HOW KNOWING IS KNOWING RECEIPT?

DIRECTORS of BCCI (Overseas) Ltd. deliberately applied its funds in breach of their duties, and Chief Akindele received those funds. Later, the company, acting by its liquidator, sued Chief Akindele both for knowing receipt of the misapplied funds and for dishonestly assisting their misapplication. The High Court dismissed the claim for dishonest assistance: the company could not prove that Chief Akindele had been dishonest. There was no appeal against this ruling. So at the very beginning of his judgment in *BCCI (Overseas) Ltd.* v. *Akindele* [2000] 4 All E.R. 221, which was the only reasoned judgment given in the Court of Appeal, Nourse L.J. stated the key remaining question about the claim for knowing receipt: "What must be the recipient's state of knowledge? Must he be dishonest?"

Earlier, in *Houghton* v. *Fayers* [2000] 1 B.C.L.C. 511 (C.A.), Nourse L.J. had indicated that the defendant would be liable if he knew, or ought to have known, that he had received either funds which were misapplied in the relevant breach of duty, or their proceeds. In the *BCCI* case, he restated the test for liability: "The recipient's state of knowledge must be such as to make it unconscionable for him to retain the benefit of the receipt". Nourse L.J. thought that this test, while it could not avoid difficulties of application, ought to avoid the difficulties of definition which have bedevilled other categorisations of the requisite degree of knowledge, such as the five point scale proposed by Peter Gibson J. in *Baden, Delvaux & Lecuit* v. *Société Generale* (1983) [1993] 1 W.L.R. 509 at pp. 575–576.

This focus on knowledge as the requisite fault element, rather than dishonesty, is welcome. Knowledge describes a person's state at a certain material time, such as on a receipt. Dishonesty is an inappropriate fault element for a cause of action founded on a receipt, notwithstanding some recent judicial pronouncements (see, *e.g.*, the *BCCI* case in the High Court, [1999] B.C.C. 669 at p. 677; *Dubai Aluminium Co. Ltd.* v. *Salaam* [1999] 1 Lloyd's Rep. 415 at p. 453; *Bank of America* v. *Arnell* [1999] Lloyd's Rep. Bank. 399 at pp. 406–407, noted [2000] C.L.J. 28 and possibly *Twinsectra Ltd.* v. *Yardley* [1999] Lloyd's Rep. Bank. 438 (C.A.) at p. 466, noted [2000] C.L.J. 444). Dishonesty describes and qualifies action, not a passive receipt. Indeed, it is for precisely that reason that dishonesty is an appropriate fault element in a cause of action founded on culpable acts: procuring or assisting a breach of trust or fiduciary duty (see *Royal Brunei Airlines* v. *Tan* [1995] 2 A.C. 378 (P.C.)). Dishonesty also suggests a greater degree of moral

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opprobrium than knowledge. Yet while the distinction between knowledge and dishonesty is appropriate, it should not be overemphasised: both knowledge and dishonesty will commonly be inferred from the same sort of facts.

It is now clear that, for practical purposes, the question of knowledge is a question of fact. Nevertheless, answering that question is likely to be very difficult. The *BCCI* case provides no guidance on what degree of knowledge of what facts must be pleaded and proved to sustain an allegation of knowing receipt. Though it might not differ much in its effects from Nourse L.J.'s test, a clearer formulation of the fault element in knowing receipt would be to make liability turn on notice (actual, constructive or imputed) of the breach of duty through which the funds were misapplied, while recognising that what amounts to notice will depend on what enquiries should have been made by the particular recipient about the origin of the funds he received (*Macmillan Inc.* v. *Bishopsgate Trust (No. 3)* [1995] 1 W.L.R. 978 at pp. 1000–1001 *per* Millett J., and Fox, "Constructive Notice and Knowing Receipt: An Economic Analysis" [1998] C.L.J. 391). The question of notice could largely be answered by comparing the recipient's behaviour to established practice in similar situations.

Nourse L.J. also addressed briefly the argument that the personal liability of those who receive funds applied in breach of trust, or their traceable proceeds, should be *prima facie* strict, though subject to defences. He correctly indicated that, in the light of current authority, such an argument could only succeed in the House of Lords; but he was inclined against it on principle as well. In his view, any such reformulation of liability would be likely to undermine the need for security of receipts. Yet security of receipts can be achieved by the application of strong defences, interpreted and applied with suitable liberality. The defences of bona fide purchase and change of position are vital in this regard. Unfortunately, change of position has generally appeared to be a rather narrowly drawn defence since its recognition in *Lipkin Gorman* v. *Karpnale Ltd.* [1991] 2 A.C. 548, and perhaps therefore unequal to its task of securing receipts. Yet the defence has recently been applied robustly in *Phillip Collins Ltd.* v. *Davis* [2000] All E.R. (D) 595, where Jonathan Parker J. allowed a change of position defence based on the increased general living expenditure consequent on receipt of a mistaken payment.

More specifically, Nourse L.J. thought that such a regime of strict liability subject to defences would be inconsistent with the policy behind *Royal British Bank* v. *Turquand* (1856) 6 El. & Bl. 327, that "persons contracting with a company and dealing in good

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faith may assume that acts within its constitution and powers have been properly and duly performed and are not bound to inquire whether acts of internal management have been regular" (*Morris* v. *Kanssen* [1946] A.C. 459 at p. 474, *per* Lord Simonds). With respect, Nourse L.J.'s concerns are difficult to understand. The application of *Turquand's* case in the present context itself provides an example of reliance on defences to secure receipts: the recipient of funds applied in breach of duty, or their proceeds, will plead *Turquand's* case to establish a defence which entitles him to retain the benefit of his receipt.

So, at present, if a company makes a claim for knowing receipt, it must demonstrate that the recipient knew about the breach of duty which founds the claim. If the breach occurred within the company's apparently proper internal management, the recipient may use the rule in *Turquand's* case to raise a presumption that he had no reason to suspect the breach (see *Rolled Steel Products (Holdings) Ltd.* v. *British Steel Corporation* [1986] Ch. 246). As long as the presumption remains unrebutted by evidence that the recipient actually knew about the breach, the company's claim will fail: the company will be unable to show that the recipient had such knowledge of the breach as to make it unconscionable for him to retain the benefit of his receipt. If liability were strict, subject to defences, the recipient would use the rule to avoid the *prima facie* liability attaching to him by virtue of his receipt. Again, the rule would establish a presumption that the recipient was not on notice of the internal irregularity which founds the company's claim for restitution. This presumption, if unrebutted, would go towards establishing a defence of bona fide purchase for value without notice of the irregularity, or a defence of innocent change of position. Once successfully made out, any such defence would preserve the receipt, either in full if bona fide purchase is proven, or else to the extent that change of position makes restitution inequitable.

There are other, practical arguments against the adoption of strict liability, though none is compelling. It might be that removing the need for a claimant to prove a recipient's fault will make it easier to commence actions in equity to recover the benefit of a receipt, including speculative actions, thus enabling the claimant to fish for evidence in documents disclosed by the recipient as the action progresses. Yet the courts' control of litigation through the Civil Procedure Rules, and the threat of what a court might do to an abusive claimant, may well be enough to contain the possibility of abuse, without shutting out meritorious claims which currently fail (or are never even brought) because of the difficulties of proving the recipient's knowledge. A more important concern is that banks and other financial intermediaries who

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innocently receive misapplied funds might feel their position was insufficiently protected if they had to make out a defence. In order to ascertain the respective practical merits of fault-based and strict liability, what is required is some more economic analysis (*cf.* Fox, above) both theorectical and empirical.

At root, the argument over whether knowing receipt should be a fault-based cause of action or strict, subject to defences, reflects a controversy about the very nature of the action. Is it about the imposition of the onerous duties of a trustee on the recipient of a fund (see *Re Diplock* [1948] Ch. 465 at p. 478; *Re Montagu's S.T.* [1987] Ch. 264 at p. 278B–C, cited in the *BCCI* case)? If so, it makes perfect sense to require that the recipient be at fault before he is subjected to those duties. Or is it about restitution of funds received (*El Ajou* v. *Dollar Land Holdings plc* [1993] 3 All E.R. 717 at p. 738 a–b; *Royal Brunei Airlines* v. *Tan* [1995] 2 A.C. 378 at p. 386 F)? Subject to any pragmatic concerns identified by economic analysis, strict liability would then be appropriate, in conformity with other restitutionary actions, but subject to defences, including those, such as bona fide purchase, which recognise that an equitable, not a legal, right is in issue. Or does the action combine, and confuse, both approaches, which should now be separated out, as suggested by Lord Nicholls in his essay "Knowing Receipt: The Need for a New Landmark" (ch. 15 in Cornish *et al.*, *Restitution: Past, Present and Future*)? As Lord Nicholls suggests, there might be a strict restitutionary action to recover funds received, coupled with a fault-based action to remedy improper dealings with property which, in equity, belongs to another.

There is to be no further appeal to the House of Lords in the *BCCI* case. It will not become the much needed landmark anticipated by Lord Nicholls.

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ENFORCING RESTRICTIVE COVENANTS IN LEASES: THE CASE OF COUNTY HALL

THE important recent decision of Neuberger J. in *Oceanic Village Ltd.* v. *United Attractions Ltd.* [2000] Ch. 234 considers the enforceability of a restrictive covenant, contained in a lease, which relates to other adjacent land of the landlord. All relevant title was registered, and the case raised the problem addressed in relation to unregistered land by *Dartstone Ltd.* v. *Cleveland Petroleum Co. Ltd.* [1969] 1 W.L.R. 1807 where Pennycuick J. held that, as such

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