of the defendant have all arisen from the requirement of dishonesty. Therefore, the test should return to one of knowing assistance only. Further, if liability in equity returned to the requirement of knowledge alone, then a failure to take reasonable care should not be as difficult a proposition to establishing liability for negligence. This dissertation will now consider the position in negligence and specifically negligent misrepresentation.

³³⁷ *Royal Brunei* (n24).

³³⁸ *Barnes* (n 27).

³³⁹ *Wallingford* (n 23).

³⁴⁰ *Smith* (n 325).

³⁴¹ *Derry* (n 326).

³⁴² *Royal Brunei* (n24).

³⁴³ *Hornal* (n 322).

8.2 Negligent misrepresentation

Negligent misrepresentation may arise where a person honestly makes a statement of belief but fails to check the facts and could easily have done so³⁴⁴. It will be negligent if it is made carelessly and in breach of a duty to take reasonable care that the representation is accurate³⁴⁵.

8.2.1 The need for a special relationship

There are a number of cases involving negligent misrepresentation, where the misrepresentation was provided by a third party. In the key case of *Hedley Byrne & Co Ltd v Heller & Partners Ltd*³⁴⁶ a bank gave a credit reference to the claimant, for one of its account holders. In such circumstances the House of Lords held that a bank owed a duty to take reasonable care. However, the duty will only arise if there is a special relationship between the parties. A special relationship will arise when:-

- (i) it is reasonably foreseeable by the representor that the representee will rely on the statement;
- (ii) there is sufficient 'proximity' between the parties; and
- (iii) it is just and reasonable for the law to impose the duty.³⁴⁷

The representation must be made in the context of a professional relationship and no action will normally arise from careless friendly advice given in a purely social relationship³⁴⁸ or by a company not engaged in the specialist field of giving skilled advice.³⁴⁹ In such instances it would be clearly unjust and unreasonable to impose a duty. The key point arising from *Hedley Byrne v Heller* is that liability may arise even though there is no contractual relationship between the representor and representee. Thus professionals³⁵⁰ and banks³⁵¹ have duties to others when making representations on

³⁴⁴ Peel (n 310) para 9-004.

³⁴⁵ *ibid* para 9-030.

³⁴⁶ [1964] AC 465.

³⁴⁷ *Smith v Eric S Bush* [1990] 1 AC 831 [865]; *Caparo Industries plc v Dickman* [1990] 2 AC 605 [617-618]; *Yeun Kun Yeu v Attorney-General of Hong Kong* [1988] AC 175; *Davies v Radcliffe* [1990] 1 WLR 821; *Law Society v KPMG Peat Marwick* [2000] 1 WLR 1921.

³⁴⁸ *Hedley Byrne* (n 346) [482].

³⁴⁹ *Mutual Life and Citizen's Ins Co Ltd v Evatt* [1971] AC 793.

³⁵⁰ *Yianni v Edwin Evans & Sons* [1982] QB 438; *Smith v Eric S Bush* [1990] 1 AC 831.

³⁵¹ *Hedley Byrne* (n 346).

behalf of their clients and may be found liable in negligence if these representations are wrong and they should have known they were wrong.

8.2.2 Has the defendant assumed responsibility?

In the case of *Caparo Industries v Dickman*³⁵², whilst Lord Bridge was against the extension of a prima facie duty of care, he did concede that it would be preferable to develop novel categories of negligence incrementally and by analogy with established categories. With this in mind, Lord Bingham considered an alternative test to the three stage test, in *Customs & Excise Commissioners v Barclays Bank plc*³⁵³. This case did not relate to negligent misrepresentation, but its principle may be applied to such cases. It confirmed that a special relationship may exist where the defendant has assumed responsibility for what is said or done to another. It will usually have all the indicia of a contractual relationship, save for consideration. If an assumption of responsibility could be shown then this would be a sufficient, but not necessary condition to establish liability. If there was no 'assumption of responsibility' then the three stage test could be considered.

Lord Bingham made clear that the test for assumption of responsibility is an objective one and the court would not consider what the defendant thought or intended. The court was solely concerned with what could be inferred from the defendant's conduct taking into account the detailed circumstances of the particular case and the relationship between the parties.

8.2.3 Comparison with the position in equity

In the case of a negligent misrepresentation, a bank or professional may be found liable to the parties to a contract, even though he is not a party to the contract himself. It is submitted that there is therefore a precedent in the common law to finding a third party to a contract liable for negligent assistance. In the common law this takes the form of an oral or written representation, but there is no reason why this should not be applied in relation to contracts where the third party is providing a similar service such as legal or financial representation. For example the solicitor in *Twinsectra*³⁵⁴ was clearly negligent. He took

³⁵² [1990] 2 AC 605 [618].

³⁵³ [2006] UKHL 28 [7].

³⁵⁴ *Twinsectra* (n 12).

money aware of the terms of an undertaking and then released the money in breach of that undertaking. When he initially received the money he was 'assuming responsibility' for the money. This alone would be sufficient to find liability under the assumption of responsibility test.

The three stage test could be equally applied and result in a finding that Leach was liable. The reliance must have been reasonably foreseeable and it is submitted that a solicitor receiving money with notice of an undertaking in respect of that money could foresee that by releasing the money in breach of the undertaking, the beneficiary of the undertaking may suffer loss. Further, by receiving the money with notice of the undertaking and holding the money on trust in the client account, there would be sufficient proximity between the claimant and solicitor. Finally, the action of releasing the money in breach of trust and without taking any reasonable action to ensure that the terms of the trust were complied with would suggest that in all the circumstances it would be just and reasonable to impose liability.

Lord Bridge recognised in *Caparo Industries v Dickman*³⁵⁵ that it is preferable to develop novel categories of negligence incrementally and by analogy with established categories. It is submitted that the liability of strangers in equity is such an established category. Indeed, equity has effectively imposed liability on strangers in the past for negligently assisting in a breach of trust, as considered earlier in the cases of *Selangor*³⁵⁶ and *Karak*³⁵⁷.

Negligent misrepresentation has demonstrated that industry has not ground to a halt as a consequence of the imposition of liability on third parties. In fact, it could be argued that as a consequence of this liability, agents have taken better precautions to ensure the facts which they relay are true and has resulted in industry suffering less problems.

³⁵⁵ *Caparo Industries* (n 352).

³⁵⁶ *Selangor* (n 61).

³⁵⁷ *Karak* (n 70).

CHAPTER 9

AN ANALYSIS OF THIRD PARTY LIABILITY IN THE COMMON LAW

9.1 The privity of contract rule

The common law has encountered difficulties in finding third parties to a contract negligent, since the case of *Tweddle v Atkinson*³⁵⁸, where Wightman J stated that no stranger to the consideration could take advantage of a contract even though made for his benefit.

This principle was followed in *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd*³⁵⁹ where the House of Lords confirmed that it was a fundamental principle of English law that only a party to a contract who had given consideration could sue on it.

In *Midland Silicones Ltd v Scruttons Ltd*³⁶⁰, Viscount Simonds suggested that the principle of '*jus quaesitum tertio*' (the right of a third party to a contract to sue) should only be introduced through legislation.³⁶¹

The failure of the law to allow a third party to a contract to sue has been strongly criticised in the House of Lords³⁶². Steyn LJ stated that there is 'no doctrinal, logical or policy reason' for it³⁶³. Denning LJ pointed out in *Drive Yourself Hire Co (London) Ltd v Strutt*³⁶⁴, that for the 200 years prior to the case of *Tweddle v Atkinson*, it was settled law that, if it was intended that the contract be enforceable by the third party, then in common law, the contract could be enforced by the third party.³⁶⁵ Denning LJ indeed made attempts to allow claims made by third parties but to no avail³⁶⁶.

³⁵⁸ (1861) 1 B & S 393; 121 ER 762.

³⁵⁹ [1915] AC 84.

³⁶⁰ [1962] AC 446.

³⁶¹ *Ibid* [467-468].

³⁶² *Beswick v Beswick* [1968] AC 58, 72; *Woodar Investment Developments Ltd v Wimpey Construction UK Ltd* [1980] 1 WLR 277 [291], [297–298], [300]; *Swain v Law Society* [1983] 1 AC 598, 611; *The Pioneer Container* [1994] 2 AC 324 [335]; *White v Jones* [1995] 2 AC 207 [262-263].

³⁶³ *Darlington BC v Wiltshier Northern Ltd* [1995] WLR 68 at 76.

³⁶⁴ [1954] 1 QB 250.

³⁶⁵ *Dutton v Poole* (1678) 2 Lev 210; 8 ER 523, *Martyn v Hind* (1776) 2 Cowp 437, 443; 98 ER 1174 [1177]; *Marchington v Vernon* (1797) 1 Bos & P 101, n (c); 126 ER 801, n (c); *Carnegie v Waugh* (1823) 1 LJ (OS) KB 89.

³⁶⁶ *Drive Yourself Hire Co (London) Ltd v Strutt* [1962] AC 446; *Smith and Snipes Hall Farm Ltd v River Douglas Catchment Board* [1949] 2 KB 500.

In 1996, the Law Commission made a number of recommendations, including reforming the privity rules through a detailed legislative scheme.³⁶⁷ However, it made clear that by introducing such a scheme it did not want to hamper any judicial creativity in this area.³⁶⁸ The Report highlighted that in the United States, New Zealand and parts of Australia, the privity rule had already been abolished³⁶⁹ and most member states of the European Union recognised and enforced the rights of third party beneficiaries under contracts³⁷⁰.

The recommendations were followed and led to the enactment of the Contracts (Rights of Third Parties) Act 1999 (“C(RoTP)A 1999”). However, whilst the C(RoTP)A 1999 did give some third parties the right to enforce contracts and a general exception to the third party rule, the general rule was left intact.³⁷¹ As a result, the Act has been described as an exception, rather than a departure from the common law doctrine of privity.³⁷²

9.1.1 Application of the doctrine of privity of contract in equity

This doctrine has created many problems in equity as the beneficiaries are not a party to the contract between the stranger and the trustees. The court of equity has traditionally been reluctant to impose duties upon strangers for fear of the impact on commercial transactions. However, the privity rule is in legal terms only relatively new and has been abolished in many countries with a common law jurisdiction, without any adverse effect. It has been recognised by the Law Commission, Parliament and many in the House of Lords that this doctrine is restrictive and can be harsh to innocent third parties who may have suffered loss through no fault of their own. It is therefore submitted that the beneficiaries of a trust should be able to enforce a contract or sue under a contract between the trustees and a stranger. After all it is the trust fund that pays the stranger’s fees and the beneficiaries are the owners in equity of the trust fund. The trustees may have legal ownership but are not the equitable owners of the fees. Having considered the doctrine of privity of contract and the problems that it has created, the common law has demonstrated

³⁶⁷ Law Commission, *Privity of Contract: Contracts for the Benefit of Third Parties* (Law Com No. 242, 1996).

³⁶⁸ *ibid* para 1.9.

³⁶⁹ *ibid* para 3.7.

³⁷⁰ *ibid* para 3.8.

³⁷¹ *ibid* para 5.16.

³⁷² Peel (n 310) para 14-002.

that it is possible to circumnavigate this particular doctrine in relation to claims under the tort of negligence. This will be considered in the next section.

9.2 Liability in the tort of negligence

Since the key case of *Donoghue v Stevenson*³⁷³ it has been possible to impose a duty of care to third parties, which if breached, will allow the third parties to sue under the tort of negligence. However, the courts have been reluctant to extend this duty too far in contractual relationships, for fear of upsetting the contractual relationship and creating uncertainty³⁷⁴.

Generally, in the law of negligence and in claims for pure economic loss the two tests which are applied are the objective 'assumption of responsibility' test or the three stage test, as considered earlier³⁷⁵.

Under the assumption of responsibility test, the third party must have a relationship with the contracting parties which is 'equivalent to contract'³⁷⁶. Its function is to make up for the shortcomings of contract where consideration has not been provided³⁷⁷ or if problems have arisen as a consequence of the privity of contract doctrine³⁷⁸.

In the case of *Riyad Bank v Ahli United Bank (UK) plc*³⁷⁹ a successful claim was brought by a third party to a contract for negligent advice. Liability was found upon the basis that there had been an assumption of responsibility on the part of the defendant towards the third party. Longmore LJ stated:-

'there cannot be a general proposition that, just because a chain exists, no responsibility... is ever assumed to a non-contractual party. It all depends on the facts'³⁸⁰

³⁷³ [1932] AC 562.

³⁷⁴ Peel (n 310) para 14-045.

³⁷⁵ *Customs & Excise Commissioners* (n 353) [7].

³⁷⁶ *Hedley Byrne* (n 346) [530].

³⁷⁷ Peel (n 310) para 14-046.

³⁷⁸ *Williams v Natural Life Health Foods Ltd* [1998] 1 WLR 830 [837].

³⁷⁹ [2006] EWCA Civ 780.

³⁸⁰ *ibid* [32].

9.2.1 Claims by the beneficiaries of a will

In the cases of *Ross v Caunters*³⁸¹ and *White v Jones*³⁸² the courts considered the position if a solicitor negligently drafted or failed to draft a will and if the beneficiaries would have a claim against the solicitor, even though they were not a party to the contract.

In *Ross v Caunters*³⁸³ a solicitor drafted and sent out a will to his client for execution. The solicitor failed to advise the client that the will should not be witnessed by the spouse of a beneficiary and the will was subsequently witnessed by a beneficiary's husband. As a consequence, the gift to the intended beneficiary failed. The solicitor admitted negligence, but argued that he only owed a duty to the client with whom he had contracted. The court held that the solicitor owed the beneficiary a duty of care, as the beneficiary was within the solicitor's direct contemplation as a party who could be injured by a failure to follow the client's instructions and draft the will correctly.

Although *Ross v Caunters* was subjected to some criticism³⁸⁴, in *White v Jones*³⁸⁵ the House of Lords upheld the principle. In this case the solicitor had been instructed to draft a new will, to include two of his client's daughters as beneficiaries, who had been 'written out' of the last will due to a family argument. Whilst the solicitor accepted these instructions, he was negligent in failing to draft the will within a reasonable period of time and the client died before the will could be executed.

The House of Lords held that the solicitor had a duty to the beneficiaries and this was established upon the basis of foreseeability, proximity and justice³⁸⁶. Financial loss to disappointed beneficiaries arising from a failure to prepare a will was clearly foreseeable.³⁸⁷ The House of Lords suggested that the category of proximity and the category of fairness, justness and reasonableness should be considered together. The court should look at the relationship and whether there 'ought' to be liability for negligence.³⁸⁸ It was also confirmed that when considering if there ought to be liability,

³⁸¹ [1980] Ch 287.

³⁸² [1995] 2 AC 207.

³⁸³ *Ross* (n 381).

³⁸⁴ *Caparo Industries* (n 352); *Murphy v Brentwood DC* [1991] 1 AC 398; *Seale v Perry* [1982] VR 193.

³⁸⁵ *White* (n 382).

³⁸⁶ *ibid* [240].

³⁸⁷ *ibid* [222].

³⁸⁸ *ibid* [222].

there is no need to prove actual and foreseeable reliance by the claimant on the defendant.³⁸⁹

9.2.2 The need for justice

It is clear from the judgment that the predominating factor as supported by Sir Donald Nicholls V-C and Steyn LJ in the Court of Appeal and Lord Goff in the House of Lords was to carry out practical justice and provide a remedy. The reason that the issue of justice was so important was that if the defendant had been successful in his argument, a curious anomaly would have been created in the law. The defendant had argued that he, the solicitor, had no duty to the beneficiaries. However, upon the basis of this argument, the only persons who the solicitor would have a duty towards were the testator, who was dead, and the executors, who had suffered no loss. Conversely, the only persons who had suffered loss were the beneficiaries, who had no valid claim.³⁹⁰ It was confirmed by the House of Lords that this created an unacceptable³⁹¹ lacuna in the law, which must be filled³⁹² due to the injustice that it created. In fact the word 'justice' was mentioned a total of twenty six times in the judgments of both the Court of Appeal and House of Lords.

It was made clear however, that for the aforementioned reasons of justice, this principle will only apply once the testator has died. Whilst the testator is still alive, he will have a claim in contract and negligence.

In the hearing, the appellants had raised a public policy and 'floodgates' argument³⁹³, but this was dismissed by Lord Goff who whilst conceding that there must be boundaries to the availability of a remedy, stated that these would have to be worked out in the future, as practical problems come before the courts.³⁹⁴ Lord Goff approached the matter in a flexible and unrestrictive manner, laying down the seeds and allowing the law to evolve in the manner the courts thought just. It was a brave and very commendable approach.

³⁸⁹ *ibid* [220], [221], [222], [223].

³⁹⁰ *ibid* [221], [234].

³⁹¹ Teresa Rosen Peacocke, 'The remedy in *White v Jones* cases: smoothing the analytical wrinkles' [2008] PN 138, 153.

³⁹² *White* (n 382) [225], [261], [266] & [269].

³⁹³ *ibid* [270].

³⁹⁴ *ibid* [270].

The principle in *White v Jones*³⁹⁵ has been extended to the beneficiaries of an insurance policy. In the case of *Gorham v British Telecommunications plc*³⁹⁶ the Court of Appeal held that the duty of care owed by an insurance company to a customer could also be extended to the dependants of the customer, providing it had been made clear to the insurance company that the customer intended the dependants to benefit.

9.2.3 Should beneficiaries of an inter vivos trust be entitled to sue?

There is clear precedent for allowing the beneficiaries of a will to sue and it is contended that providing the professional is aware that he is dealing with a trust, the beneficiaries of an inter vivos trust are similar in their position to the dependants of the customer of the insurance company in *Gorham v BT plc*³⁹⁷.

The reason for allowing the beneficiaries of a will to sue the solicitor in negligence was because of the lacuna in the law and the need to do justice. It is submitted that a similar lacuna and need to do justice is created in relation to the beneficiaries of an inter vivos trust where the trustee is dishonest and impecunious. If the stranger complies with the instructions of a dishonest trustee, negligently failing to realise that he is assisting in a breach of trust, his duty of care is only to the trustee, who has not suffered loss. The only persons who have suffered loss are the beneficiaries and if the stranger does not have a duty to them, then they will be unable to recover their losses.

This is fundamentally different to the position where the trustees are honest and the stranger is dishonest. In such a circumstance, the beneficiaries could sue the trustees and the trustees would be able to claim an indemnity against the stranger for breaching their duty. Whilst this seems to reflect the degree of culpability of the trustee, it is unjust to the beneficiaries that they will have better prospects of recovering finances from a stranger if the trustee is honest, than if the trustee is dishonest. This may have been a consideration of Lord Selborne when he stated the requirement that the trustee was dishonest in *Barnes v Addy*, but this is only conjecture.

³⁹⁵ *White* (n 382).

³⁹⁶ [2000] 1 WLR 2129.

³⁹⁷ *ibid.*

The problem with introduction of the subjective element in equity in *Twinsectra*³⁹⁸ is that strangers now have a defence that whilst they may be dishonest by objective standards, they negligently failed to realise that what they were doing was dishonest. However, surely justice demands that a stranger should not be afforded a civil defence for being negligent.

Andrews posed the following two questions:-

Does the assumption of responsibility by a solicitor or other professional to a trustee extend to the beneficiary who may, as a result of the solicitor's negligence or breach of fiduciary duties, suffer loss?; and

Is the relationship between the solicitor and beneficiary a "special relationship"?³⁹⁹

The difficulty is that the common law does not normally recognise a beneficial interest. However, Andrews contended that this difficulty is not insurmountable and she referred to the case of *Leigh and Sullivan Ltd v Aliakmon Shipping Co Ltd*⁴⁰⁰. In this case, Lord Brandon sitting in the House of Lords, considered the difficult question of whether the equitable owner of property could sue in tort for negligence. Lord Brandon confirmed that:-

"if the person is the equitable owner of the goods and no more, then he must join in the legal owner as a party to the action, either as a co-plaintiff if he is willing or as a co-defendant if he is not".⁴⁰¹

It was therefore argued by Andrews that providing the trustees or fiduciaries are joined as co-claimants or co-defendants, then a claim in negligence may be possible by the beneficiaries of the trust. This would represent a very satisfactory solution to this long standing problem and follow in the very brave and enterprising footsteps of Lord Goff in *White v Jones*.

³⁹⁸ *Twinsectra* (n 12).

³⁹⁹ Georgina Andrews, 'The redundancy of dishonest assistance' [2003] Conv 398, 403.

⁴⁰⁰ [1986] A.C. 785.

⁴⁰¹ *ibid* [812].

9.3 The tort of interference with contractual rights

A duty not to interfere with contracting parties or cause loss by unlawful means can be traced back many hundreds of years. In the case of *Tarleton v M'Gawley*⁴⁰², Lord Kenyon considered the position where a ship had been trading off the west coast of Africa and another ship deliberately fired its cannon at the native African's canoe killing one of the men on board. Lord Kenyon described the firing of the cannon as 'contriving and maliciously intending to hinder and deter'⁴⁰³. In the circumstances, the defendants were found to be liable.

In the case of *Lumley v Gye*⁴⁰⁴ a singer had been enticed and procured by a third party to breach her contract with the claimant. The court found that the third party had knowledge of the transaction and had maliciously intended to injure the claimant⁴⁰⁵ and was consequently held liable for maliciously procuring a breach of contract.

Lord Mcnaghten in *Quinn v Leathern*⁴⁰⁶ confirmed that interference with contractual relations would be a violation of a legal right, unless sufficient justification could be shown. However, in relation to the decision made in *Lumley v Gye*⁴⁰⁷, whilst he stated that the decision was right, he did not consider this should be on the ground of malicious intention, but on the ground that a violation of a legal right committed knowingly is a cause of action. In the same case, Lord Lindley confirmed that this principle applied to all wrongful acts done intentionally to damage a particular individual.

In the case of *D C Thomson & Co Ltd v Deakin*⁴⁰⁸ Jenkins LJ confirmed that interference may be direct by persuasion, procurement or inducement, or indirect such as influence of one kind of another.

Direct interference would be regarded as a wrongful act in itself and would amount to an actionable interference if:-

⁴⁰² (1793) Peake 270.

⁴⁰³ *ibid* [271].

⁴⁰⁴ (1853) 2 El & Bl 216.

⁴⁰⁵ *ibid* [217].

⁴⁰⁶ [1901] AC 495 [51].

⁴⁰⁷ *Lumley* (n 404).

⁴⁰⁸ [1952] Ch 646 [693].

- (i) the third party had knowledge of the contract; and
- (ii) had the intention of bringing about the breach.⁴⁰⁹

However, if the interference is indirect, the claimant must also demonstrate that the act itself is unlawful⁴¹⁰ or there will be no liability.

Lord Pearce confirmed in *J T Stratford & Sons Ltd v Lindley*⁴¹¹, that the third party should have sufficient knowledge of the terms to know that he was inducing a breach of contract.

In the case of *Emerald Construction Co Ltd v Lowthian*⁴¹², the Court of Appeal confirmed that ignorance of the precise terms of the sub-contract was not enough to show an absence of intent to procure its breach.

Lord Diplock reiterated Jenkins LJ's view in *Thomson v Deakin* that the third party must have knowledge of the existence of the contract and an intention to interfere with its performance in *Merkur Island Shipping Corporation v Laughton and others*⁴¹³

In *Lonrho plc v Fayed*⁴¹⁴, Woolf LJ stated that liability could be imposed upon the basis of foresight of harm. This approach was supported in *Millar v Basse*⁴¹⁵, where the Court of Appeal confirmed that intention could be implied from the knowledge of the third party, in the absence of any reasonable explanation by the third party for his conduct. The approach was not however unanimous and Peter Gibson LJ delivered a dissenting judgment stating that the third party, by his conduct, must intend to break or otherwise interfere with the contract.⁴¹⁶

The subject of intentional wrongdoing was considered further in the Court of Appeal cases of *Douglas and others v Hello! Ltd and others (No 3)*⁴¹⁷, *Mainstream Properties Ltd v Young*⁴¹⁸ and *OBG Ltd v Allan*⁴¹⁹.

⁴⁰⁹ *ibid* [694].

⁴¹⁰ *ibid* [693].

⁴¹¹ [1965] AC 269 [332].

⁴¹² [1966] 1 All ER 1013.

⁴¹³ [1983] 2 AC 570 [607F].

⁴¹⁴ [1990] 2 QB.

⁴¹⁵ [1994] EMLR 44.

⁴¹⁶ *ibid* [203].

⁴¹⁷ [2005] EWCA Civ 595 [220].

⁴¹⁸ [2005] EWCA Civ 861 [72].

In *Douglas v Hello*⁴²⁰, Lord Phillips sitting in the Court of Appeal made clear that foreseeability of loss would not be sufficient to establish an intention to interfere with a contract and approved the dissenting approach of Peter Gibson LJ in *Lonrho v Fayed*⁴²¹. The conduct must be aimed or directed at the claimant, with the purpose or object of causing that claimant economic loss.

This approach was agreed as the correct approach by Arden LJ in *Mainstream Properties v Young*⁴²² who identified the need for a 'specific subjective intention'⁴²³. She considered that the imposition of greater liability on third parties would carry with it the risk of inhibiting competition and entrepreneurialism.⁴²⁴

With Mance LJ dissenting, the Court of Appeal held in *OBG Ltd v Allan*⁴²⁵ that the essential ingredient to establishing liability is an intention to procure a breach of a contract.

All three of the aforementioned cases were then appealed to the House of Lords⁴²⁶. In the the House of Lords Lord Hoffman sought to distinguish between the torts of inducing a breach of contract (*Lumley v Gye*⁴²⁷), causing loss by unlawful means (*Tarleton v M'Gawley*⁴²⁸) and interference with contractual relations⁴²⁹. The latter Lord Hoffman later described as falling within the tort of causing loss by unlawful means⁴³⁰. This was subject to criticism and Simpson questioned why these limited reports of liabilities imposed in entirely different circumstances some 200 or 400 years ago should be treated as any part of an acceptable justification for redefining the scope of economic tort liability in the 21st century⁴³¹

⁴¹⁹ [2005] EWCA Civ 106; [2005] QB 762.

⁴²⁰ *Douglas* (n 417).

⁴²¹ *Lonrho* (n 414).

⁴²² *Mainstream Properties* (n 418).

⁴²³ *ibid* [72].

⁴²⁴ *ibid* [76].

⁴²⁵ *OBG Ltd* (n 419).

⁴²⁶ *OBG Ltd and others v Allan and others, Douglas and another v Hello! Ltd and others, Mainstream Properties Ltd v Young and others* [2007] UKHL 21.

⁴²⁷ *Lumley* (n 404).

⁴²⁸ *Tarleton* (n 402).

⁴²⁹ *OBG Ltd and others v Allan and others, Douglas and another v Hello! Ltd and others, Mainstream Properties Ltd v Young and others* (n 426) [2].

⁴³⁰ *ibid* [44].

⁴³¹ Bob Simpson: 'Economic tort liability in labour disputes: decision in *OBG v Allan*' [2007] ILJ 468, 473.

9.3.1 Causing loss by unlawful means

Lord Hoffman described the tort of causing loss by unlawful means as⁴³²:-

- (i) a tort of primary liability, not requiring a wrongful act by anyone else;
- (ii) requiring the use of unlawful means;
- (iii) not depending upon the existence of contractual relations; and
- (iv) the defendant must have an intention to cause damage to the claimant.

The basis of this type of claim is:-

- (i) a wrongful interference with the actions of a third party in which the claimant has an economic interest; and
- (ii) an intention to cause loss to the claimant.

The wrongful interference must be unlawful⁴³³ and a defendant will not be liable for loss which is merely a foreseeable consequence of the defendant's actions.⁴³⁴

Lord Nicholls who was also sitting in the House of Lords agreed with Lord Hoffman that this is a 'stand-alone' tort imposing primary liability on a defendant for his own conduct⁴³⁵ and that the conduct must be unlawful.

9.3.2 Inducing a breach of contract

Lord Hoffman confirmed that liability under the tort of inducing a breach of contract will be secondary and requires a primary breach of contract by one of the contracting parties. The third party's act must be 'wrongful', with knowledge and intention to cause the breach of contract.⁴³⁶

⁴³² *OBG Ltd and others v Allan and others, Douglas and another v Hello! Ltd and others, Mainstream Properties Ltd v Young and others* (n 426) [8].

⁴³³ *ibid* [51].

⁴³⁴ *ibid* [62].

⁴³⁵ *ibid* [173].

⁴³⁶ *ibid* [173].

The test for knowledge is subjective and foreseeability of damage is not sufficient to demonstrate an intention. The act must be ‘targeted’ or ‘aimed at’ the claimant.

9.3.3 Interfering with contractual relations

Lord Nicholls whilst referring to this area as ‘troubled waters’⁴³⁷, stated that the rationale and ingredients for interfering with contractual relations is the same as the tort of causing loss by unlawful means.⁴³⁸

9.3.4 Comparison with the position in equity

The recognition of the tort of causing loss by unlawful means and interference with a contract as one of primary liability is welcomed. However, this area does appear to be replicating the problems encountered in equity with the area being made unnecessarily overcomplicated with the requirement that the conduct be unlawful for interfering with a contract and a subjective test for knowledge to establish liability for inducing a breach of contract. It is therefore no surprise that two of the Law Lords sitting in the key case of *OBG Ltd v Allan, Douglas v Hello! Ltd and Mainstream Properties Ltd v Young*⁴³⁹ were Lord Hoffman and Lord Nicholls who were respectively involved in the cases in equity of *Twinsectra*⁴⁴⁰ and *Royal Brunei*⁴⁴¹. This approach of concentrating on knowledge and intention is also similar to the approach taken in respect of fraudulent misrepresentation which involves criminal allegations of fraud.

This area looks set to encounter the same problems as equity in the future, not least given the introduction of the requirement of subjective knowledge. What is surprising is that both Lord Hoffman and Lord Nicholls were sitting in the case of *Barlow Clowes International Ltd v Eurotrust International Ltd*⁴⁴² where the Privy Council sought to return to a solely objective test for dishonesty and were well aware of the problems that subjective requirements can cause. Lord Millett had advocated intentional wrongdoing as a way forward for equity, however he could not have anticipated that this would possibly

⁴³⁷ *ibid* [174].

⁴³⁸ *ibid* [180].

⁴³⁹ *OBG Ltd and others v Allan and others, Douglas and another v Hello! Ltd and others, Mainstream Properties Ltd v Young and others* (n 426).

⁴⁴⁰ *Twinsectra* (n 12).

⁴⁴¹ *Royal Brunei* (n24).

⁴⁴² [2005] UKPC 37.

represent a return to the problems associated with subjective knowledge. This area of the common law does appear to be heading in the wrong direction and not learning from the difficulties encountered in equity. The next chapter will therefore look at the Privy Council case of *Barlow Clowes*⁴⁴³.

⁴⁴³ *ibid.*

CHAPTER 10

CONSIDERATION OF *BARLOW CLOWES INTERNATIONAL LTD (IN LIQUIDATION) AND ANOTHER V EUROTRUST INTERNATIONAL LTD AND ANOTHER*⁴⁴⁴

This Privy Council case related to a fraudulent offshore investment scheme operated by Peter Clowes through a Gibraltar company called Barlow Clowes International Ltd. The scheme collapsed in 1988 and Mr Clowes was convicted and sent to prison. Millions of pounds of funds had been dissipated through bank accounts maintained by a company known as International Trust Corporation (Isle of Man) Ltd (“ITC”). The Directors of ITC were Peter Henwood and Andrew Sebastian. A claim for dishonest assistance was brought by the liquidators of one of the creditors against ITC and the directors.

The case against Henwood was that from the circumstances of the transactions and Henwood’s knowledge of the Barlow Clowes business, he must have held strong suspicions that the money was being misappropriated and he acted dishonestly in assisting in its disposal.

10.1 Is the test for dishonesty objective and/or subjective?

The Privy Council reviewed the position in *Royal Brunei*⁴⁴⁵, where it was confirmed that a dishonest state of mind may consist in knowledge that the transaction is one in which he cannot honestly participate or it may consist in suspicion combined with a conscious decision not to make inquiries which might result in knowledge. The Privy Council confirmed that:-

‘Although a dishonest state of mind is a subjective mental state, the standard by which the law determines whether it is dishonest is objective. If by ordinary standards a defendant’s mental state would be characterised as dishonest, it is irrelevant that the defendant judges by different standards’⁴⁴⁶.

⁴⁴⁴ *Barlow Clowes* (n 442).

⁴⁴⁵ *Royal Brunei* (n24).

⁴⁴⁶ *Barlow Clowes* (n 442) [10].

In summary, the test is objective and the defendant's subjective view of dishonesty is irrelevant. The Privy Council agreed with this as being the correct state of the law.⁴⁴⁷

10.2 An element of ambiguity

The case had been appealed to the Privy Council upon the basis that to establish a dishonest state of mind, it is incumbent upon the claimant to prove that the stranger was aware that by ordinary standards he would be regarded as dishonest. The Privy Council considered the case of *Twinsectra*⁴⁴⁸, and particularly Lord Hutton's remarks and concluded that:-

'there is an element of ambiguity in these remarks which may have encouraged a belief, expressed in some academic writing, that *Twinsectra* had departed from the law as previously understood and invited inquiry not merely into the defendant's mental state about the nature of the transaction in which he was participating but also into his views about generally acceptable standards of honesty'.

It could be argued that there was no element of ambiguity in the remarks and Lord Hutton could not have been clearer, albeit his logic in applying this principle was wrong. Further doubt is created as Lord Hoffman as well as sitting in the Privy Council for this case, had also been involved in delivering the judgment in *Twinsectra*⁴⁴⁹ where he had concurred with all of Lord Hutton's remarks on the requirement of subjective dishonesty.

The Privy Council went on to explain that it was not intended in *Twinsectra*⁴⁵⁰ that a stranger should have to reflect about what normally acceptable standards of honesty were. It was explained that the House of Lords had considered what the defendant's view of dishonesty was and then objectively decided that a solicitor who held the honest view that he could do with the money as he pleased, was not by normal standards dishonest⁴⁵¹.

⁴⁴⁷ *ibid* [10].

⁴⁴⁸ *Twinsectra* (n 12).

⁴⁴⁹ *ibid*.

⁴⁵⁰ *ibid*.

⁴⁵¹ *Barlow Clowes* (n 442) [17].

10.3 Summary

Essentially, the argument was that the subjective statement in *Twinsectra*⁴⁵² that the solicitor was not aware that he was acting dishonestly was a finding of fact, and upon the basis of this finding of fact and other considerations, the Lords objectively found that the stranger was not dishonest, applying the test in *Royal Brunei*⁴⁵³. However, it is difficult to comprehend the Privy Council's assertion that the principles laid down in *Twinsectra*⁴⁵⁴ were no different from the principles in *Royal Brunei*⁴⁵⁵. It is also somewhat ironic that the House of Lords in *Twinsectra*⁴⁵⁶ 'creatively' applied the Privy Council test in *Royal Brunei*⁴⁵⁷ to establish a subjective requirement and it has been necessary for the Privy Council in *Barlow Clowes*⁴⁵⁸ to 'creatively' apply the House of Lords test in *Twinsectra*⁴⁵⁹ to arrive back at the original decision in *Royal Brunei*⁴⁶⁰.

This 'u-turn' has been described by academics as a 'reinterpretation and restatement of *Twinsectra*'⁴⁶¹, 'more in accordance with Lord Millett's dissent'⁴⁶² and a '*volte face* by the Privy Council'⁴⁶³. The interpretation and clarification by the Privy Council was described as 'unconvincing' by Yeo⁴⁶⁴, 'implausible' by Penner⁴⁶⁵ and 'unpersuasive' by Petch⁴⁶⁶.

However, as confirmed by Martin, this decision has been welcomed⁴⁶⁷ and was described in Snell's Equity as the 'better view'⁴⁶⁸ and was welcomed by Lee as 'appearing to settle the law at last'⁴⁶⁹. The decision did serve an important purpose and provided the opportunity to move away from the draconian requirement that a claimant must

⁴⁵² *Twinsectra* (n 12).

⁴⁵³ *Royal Brunei* (n24).

⁴⁵⁴ *Twinsectra* (n 12).

⁴⁵⁵ *Royal Brunei* (n24).

⁴⁵⁶ *Twinsectra* (n 12).

⁴⁵⁷ *Royal Brunei* (n24).

⁴⁵⁸ *Barlow Clowes* (n 442).

⁴⁵⁹ *Twinsectra* (n 12).

⁴⁶⁰ *Barlow Clowes* (n 442).

⁴⁶¹ Oakley (n 30) para10-179.

⁴⁶² Martin (n 29) para 12-014.

⁴⁶³ Desmond Ryan, 'Royal Brunei dishonesty: clarity at last?' [2006] Conv 188; cf Margaret Halliwell & Elizabeth Prochaska, 'Assistance and dishonesty: ring-a-ring o'roses' [2006] Conv 465.

⁴⁶⁴ TM Yeo, 'Dishonest assistance: restatement from the Privy Council' [2006] LQR 171, 173.

⁴⁶⁵ JE Penner, 'Dishonest assistance revisited: Barlow Clowes International Ltd (in liquidation) and others v Eurotrust International Ltd' (2006) Tru LI 122, 123.

⁴⁶⁶ Tolek Petch, 'The investment adviser as constructive trustee' [2006] JIBLR 377, 383.

⁴⁶⁷ Martin (n 29) para 12-014.

⁴⁶⁸ McGhee (n 124) para 30-078.

⁴⁶⁹ Rebecca Lee, 'Dishonesty and bad faith after Barlow Clowes: Abou-Rahmah v Abacha' [2007] JBL 209, 209.

demonstrate to the satisfaction of the court that the defendant knew he was dishonest according to the standards of the ordinary decent person. Whilst the logic behind the decision may be questionable, it is nevertheless more helpful to the innocent beneficiary than the position prior to the judgment. In criminal law, the subjective standard only really helps defendants with limited intelligence or lacked capacity, however in equity the subjective element was open to abuse by allowing strangers the opportunity to escape liability upon the basis that they negligently failed to realise they were acting dishonestly⁴⁷⁰.

The Privy Council also helpfully clarified that to establish liability it was not necessary to demonstrate that the stranger knew the money was being held on trust or indeed what a trust was⁴⁷¹.

⁴⁷⁰ *Twinsectra* (n 12).

⁴⁷¹ At [28].

CHAPTER 11

CONSIDERATION OF *ABOU-RAHMAH & OTHERS V ABACHA & OTHERS*⁴⁷²

This was an appeal by the claimant to the Court of Appeal. Although the defendant bank was represented at the court of first instance, by the time of the Appeal hearing the bank was no longer represented. The bank's licence had been revoked and a winding up order had been made against it. Therefore, the Court of Appeal only heard submissions from the claimant's legal counsel. This was described by the Court of Appeal as:-

'a matter of concern... for important issues are potentially at stake'⁴⁷³.

This should therefore be borne in mind whilst considering this judgment.

The circumstances of the case were that Mr Abou-Rahmah was a lawyer practising in Kuwait. He had been contacted by Mr Abacha to invest money in the capital of a family trust, in an Arab country. In a series of meetings between Abou-Rahmah and Abacha and two other fraudsters, Abou Rahmah agreed to identify suitable investments and to manage these investments on behalf of the trust, in return for 40% of the capital and 15% of its income. Over a period of time, Abou Rahmah and the other claimants were tricked into contributing their own money and between August 2001 and March 2002 paid over a total sum of US\$1,375,000.

The money was paid over by a number of payments, two of which were paid into the Nigerian bank, City Express Bank, for onward transmission to a client of the bank described as Trusty International. Following the money being paid over both the fraudsters and trust money disappeared.

The claimants brought a number of claims including a claim for knowing/dishonest assistance. At first instance, the court accepted that the fraud amounted to a breach of trust, but it was not accepted that the bank had acted with the requisite knowledge or dishonesty and the claim failed.

⁴⁷² [2006] EWCA CIV 1492.

⁴⁷³ *Ibid* [13].

11.1 The test

Rix LJ considered what a claimant would need to prove in order to succeed in a claim for knowing/dishonest assistance⁴⁷⁴:-

- (i) The defendant must have the requisite knowledge;
- (ii) With that knowledge, the defendant must act in a way which is contrary to normally acceptable standards of honest conduct (an objective test); and
- (iii) (Possibly) the defendant must in some sense be dishonest himself (a subjective test).

Rix LJ was not clear as to the necessity of the final element of the test and inserted the word 'possibly'. He also made clear that he was only 'merely hazard[ing] this analysis'. This may explain why he also referred to the liability as knowing/dishonest assistance and indicate that he may have considered that without the subjective element the assistance would return to the description prior to *Royal Brunei*⁴⁷⁵ of knowing assistance. It is contended this is the case as he later in the judgment referred to liability as being knowing assistance only.

11.2 Does the defendant need to be conscious of his own wrongdoing?

Both *Twinsectra* and *Barlow Clowes* were considered by Rix LJ, who refused to enter into the controversy created by the conflicting statements on the question of subjective dishonesty. Instead he stated:-

'it was 'sufficient to concentrate on what was said in *Barlow Clowes* about the element of knowledge required'.⁴⁷⁶

In this respect, he stated there may be sufficient knowledge in suspicion and the stranger did not need to know that the money was held in trust at all.

⁴⁷⁴ *ibid* [16].

⁴⁷⁵ *Royal Brunei* (n 24).

⁴⁷⁶ *Abou Rahmah* (n 472) [23].

Again, in this case, the trial judge had made a finding that the defendant was not dishonest and the effect of going against this finding would be the need to order a retrial. Rix LJ confirmed the Court of Appeal were not in a position to reverse this finding⁴⁷⁷ as the judge had heard the evidence.

Arden LJ confirmed that the Court of Appeal should follow the decision in *Barlow Clowes*⁴⁷⁸ on the issue of dishonesty, that:-

‘it is unnecessary to show subjective dishonesty in the sense of consciousness that the transaction is dishonest. It is sufficient that the defendant knows of the elements of the transaction which make it dishonest according to normally accepted standards of behaviour’.⁴⁷⁹

Arden LJ explained that *Barlow Clowes*⁴⁸⁰ had ‘clarified’ that the interpretation of *Twinsectra*⁴⁸¹ as requiring subjective dishonesty was wrong. A defendant did not need to be conscious of his wrongdoing and the test of dishonesty is predominantly objective, with subjective aspects⁴⁸².

11.3 The outcome of the judgment

For reasons outlined in the judgment, Arden LJ confirmed that the law laid down in the *Twinsectra*⁴⁸³ case, as interpreted in the Privy Council in *Barlow Clowes*⁴⁸⁴, represented the law of England and Wales.⁴⁸⁵

Both Rix LJ and Arden LJ also considered the possibility of the equitable remedy of restitution which will be considered next.

⁴⁷⁷ At [40].

⁴⁷⁸ *Barlow Clowes* (n 442).

⁴⁷⁹ At [59].

⁴⁸⁰ *Barlow Clowes* (n 442).

⁴⁸¹ *Twinsectra* (n 12).

⁴⁸² At [66].

⁴⁸³ *Twinsectra* (n 12).

⁴⁸⁴ *Barlow Clowes* (n 442).

⁴⁸⁵ *Abou Rahmah* (n 472) [69].

CHAPTER 12

THE EQUITABLE REMEDY OF RESTITUTION

Restitution was suggested by Saiman to have emerged as a 'global phenomenon'⁴⁸⁶. Lord Steyn observed in *Banque Financiere de la Cite v Parc (Battersea) Ltd*⁴⁸⁷ that unjust enrichment ranks next to contract and tort as part of the law of obligations. It is an independent source of rights and obligations⁴⁸⁸. He confirmed the appropriate questions to be asked in a case of restitutionary remedy were:-

- (i) Has the defendant been enriched at the third party's expense?
- (ii) Was the enrichment at the expense of the claimant?
- (iii) Was the enrichment unjust?
- (iv) Are there any defences?⁴⁸⁹

12.1 The amount that can be recovered

It is submitted that the difficulty of calling upon the equitable remedy of restitution against an intermeddling stranger, is the amount that can be recovered. The claimant will only likely be able to recover:-

- (i) the value received by the defendant at the claimant's expense; or alternatively
- (ii) the value surviving in the defendant's hands.⁴⁹⁰

This is unlikely to help the beneficiaries of a trust, as the stranger will usually be a solicitor, accountant or other professional and the only unjust enrichment will be their fees in acting for the trustees/fiduciary. This will be of little consolation to beneficiaries who have suffered a major loss of trust funds. Further, it would appear unjust enrichment is more appropriate to the recovery of trust property, where equity already recognises a remedy of imposing a constructive trust for 'knowing receipt'.

⁴⁸⁶ Chaim Saiman, 'Restitution in America: why the US refuses to join the global restitution party' [2008] 99, 99.

⁴⁸⁷ [1999] 1 AC 221.

⁴⁸⁸ *ibid* [227].

⁴⁸⁹ *ibid* [227].

⁴⁹⁰ Birks, 75-77.

12.2 'Something inequitable'

In the case of *Abou-Rahmah*⁴⁹¹, Lord Rix considered the possibility of a claim in restitution, as the claimants had made the payments under a mistake of fact. He identified that the claimant must show 'something inequitable'⁴⁹², or citing Moore-Bick J in *Niru Battery Manufacturing Co Ltd v Milestone Trading*:-

'something capable of embracing a failure to act in a commercially acceptable way';

or

'a sharp practice of a kind that falls short of outright dishonesty'.⁴⁹³

Lord Rix found there to be a causal link between the opening of the bank account and the loss and the bank receiving the money beneficially. Whilst the causal link appears logical, Lord Rix's assertion that the bank received the money beneficially does create difficulty. The purpose of a bank is to 'look after money' for an account holder, not to borrow the money from an account holder to use as it sees fit. Therefore a bank is never the beneficial owner of the money. It must therefore regrettably follow that Lord Rix was wrong in finding that the bank had received the money beneficially. It is regrettable because if it had been correct, this would go some way to creating a means of compensation to the innocent victims of fraud. Difficulty also arises in that as the bank did not have beneficial ownership it could not have been unjustly enriched to the value of the money paid into the account.

Arden LJ also considered the position of restitution in *Abou Rahmah*⁴⁹⁴ and noted that the bank had not received the funds beneficially, so was not in the same position as a party who receives funds for its own use and benefit.⁴⁹⁵ As stated by Professor Burrows⁴⁹⁶:-

'it is imperative that, even on the wide formation, there is a sufficient causal link between the defendant's unjust enrichment and his pecuniary loss'.

⁴⁹¹ *Abou Rahmah* (n 472).

⁴⁹² At [42].

⁴⁹³ [2002] EWHC 1425 [135], approved by the Court of Appeal [2003] EWCA 1446 [164].

⁴⁹⁴ *Abou Rahmah* (n 472).

⁴⁹⁵ *Niru Battery* (n 493) [84].

⁴⁹⁶ Andrew Burrows, *The Law of Restitution* (2nd edn, OUP 2004) 514.

12.3 Summary

Whilst Rix LJ has slightly opened the possibility of a claim for restitution, it is submitted that even if a claim is established, the amount to which the stranger has been unjustly enriched, whilst the money is in the account, will be negligible. As confirmed by Grantham and Rickett gains made by the defendant and the loss to be repaired to the plaintiff are 'opposite sides of the same coin'⁴⁹⁷. Essentially, the defendant is only liable therefore to the extent of the gains that he has made or has been unjustly enriched.

There is the possibility that if a stranger was to receive some indirect benefit as a consequence of assisting in a breach of trust, such as an increase in the value of assets owned, and if this could be directly causally linked, then a claim for unjust enrichment may be possible. However, this is certainly likely to be very difficult to prove and will be the exception rather than the norm.

⁴⁹⁷ Ross Grantham & Charles Ricketts, 'A normative account of defences to restitutionary liability' [2008] CLJ 92, 99.

CHAPTER 13

IS THE REQUIREMENT OF DISHONESTY STILL APPROPRIATE AS THE TEST FOR EQUITABLE LIABILITY?

The early cases for knowing/dishonest assistance focused on the knowledge of the stranger⁴⁹⁸. *Barnes v Addy*⁴⁹⁹ introduced the requirement that the stranger must be:-

‘cognisant of a dishonest design on the part of the trustee’.⁵⁰⁰

Cognisant means to have knowledge or to suspect⁵⁰¹. The test to be applied was:-

‘whether the [stranger] ought or ought not from the circumstances of the case, be held to have been aware that something wrong was intended’.⁵⁰²

When arriving at the decision, the court will take account of what ‘evidence, justice and reason’ demands.⁵⁰³ This infrequently reported consideration provides a similar approach to that which the common law has taken in the final stage of the special relationship test to establish a negligent misrepresentation⁵⁰⁴. In the common law, the court will consider if it is just and reasonable for the law to impose the duty.

Prior to the early 1990s, it was accepted in a number of cases that the test for constructive objective knowledge in *Selangor*⁵⁰⁵ was the correct approach.⁵⁰⁶ The test was:-

‘what should the stranger have known from the facts apparent to him?’; and
what would a reasonable person have concluded from these facts?’.⁵⁰⁷

⁴⁹⁸ *Fyler* (n 16); *Leicester Corp* (n 17); *Eaves* (n 20); *Farah Constructions* (n 25); *Ridge & Dietrich* (n 22) 29.

⁴⁹⁹ *Barnes* (n 27).

⁵⁰⁰ *ibid* [244].

⁵⁰¹ *ibid* [245], [252].

⁵⁰² *ibid* [254].

⁵⁰³ *ibid* [254].

⁵⁰⁴ *Hedley Bynre* (n 346).

⁵⁰⁵ *Selangor* (n 61).

⁵⁰⁶ *Karak* (n 70); *Baden* (n 74); *Agip* (n 89).

⁵⁰⁷ *Selangor* (n 61) [968].

Constructive knowledge was defined in *Baden*⁵⁰⁸ as:-

‘knowledge of circumstances which would indicate the facts to an honest and reasonable man or put him on inquiry.’

However, Megarry VC led the move away from constructive knowledge, to a requirement of actual knowledge in the early 1990s⁵⁰⁹, which was subsequently followed by the introduction in *Royal Brunei*⁵¹⁰ of dishonesty as a necessary and essential ingredient to liability.⁵¹¹ Whilst equating dishonesty to unconscionable conduct and want of probity, Lord Nicholls made clear that the standard to be applied was objective⁵¹² and stated:-

‘the individual is expected to attain the standard which would be observed by an honest person placed in those circumstances’.⁵¹³

This is an appropriate test to apply for unconscionable conduct and want of probity, but is not a test for dishonesty. Therefore the problem seems to arise from Lord Nicholls insistence in describing this as a standard for dishonesty. Unconscionable conduct and want of probity are not the same as dishonesty.

This problem was further exacerbated by Lord Hutton’s focus on the stranger’s state of mind and the need for conscious impropriety in *Twinsectra*⁵¹⁴. Despite Lord Nicholls making clear the standard was objective, the majority of the House of Lords imposed a *Ghosh*⁵¹⁵ style criminal test to what is an equitable liability. This was criticised by academics⁵¹⁶ and by the dissenting Lord Millett⁵¹⁷ as a wrong application of the law. As confirmed by Sir Anthony Clarke MR caution should be exercised when drawing analogies between tests from different areas of law which is prone to lead to confusion.⁵¹⁸

⁵⁰⁸ *Baden* (n 74).

⁵⁰⁹ *Montagu* (n 97).

⁵¹⁰ *Royal Brunei* (n24).

⁵¹¹ *ibid* [97].

⁵¹² *ibid* [107]

⁵¹³ *ibid* [107]

⁵¹⁴ *Twinsectra* (n 12).

⁵¹⁵ *Ghosh* (n 181).

⁵¹⁶ *Kiri* (n 190); Thompson (n 191); Oakley (n 30); Panesar (n 192).

⁵¹⁷ *Twinsectra* (n 12) [120].

⁵¹⁸ Sir Anthony Clarke MR, ‘Claims against Professionals: Negligence, Dishonesty and Fraud’ [2006] PN 70, 76.

Lord Millett confirmed that the court's focus should be on the stranger's conduct and not his state of mind. He stated:-

'consciousness of wrongdoing is an aspect of *mens rea* which is an appropriate condition of criminal liability: it is not an appropriate condition of civil liability'.⁵¹⁹

The fusion of criminal law into equity created by the combined test in *Twinsectra*⁵²⁰, has led to both problems and confusion.

Even the criminal courts have encountered difficulty in assessing the standard of dishonesty, due to the necessity of having to characterise the existing facts and then make a judgment upon the basis of an undefined moral standard.⁵²¹ It has often led in trials to a disproportionate amount of time being spent on the issue.⁵²²

The offence of handling stolen goods has also demonstrated the difficulties that can be faced from applying a subjective test to knowledge.⁵²³

Whilst the Fraud Act 2006 incorporated the requirement of dishonesty to the majority of fraud offences covered by it, the offences of possession of articles for use in fraud⁵²⁴ and making or supplying articles for use in fraud⁵²⁵ had no express requirement for dishonesty. Making or supplying articles requires knowledge or intention and the Government have suggested that a general intention is required for possession of articles.⁵²⁶ However, interestingly the offence of possession does not contain any statutory *mens rea*.

The requirement of dishonesty is a key element of the tort of fraudulent misrepresentation.⁵²⁷ Similarly, as with dishonest assistance, a subjective element has crept into this area⁵²⁸ and the requirement of dishonesty has also led to the burden of proof in cases where fraud and dishonesty is alleged, as higher than the civil burden of 'on

⁵¹⁹ *ibid* [127].

⁵²⁰ *Twinsectra* (n 12).

⁵²¹ Law Commission, *Legislating the Criminal Code: Fraud and Deception* (n 248).

⁵²² Scanlan & Kiernan (n 285).

⁵²³ *R v Forsyth* (n 294).

⁵²⁴ Fraud Act 2006, s 6.

⁵²⁵ *ibid*, s 7.

⁵²⁶ Home Office Consultation paper, 'Fraud Law Reform: Government Response to Consultations' (n 280).

⁵²⁷ *Ansbacher & Co* (n 312).

⁵²⁸ *Akerheilm* (n 314).

the balance of probabilities'.⁵²⁹ It is therefore a far more arduous task to succeed in a claim where fraud or dishonesty is alleged.

Misrepresentation can also be carried out negligently. A third party to a contract will be liable if there is a special relationship, which is ascertained by a three stage test of reasonable foreseeability, sufficient proximity and if it is just and reasonable in the circumstances⁵³⁰ or alternatively, if there has been an assumption of responsibility.⁵³¹

The problems third parties face in suing in the common law arises from the privity of contract rules. This rule has been recognised by the judiciary⁵³², the Law Commission⁵³³ and Parliament⁵³⁴ as restrictive and harsh to innocent third parties. However, the common law has seemingly developed to deal with the issue of privity of contract in the cases of *White v Jones*⁵³⁵ and *Gorham v BT plc*⁵³⁶. It also seems the common law has taken, in these cases, the first steps towards allowing a claim by beneficiaries of an *inter vivos* trust in negligence. As stated by Andrews⁵³⁷, the case of *Leigh and Sullivan Ltd v Aliakmon Shipping Co Ltd*⁵³⁸ may suggest that it is already possible for the equitable owner of a property to sue in tort for negligence.

It is therefore somewhat ironic that the original purpose of equity was to 'plug the gaps in the common law' and it now seems that the common law is effectively 'plugging the gaps in equity', by recognising equitable ownership as giving sufficient *locus standi* for a person to sue. This does highlight the urgent need for the courts in equity to address whether an equitable interest should give a claimant sufficient *locus standi* to raise a claim in equity, but this is perhaps an area for consideration in further research.

⁵²⁹ *Hornal* (n 322).

⁵³⁰ *Hedley Byrne* (n 346).

⁵³¹ *Customs & Excise Commissioners* (n 353).

⁵³² *Drive Yourself Hire Co (London) Ltd v Strutt* [1962] AC 446; *Smith and Snipes Hall Farm Ltd v River Douglas Catchment Board* [1949] 2 KB 500; *Beswick v Beswick* [1968] AC 58, 72; *Woodar Investment Developments Ltd v Wimpey Construction UK Ltd* [1980] 1 WLR 277 [291], [297–298], [300]; *Swain v Law Society* [1983] 1 AC 598, 611; *The Pioneer Container* [1994] 2 AC 324 [335]; *White v Jones* [1995] 2 AC 207 [262–263]; *Darlington BC v Wiltshier Northern Ltd* [1995] WLR 68 at 76.

⁵³³ Law Commission, *Privity of Contract: Contracts for the Benefit of Third Parties* (Law Com No. 242, 1996).

⁵³⁴ Contract (Right of Third Parties) Act 1999

⁵³⁵ *White* (n 382).

⁵³⁶ *Gorham* (n 396).

⁵³⁷ Georgina Andrews, 'The redundancy of dishonest assistance' [2003] Conv 398, 403.

⁵³⁸ [1986] A.C. 785.

A lot of the problems seem to arise from the reference to negligence. Gardner considered it is probably wrong to rule out a negligence liability in knowing assistance on the basis that it would overlap with a similar liability in contract or tort, rather than on more substantive grounds.⁵³⁹ However, reference to negligence for this type of liability is best avoided and forgotten. Negligence is a tort in the common law and should remain separate from equitable liability. Even if the test and outcome are similar in equity, it should not be described as negligence. They are two separate areas of law and this fixation on the term 'negligence' has led to many of the twists and turns and confusion in this area. Equity and the common law should remain separate. Negligence is evolving in the common law and has recognised the interests of beneficiaries and should be encouraged to evolve further.

In equity, the Privy Council in *Barlow Clowes*⁵⁴⁰ has fortunately moved back to the position where the appropriate test to be applied is objective and where the defendant's subjective view of dishonesty is not relevant⁵⁴¹. The Court of Appeal in *Abou Rahmah*⁵⁴² has confirmed this as a correct interpretation of the judgment in *Twinsectra*.⁵⁴³ The difficulty is that *Twinsectra*⁵⁴⁴ as a House of Lords judgment, still remains the leading judgment in relation to this matter and whilst the interpretation of the *Twinsectra*⁵⁴⁵ judgment was welcomed it is a very 'creative' interpretation of the judgment in *Twinsectra*⁵⁴⁶. As identified by Kiri, until the Supreme Court opines on the issue the uncertainty is likely to persist for some time⁵⁴⁷.

This is therefore an area in urgent need of review by the Supreme Court. The Privy Council and Court of Appeal have sounded a welcome retreat from the requirement of subjective dishonesty. The answer to the problems, as has already been alluded to by Rix LJ in the Court of Appeal judgment in *Abou Rahmah*⁵⁴⁸, would be to remove the requirement of dishonesty altogether and return to the requirement of knowledge which is ascertained by an objective test. Momentum should be allowed to gain, to return to a requirement of constructive objective knowledge being sufficient, as confirmed in the

⁵³⁹ Simon Gardner, 'Knowing assistance and knowing receipt: taking stock' [1996] LQR 56, 75.

⁵⁴⁰ *Barlow Clowes* (n 442).

⁵⁴¹ *ibid* [10].

⁵⁴² *Abou Rahmah* (n 472).

⁵⁴³ *Twinsectra* (n 12).

⁵⁴⁴ *Twinsectra* (n 12).

⁵⁴⁵ *Twinsectra* (n 12).

⁵⁴⁶ *Twinsectra* (n 12).

⁵⁴⁷ Kiri (n 190) 305.

⁵⁴⁸ *Abou Rahmah* (n 472) [16].

cases of *Selangor*⁵⁴⁹, *Karak*⁵⁵⁰, *Baden*⁵⁵¹ and *Agip*⁵⁵² with an additional requirement that it must be 'just and reasonable' to impose liability, as considered by Lord Selborne in *Barnes v Addy*⁵⁵³. It has been an eventful voyage, but even the most intrepid of explorers know when to turn around, re-trace their steps and set off again in a new direction. This time has now arrived for the equitable liability of dishonest assistance and to return to a liability for knowing assistance.

In *Barnes v Addy*⁵⁵⁴ commercial realities and public policy weighed heavily on the judge's mind, but one quote by Lord Selborne is very relevant to the position today:-

'[there is] no better mode of undermining the sound doctrines of Equity than to make unreasonable and inequitable applications of them'.⁵⁵⁵

The current position is a stranger may have knowledge of a trust, knowledge of a breach of trust and assist in that breach of trust and escape liability for not being dishonest. The effect of this may be to deprive an innocent beneficiary, who has suffered large financial loss, of a means of recovery. This is a wholly inequitable application of this doctrine and the requirement of dishonesty undermines what is otherwise a sound doctrine of equity. As referred to by Lord Bingham in *Customs & Excise Commissioners v Barclays Bank*⁵⁵⁶ and originally stated in *X (Minors) v Bedfordshire County Council*⁵⁵⁷ the rule of public policy, which has first claim on the loyalty of the law, is that wrongs should be remedied.

⁵⁴⁹ *Selangor* (n 61).

⁵⁵⁰ *Karak* (n 70).

⁵⁵¹ *Baden* (n 74).

⁵⁵² *Agip* (n 89).

⁵⁵³ *Barnes* (n 27).

⁵⁵⁴ *ibid.*

⁵⁵⁵ *Barnes* (n27) [251].

⁵⁵⁶ [2006] UKHL 28 [4].

⁵⁵⁷ [1995] 2 AC 633 [749].

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