Standard of Fault for Recipient and Accessory Liability

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Abstract

Barnes v Addy is arguably one of the most important judgments in modern equity as it represented for the first time that third parties could be held personally liable to a beneficiary under a trust, through either recipient or accessory liability. These two liabilities are now commonly known respectively as 'knowing receipt' and 'dishonest assistance'. There has been considerable amount of controversy relating to the standard of fault required for each form of liability resulting from two English cases decided in early 2000s, *Twinsectra v Yardley* and *BCCI (Overseas) Ltd v Akindele*. This article seeks to critically assess the development of the law on the standard of fault for each liability post-*Twinsectra* and *Akindele*, and the treatment of the law by the Malaysian courts. This article will also examine how Malaysian courts have failed to adopt a principled approach in setting the standards of fault for recipient or accessory liability.

Keywords: Knowing Receipt, Dishonest Assistance, Equity.

I. INTRODUCTION

The law on dishonest assistance and knowing receipt found its origin in the House of Lords case of *Barnes v Addy*.[1] The case is arguably one of the most important judgments in modern equity as it represented for the first time that third parties could be held personally liable to a beneficiary under a trust.

In *Barnes v Addy*, Lord Selborne LC set out two circumstances upon which third parties can be held liable to a beneficiary under a trust. The first scenario is where the third party receives some part of the trust property in breach of trust. This is often referred to as the first limb of *Barnes v Addy* and is usually stated as liability for 'knowing receipt'. The second situation is where a third party dishonestly assisted in the breach of trust by a trustee. This form of liability is known as the second limb of *Barnes v Addy* and is commonly referred to as liability for 'dishonest assistance'.

There has been considerable amount of controversy relating to the standard of fault required for each form of liability resulting from two English cases decided in early 2000s,

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1 (1874) LR 9 Ch App 244.

Twinsectra v Yardley[2] (*Twinsectra*) and *BCCI (Overseas) Ltd v Akindele*[3] (*Akindele*). This article seeks to critically assess the development of the law on the standard of fault post-*Twinsectra* and *Akindele*, and the treatment (or rather, mistreatment) of the law by the Malaysian courts.

II. COMMON FEATURES AND DIFFERENCES OF THE TWO LIABILITIES

There are, in essence three common features for liabilities under knowing receipt and dishonest assistance.[4]

First, the plaintiff in an action for 'knowing receipt' and 'dishonest assistance' enforces a personal remedy, and not a proprietary remedy against the defendant. The remedy to which the plaintiff is claiming is not restoration of the trust property *in specie*, but restoration of the equivalent value of the trust property.

Secondly, when a defendant is found liable for either knowing receipt or dishonest assistance, he is liable to account as a 'constructive trustee', which means that he is liable to account for any gain or profit that he has made from the trust property.[5] It is said that the words 'constructive trustee' in this context denotes that the defendant is 'construed by the court' to have rendered himself personally liable to account to the plaintiff beneficiary in the same way that a trustee would be liable in a case of breach of trust.[6] The defendant will thus be treated *as though* he is a constructive trustee, although he, in fact, is not a trustee.[7]

The last common feature for both forms of liability is that they are both fault-based liabilities. As a form of fault-based liability (instead of strict liability), the state of knowledge of the defendant is an important constituent element to both forms of liability. It is this third common feature, i.e. the element of knowledge, that has been subject to much judicial debate and controversy for many years.

While the English courts have consistently acknowledged that different tests of knowledge should apply to the two limbs of *Barnes v Addy*, little has been said of the doctrinal justification for the difference. Brightman J in *Karak Rubber Co Ltd v Burden*

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2 [2002] 2 AC 164.

3 [2000] EWCA Civ 502.

4 See, Snell's Equity, Sweet & Maxwell, para 30-066.

5 *Paragon Finance plc v D B Thakerar & Co* [1999] 1 All ER 400; *Novoship (UK) Limited & ors v Nikitin & ors* [2014] EWCA Civ 908.

6 Aliastair Hudson, Equity and Trusts (6th Ed., Routledge Cavendish), p.872.

7 See *Dubai Aluminium Co v Salaam* [2002] UKHL 48, where for this reason, Lord Millet has suggested for the words 'accountable as constructive trustee' in the context of third-party liability be replaced with the words 'accountable in equity'. The characterisation of accessories to breach of trust as not being true trustees has important implications. For example, in *Williams v Central Bank of Nigeria* [2014] UKSC 10, the English Supreme Court held that a defendant under dishonest assistance and knowing receipt is not a "true trustee" and any action against it does not fall under s. 21(1)(a) of the English Limitation Act 1980 (which prescribed for no period of limitation for an action by a beneficiary for breach of trust). S. 22(1)(a) of the Malaysian Limitation Act 1953 is *in pari materia* with s. 21(1)(a) of the English Limitation Act 1980.

(No. 2) questioned whether there was "any particular logic in having different fault requirements for the two different liabilities".

Professor Paul S Davies takes the view that the normative basis of recipient liability is different from assistance liability, and therefore, the two liabilities should be treated differently.[8] Liability in knowing receipt is non-participatory and inherently passive. As such, a person who is in receipt of a trust property may not have necessarily contributed to the primary wrong. Thus, *Davies* opined that it is not helpful to amalgamate both forms of liability. His view on why both should be treated differently is encapsulated in the following passage:

> Recipient liability is based upon accounting for a benefit actually received, and considerations regarding the vindication of equitable property rights must be balanced against the importance of protecting the defendant's ability to rely upon property receipt. This principle of security of receipt is irrelevant to the general principles of accessory liability, since such liability is not premised upon the defendant's receipt of anything.[9]

As a corollary to this, it can be argued that the reason why the standard of fault for liability for recipient liability[10] should be lower than that of assistance liability[11] lies with the question of whether the defendant has gained from his wrongdoing. A defendant under accessory liability does not retain the trust property. For recipient liability, the defendant has gained from his wrongdoing in the form of the receipt of the trust property, which justifies the lower standard of knowledge.[12] Viewed from this perspective, recipient liability should therefore be treated as different from assistance liability.

III. KNOWING RECEIPT – THE MOVE FROM CONSTRUCTIVE KNOWLEDGE TO UNCONSCIONABILITY

A. Pre-Akindele

With respect to liability under knowing receipt, English courts were traditionally divided as to what standard of knowledge is required for the liability to exist. On one hand, courts have found that liability for knowing receipt must be based on the existence of

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8 Paul S Davies, *Accessory Liability*, (Oxford: Hart Publishing, 2015), p. 92.

9 *Ibid.*

10 Historically, the standard of fault for recipient liability is constructive knowledge and more recently, unconscionability.

11 The standard of fault is 'dishonesty'.

12 Although it is important to qualify that a recipient would remain liable for knowing receipt even if he has subsequently transferred the trust property to another person.

actual knowledge.[13] On the other hand, some courts have also accepted that constructive knowledge is sufficient.[14]

In *Baden, Delvaux and Lecuit and others v Societe Generale pour Favoriser le Developpement du Commerce et de l'Industrie en France SA*[15] *(Baden),* Peter Gibson J comprehensively set out the five levels of knowledge that will typically give rise to constructive trusteeship.[16] These different levels of knowledge in the 'Baden scale' are:

(i) actual knowledge;
(ii) willfully shutting one's eyes to the obvious;
(iii) willfully and recklessly failing to make such enquiries 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 will put an honest and reasonable man on inquiry.

Nourse LJ in *Akindele* opined that knowledge on the scale of (i) to (iii) are considered as categories of actual knowledge, whereas from scale (iv) to (v) are categories of constructive knowledge.[17]

The following passage from the judgment of Millet J in *Agip v Jackson*[18] is often cited as the authority for the proposition that constructive knowledge is sufficient to establish knowing receipt:

> [T]he person who receives for his own benefit trust property transferred to him in breach of trust ... is liable as a constructive trustee if he received it with notice, actual or constructive, that it was trust property and that the transfer to him was a breach of trust, or if he received it without such notice but subsequently discovered the facts. In either case he is liable to account for the property, in the first case as from the time he received the property and in the second as from the time he acquired notice

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13 *In re Montagu's Settlement Trusts* [1987] Ch 264; *Eagle Trust plc v SBC Securities Ltd* [1993] 1 WLR 484 and *Cowan de Groot Properties Ltd v Eagle Trust plc* [1992] 4 All ER 700.

14 *Agip v Jackson* [1990] Ch 265, 291; *Rolled Steel Products (Holdings) Ltd v British Steel Corporation* [1986] Ch 246; Houghton v Fayers [2000] 1 BCLC 511.

15 [1992] 4 All ER 161, [1993] 1 WLR 509, 575-576.

16 See, for e.g. *Re Montagu's Settlement Trust; Westpac Banking Corporation v Savin* [l985] 2 NZLR 41, 42 *Equitycorp Industries Group Ltd v Hawkins* [l991] 3 *NZLR* 700, 703; *Agip (Africa) Ltd v Jackson* [l990] Ch 265, 267 and 292; *Cowan de Groot Properties Ltd v Eagle Trust plc* [l9921 4 All ER 700,702 and 754; *Polly Peck International plc v Nadir* (No 2) [l9921 4 All ER 769,771; *Eagle Trust plc v SBC Securities Ltd* (No 2) [l9961 1 BCLC 121,122.

17 See however, *Davies*, supra note 6 at p. 72, where the author opined that only category (i) of the *Baden* scale of knowledge amounts to actual knowledge.

18 [1990] Ch 265, 291, cited with approval in *Pharmmalaysia Bhd v Dinesh Kumar Jashbhai Nagjibha Patel & Prs* [2004] 7 CLJ 465 at 559 and *Multi-Code Electronics Industries (M) Berhad & Anor v Gordon Toh Chun Toh & Ors* [2013] 3 MLRH 182 at page 161. Emphasis added.

In the same vein, Millett J in *El Ajou* v *Dollar Land Holdings plc*[19] observed in obiter that "dishonesty or want of probity involving actual knowledge (whether proved or inferred)" was not required for knowing receipt as:

> [a] recipient is not expected to be unduly suspicious and is not to be held liable unless he went ahead without further inquiry in circumstances in which an honest and reasonable man would have realized that the money was probably trust money and was being misapplied.

In this regard, Sir Robert Megarry in *Re Montagu's Settlement Trusts Duke of Manchester v National Westminster Bank Ltd and others*[20] observed as follows vis-à-vis actual knowledge:

> The relevant knowledge which would make a recipient of trust property a constructive trustee was actual knowledge that the property was trust property, or knowledge which would have been acquired but for ignoring the obvious or willfully and recklessly failing to make such inquiries as a reasonable and honest man would have made, since in such cases there was a want of probity which justified imposing a constructive trust

In essence, it is widely accepted that knowledge falling under any part of the Baden scale spectrum is sufficient to find liability for knowing receipt. In *International Sales and Agencies Ltd* v *Marcus,*[21] *Lawson J* said*:*

> In my judgment, the knowing recipient of trust property for his own purposes will become a constructive trustee of what he receives if either he was in fact aware at the time that his receipt was affected by a breach of trust, or if he deliberately shut his eyes to the real nature of the transfer to him . . . or if an ordinary reasonable man in his position and with his attributes ought to have known of the relevant breach. This I equate with constructive notice . . . I am satisfied that in respect of actual recipients of trust property to be used for their own purposes the law does not require proof of knowing participation in a fraudulent transaction or want of probity, in the sense of dishonesty, on the part of the recipient.

However, this position has changed following the formulation of the much broader unconscionability test by Nourse LJ in *Akindele*, which has since been adopted in other common law jurisdictions.[22]

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19 [1993] 3 All ER 717.

20 [1992] 4 All ER 308, cited with approval by the Court of Appeal in *Tan Sri Dato' (Dr) Rozali Ismail & Ors v Chua Lay Kim (P) & Ors* [2016] 3 CLJ 84. Emphasis added.

21 [1982] 3 All ER 551.

22 *George Raymond Zage III and another v Ho Chi Kwong and another* [2010] 2 SLR 589 (Singapore Court of Appeal); *Thanakharn Kasikorn Thai Chamkat (Mahachon) (aka Kasikornbank Public Co Ltd) v Akai Holdings Ltd (in liquidation)* (Hong Kong Court of Final Appeal).

B. Akindele – The Test of Unconscionability

The case of *Akindele* concerns a claim by the liquidators of the ill-fated Bank of Credit and Commerce International (BCCI) against Mr. Akindele, a Nigerian businessman for the return of the payments he received under a divestiture agreement in 1988.

The genesis of the case started in 1985, when Mr. Akindele agreed with ICCI Overseas to purchase 250,000 shares in BCCI Holdings. ICCI Overseas imposed a condition that Mr. Akindele was to hold the shares for two years. It was also agreed that upon the expiry of the two years and up to five years from the date of the agreement, Mr. Akindele will receive a return of 15% per annum on his investment if he was to sell his shares. In 1998, Mr Akindele decided to sell the shares by way of a divestiture agreement, and ICCI Overseas paid him a total of US$ 16.679 million. The whole arrangement was in fact part of a fraudulent scheme perpetrated by BCCI to purchase its own shares through nominee companies. The liquidators for BCCI claimed that Mr. Akindele was liable as a constructive trustee both on the ground of 'knowing assistance' and, in relation to the 1988 divestiture payment, on the ground of 'knowing receipt'.

It was therefore important for the Court of Appeal to decide whether Mr. Akindele had the requisite mental element, given that he did not knowingly participate in the fraudulent scheme. His Lordship took the view that the *Baden* categorisation was "not formulated with knowing receipt in mind."[23] Nourse LJ propounded the single test of knowledge for knowing receipt, which entails the law to consider whether "[t]he recipient's state of knowledge must be such as to make it unconscionable for him to retain the benefit of the receipt". This test, according to his Lordship, is simpler and has the advantage of enabling the courts to "… give common-sense decisions in the commercial context in which claims in knowing receipt are now frequently made…" in comparison to the *Baden* scale espoused by Peter Gibson J.

Following Nourse LJ's introduction of the unconscionability standard, some academicians have now recast the liability of knowing receipt as 'unconscionable receipt'.[24] It is important to note that although Nourse LJ has introduced the concept of 'unconscionability' to knowing receipt, his Lordship was quite unequivocal in stating that the nature of its liability is not restitutionary-based, but fault-based, given that strict liability (which is the nature of a claim in restitution) is not suitable for commercial transactions.[25]

Nourse LJ had opined that the unconscionability test is designed to "avoid those definition and allocation to which the previous categorisations [i.e. the *Baden* test] have led". If that was its intention, then an examination of cases post-*Akindele* will reveal that the unconscionability test has failed to achieve its intended purpose. Although the *Akindele* test has eschewed the more principled approach in the *Baden* test in favour of the more

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23 At 454, G-H.

24 See Graham Virgo*, Principles of the Law of Restitution* (OUP, 2015), at 645; Alastair Hudson, *Principles of Equity and Trusts* (Routledge, 2016); See also, Susan Barkehall Thomas, '*Goodbye' Knowing Receipt. 'Hello' Unconscientious Receipt*, Oxford Journal of Legal Studies, Volume 21, Issue 2, 1 January 2001, Pages 239–265, where the author used the term 'unconscientious receipt'.

25 The rejection of restitutionary basis for knowing receipt is re-affirmed in *Brown v Bennett* [1999] 1 BCLC 649 and *Houghton v Fayers* [2000] 1 BCLC 571.

'flexible' test of unconscionability, courts have continued to use the *Baden* categorisations to inform the meaning of 'unconscionability'. For example, post-*Akindele*, courts have interpreted unconscionability to include dishonesty, willfully and recklessly failing to make such inquiries as an honest and reasonable person would make.[26]

The perceived 'flexibility' of the unconscionability test is problematic for a number of reasons. For one, Nourse LJ did not provide a clear guidance as to what standard should unconscionability be judged upon i.e. whether it is an objective or a subjective test. *Akindele* did not provide any guidance as to the pertinent question of whose conscience has to be affected i.e. the recipient, or a reasonable person, or a reasonable person with the knowledge of the recipient. Critics have said that "it is difficult to clearly ascertain what unconscionability means and how it is to be assessed"[27] and that the word 'unconscionability' is "the most slippery of words".[28] One should note that unconscionability "is a very unruly horse, and once you get astride it, you never know where it will carry you".[29] Professor Peter Birks had said:[30]

> "Unconscionable" gives no guidance. At one extreme it is unconscionable not to repay what you were not intended to receive. At the other extreme, it is unconscionable to be dishonest. "Unconscionable," indicating unanalysed disapprobation, thus embraces every position in the controversy. If we look at what the court did, rather than at the word in which it summed up the test which it intended to apply, we can see that Chief Akindele held onto his money as a result of a factual inquiry resembling an inquiry into constructive notice: he neither knew nor ought to have known of the improprieties going on inside BCCI. In this inquiry "unconscionable" seems no more than a fifth wheel on the coach.

At this juncture, it is relevant to recall that Lord Nicholls in *Royal Brunei Airlines v Tan*[31] has cautioned against the use of unconscionability for accessory liability,[32] as it is not clear what the word means, especially to non-lawyers. His Lordship observed that:

> Unconscionable is a word of immediate appeal to an equity lawyer. Equity is rooted historically in the concept of the Lord Chancellor, as the keeper of the Royal Conscience, concerning himself with conduct which was contrary to good conscience. It must be recognised, however, that unconscionable is not a word in everyday use by non-lawyers. If it is to be used in this context, and if it is to be the

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26 *Niru Battery Manufacturing Co v Milestone Trading Ltd [*2002] EWHC 1425 (Comm), [2002] 2 All ER (Comm) 705, 741. This was endorsed in the Court of Appeal: [2003] EWCA 1446 (Civ); *Abou-Rahmah v Abacha* [2006] EWCA Civ 1492.

27 Davies, *supra note 6,* p. 77.

28 Andrew Burrows*, Construction and Rectification* in A Burrows and E Peel, *Contract Term*s (OUP, 2007), p. 88.

29 Quote credited to Burrough J in *Richardson v Mellish* [1824] 2 Bing 229, 252, who had made that statement in the context of the application of public policy in the realm of conflict of laws.

30 Peter Birks, Arianna Pretto-Sakmann, *Breach of Trust* (Hart Publishing, 2002), p. 201.

31 [1995] 2 AC 378.

32 [1995] 2 AC 378 (PC), 392

> touchstone for liability as an accessory, it is essential to be clear on what, in this context, unconscionable means. If unconscionable means no more than dishonesty, then dishonesty is the preferable label. If unconscionable means something different, it must be said that it is not clear what that something different is. Either way, therefore, the term is better avoided in this context.

The unconscionability test does not provide any guidance to a person as to how one should order his or her conduct. Nonetheless, it has been acknowledged that *Akindele* "represents the present law in England".[33]

Indeed, the difficulty in the application of the unconscionability test becomes apparent if one is to examine its application in Malaysian courts.

C. Malaysian Courts' Application of the Akindele Test

The Court of Appeal was accorded the opportunity to re-examine the standard of knowledge for knowing receipt under Malaysian law in *Ooi Meng Khin v Amanah Scotts Properties (KL) Sdn. Bhd.*[34] (*Ooi Meng Khin*). The facts of *Ooi Meng Khin* are as follows.

The plaintiff had discovered that its employee, the third defendant had carried out large numbers of unauthorised transactions to siphon monies out of the plaintiff to fund his gambling activities. The plaintiff claimed that the fourth, fifth, and seventh defendants were each liable to pay the monies they had received from the third defendant for liability under knowing receipt. One of the contentious points in this case was whether the fourth, fifth, and seventh defendants had the necessary knowledge of the breach of trust by the third defendant when they received monies under the impugned transactions.

In this regard, at paragraph [21] of the judgment in *Ooi Meng Khin*, Abang Iskandar JCA opined that the essential element of the causes of action of receipt and assistance is 'dishonesty':

> In both these causes of action of receipt and assistance, the essential element that the claimant will have to establish against the third party is that his receipt of the claimant's property must be one that was dishonest, and that the assistance rendered was also dishonest, in which case, he has acted as an accessory to the breach of trust.

Immediately in the subsequent paragraph however, Abang Iskandar JCA appears to have endorsed Nourse LJ's test of unconscionability when his Lordship said at paragraphs [22] and [23] that:

> [22] We noted that the learned trial judge had rightly referred to the Singapore case of *George Raymond Zage III and another v Ho Chi Kwong and another* [2010] 2 SLR 589 which had in the course of its deliberation, referred to the decision of learned Justice Nourse LJ in the English Court of Appeal case of *Bank of Credit and Commerce International (Overseas) Ltd and another v Akindele* [2001] Ch

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33 *Charter Plc v City Index Ltd* [2008] Ch 313.

34 [2014] 6 MLJ 488. (Emphasis added).

> 437 where the learned Lord Justice had stated the test in determining precisely the degree of knowledge for the recipient of trust property, to be fixed with liability, to be as follows, namely … [t]he recipient's state of knowledge must be such as to make it unconscionable for him to retain the benefit of the receipt.
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> …
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> [24] With respect, we found that the learned trial judge did not err in adopting the test the Lord Justice Nourse's test as enunciated in the *Akindele*'s case and further clarified by Justice VK Rajah JA in the *Zage III*'s case.

Despite having adopted Nourse LJ's test of unconscionability, his Lordship still proceeded to state at paragraph [34] that "[c]entral, therefore, in this concept of knowing receipt is the proof of dishonesty on the part of the recipient…". This is respectfully incorrect, as liability for receiving property that has been dissipated in breach of trust is not dependent upon the dishonest state of mind of the recipient. Instead, the plaintiff is required to only show that the recipient has knowledge that will make it unconscionable for him to retain the trust property. If the claimant is able to show that the defendant is dishonest, it follows that he will meet the threshold of unconscionability.

In other words, while it is unconscionable to be dishonest, absence of dishonesty should not be equated with absence of unconscionability as one can still be unconscionable but not necessarily dishonest. It is not correct to say that "the essential element that the claimant will have to establish against the third party is that his receipt of the claimant's property must be one that was dishonest", as even something below dishonesty would suffice to establish 'unconscionability' under knowing receipt. In this regard, it is instructive to refer to the judgment of VK Rajah JA in the Singapore Court of Appeal in *George Raymond Zage III and another v Ho Chi Kwong and another*,[35] which was cited with approval in *Ooi Meng Khin*:

> As candidly acknowledged by Nourse LJ when he formulated the test in *Akindele*, unconscionability is a malleable standard that is not free from difficulty in its application. The degree of knowledge required to impose liability will necessarily vary from transaction to transaction. In cases where there is no settled practice of making routine enquiries and prompt resolution of the transaction is required it seems to us clear that clear evidence of the degree of knowledge and fault must be adduced. We are also inclined to agree that the test, as restated in *Akindele*, does not require actual knowledge. This would be contrary to what we believe was the spirit and intent of Nourse LJ's formulation: it seems to us that actual knowledge of a breach of trust or a breach of fiduciary duty is not invariably necessary to find liability, particularly, when there are circumstances in a particular transaction that are so unusual, or so contrary to accepted commercial practice, that it could be unconscionable to allow a defendant to retain the benefit of receipt. The test of unconscionability should be kept flexible and be fact-centered.

[35] [2010] 2 SLR 589, para. [32]. (Emphasis added).

It is clear Nourse LJ's conception of unconscionability for knowing receipt does not require the plaintiff to establish actual knowledge. Therefore, the test for unconscionability cannot be subjective dishonesty because that would require the plaintiff to establish actual knowledge. Therefore, Abang Iskandar JCA had, with respect, erred in saying that the state of mind for recipient liability "must be one that was dishonest".

To further add to the confusion, the Court of Appeal in *Ooi Meng Khin* then went on to endorse the defence of change of position for recipient liability, at paragraph [37]:

> In the circumstances of this case, D7 was only a mere conduit and that it had not been dishonest and as such it ought to be entitled to avail itself to the defence of change of position.

The defence of change of position is a defence available for a defendant in an unjust enrichment claim. It is the law's response to the unfairness of a strict-liability claim of unjust enrichment and as such, it is irrelevant to the claim of knowing receipt which a fault-based claim is. To put it simply, if a person is found to be liable for knowingly receiving a property dissipated in breach of trust, he cannot be allowed to avail himself to the defence of change of position which at its core, is dependent upon absence of fault.

As such, the decision of the Court of Appeal in *Ooi Meng Khin* is unsatisfactory for two reasons. Firstly, it appears that dishonesty is now required in order to establish knowing receipt. This is contrary to the approach taken in other common law jurisdictions, which require only proof of unconscionability. Secondly, having now elevated knowing receipt to a highest form of fault-based liability, the Court of Appeal then endorsed the defence of change of position for knowing receipt, a defence designed to counteract the effect of a strict-liability claim.

The Court of Appeal was presented with the opportunity to clarify *Ooi Meng Khin* two years later in *Tan Sri Dato' (Dr) Rozali Ismail & Ors v Chua Lay Kim (P) & Ors (Rozali Ismail)*,[36] but the case only managed to add to the confusion created by *Ooi Meng Khin*. In *Rozali Ismail,* Abdul Aziz Abdul Rahim JCA cited the following passage from *Re Montagu's Settlement Trusts Duke of Manchester v National Westminster Bank Ltd and others*[37] at page 308:

> The relevant knowledge which would make a recipient of trust property a constructive trustee was actual knowledge that the property was trust property, or knowledge which would have been acquired but for ignoring the obvious or willfully and recklessly failing to make such inquiries as a reasonable and honest man would have made, since in such cases there was a want of probity which justified imposing a constructive trust.

One would note that "willfully and recklessly failing to make such enquiries as an honest and reasonable man would make" in the *Baden* scale is a form of actual knowledge.

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[36] [2016] 3 CLJ 84 at page 106.

[37] [1992] 4 All ER 308. Emphasis added.

It is noted that in *Rozali Ismail*, the Court of Appeal (apart from endorsing the actual knowledge test) also endorsed the unconscionability test in *Akindele* for recipient liability:

> [45] We also refer to the case *Bank of Credit and Commerce International (Overseas) Ltd v Akindele* [2000] 4 All ER 221 where Lord Justice Nourse sets out in his grounds of judgment at p. 455 and we quote (and agree):
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> > All that is necessary is that the recipient's state of knowledge should be such as to make it unconscionable for him to retain the benefit of the receipt.
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> > For these reasons I have come to the view that, just as there is now a single test of dishonesty for knowing assistance, so ought there to be a single test of knowledge for knowing receipt. The recipient's state of knowledge must be such as to make it unconscionable for him to retain the benefit of the receipt. A test in that form, though it cannot, any more than any other, avoid difficulties of application, ought to avoid those of definition and allocation to which the previous categorisations have led. Moreover, it should better enable the courts to give common sense decisions in the commercial context in which claims in knowing receipt are now frequently made, paying equal regard to the wisdom of Lindley LJ on the one hand and of Richardson J on the other.

It is evident that the Court of Appeal in *Ooi Meng Khin* and *Rozali Ismail* has blurred the lines between actual knowledge, constructive knowledge, and unconscionability. This approach is contrary to Nourse LJ's view in *Akindele* that there should be a single test of knowledge on knowing receipt, and that the standard should be one of unconscionability.

It appears that under Malaysian law, recipient liability can exist if the recipient has acted 'unconscionably' which is defined as dishonestly or has willfully and recklessly failed to make such enquiries as an honest and reasonable man would make. The confusing way in which the Malaysian courts have applied the test of unconscionability belies Nourse LJ's view that the unconscionability test will enable courts to give "common sense decisions in the commercial context". The current lack of clarity as to what amounts to 'unconscionability' is an antithesis to common sense.

Therefore, it is hoped that Malaysian courts will revisit the question of whether Nourse J's unconscionability test is appropriate for recipient liability. In this regard, it is helpful to seek guidance from Australia where its apex court in *Farah Constructions Pty Ltd v Say-Dee Pty Ltd*[38] has reaffirmed the Baden test of knowledge for recipient liability:

> … circumstances falling within any of the first four categories of Baden are sufficient to answer the requirement of knowledge in the first limb of *Barnes v Addy* but does not travel fully into the field of constructive notice by accepting the fifth category. In this way, there is accommodated, through acceptance of the fourth category, the proposition that the morally obtuse cannot escape by failure

38 [2007] HCA 22.

> to recognise an impropriety that would have been apparent to an ordinary person applying the standards of such persons. These conclusions … as to what is involved in 'knowledge' for the second limb represent the law in Australia.

The Australian High Court did not adopt the unconscionability test in *Akindele* and at the same time, also rejected t the strict liability test for recipient liability which was adopted by the Court of Appeal.

More recently, the Supreme Court of Victoria[39] provided further guidance on how one should interpret the third and fourth categories of the Baden scale of knowledge. For the third category - wilfully and recklessly failing to make inquiries as an honest and reasonable person would make, it "involves such a calculated abstention from inquiry as would disentitle the third party to rely upon lack of actual knowledge of the trustee's or fiduciary's wrongdoing".[40] For the fourth category - knowledge of circumstances which would indicate the facts to an honest and reasonable person – the court observed that this category "is designed to prevent a third party setting up his or her own moral obtuseness" as an excuse for not recognising an impropriety that would have been apparent to an ordinary person applying the standards of such ordinary person.[41]

The effortless manner in which the Australian courts have applied the Baden test for recipient liability brings into question whether there was a need for Nourse LJ to introduce the unconscionability for recipient liability in the first place. The answer to that question is evident if one is to observe how Malaysian courts have struggled to understand Nourse LJ's test. As such, Malaysian courts should follow the approach taken in Australia, and reinstate the Baden test for recipient liability.

IV. DISHONEST ASSISTANCE – OBJECTIVE DISHONESTY OR SUBJECTIVE DISHONESTY?

A. Dishonesty as defined by Lord Nicholls in Royal Brunei Airlines v Tan[42]

As for liability for assisting in breach of trust, it is settled law that the standard of knowledge required is one of 'dishonesty'.[43] The 'objective dishonesty' test propounded by Lord Nicholls in *Royal Brunei Airlines v Tan*[44] (Royal Brunei Airlines) is widely accepted as the standard bearer for the dishonesty test under dishonest assistance.

There are two interwoven facets to the test of dishonesty for liability under dishonest assistance as propounded by Lord Nicholls in *Royal Brunei Airlines*.[45] First, accessory liability does not require a dishonest and fraudulent design on the part of the trustee.

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39 *Harstedt Pty Ltd v Tomanek* [2018] VSCA 84.

40 *Harstedt Pty Ltd v Tomanek* [2018] VSCA 84, para. 86.

41 *Ibid.*

42 [1995] 2 AC 378.

43 *Royal Brunei Airlines v Tan* [1995] 2 AC 378; *Karak Rubber Co Ltd v Burden (No 2)* [1972] 1 All ER 1210; *Baden v Société Générale pour Favoriser le Développement du Commerce et de l'Industrie en France SA* [1992] 4 All ER 161, [1993] 1 WLR 509; *Selangor United Rubber Estates Ltd v Cradock (a bankrupt)* (*No 3*) [1968] 2 All ER 1073.

44 [1995] 2 AC 378.

45 [1995] 2 AC 378.

This is simply logical, for otherwise, a dishonest third party may defraud an honest albeit ignorant trustee to commit a breach of trust, and not be caught because there was no dishonest and fraudulent design on the part of the trustee.

Secondly, the liability of the accessory should be dependent on the accessory's own dishonest participation in the breach rather than knowledge, as the requirement of knowledge has led the courts into "tortuous convolutions" in deciding the level of knowledge possessed and required.

Dishonesty, according to Lord Nicholls, is a question of whether the third party has come up to the standard of an honest person in the circumstances, taking into account the third party's knowledge of the facts, his experience, intelligence and practicability of his or the trustees' actions amongst other things.

Therefore, while one has to show that the defendant has engaged in an 'advertent conduct' assessed in the light of defendant's actual awareness at the relevant time, the test for dishonesty does not require that the defendant himself should have appreciated the fact that he was dishonest.

In this regard, if the mental state of the defendant is dishonest by ordinary standards, it matters not that he adheres to a different moral code because honesty is not an 'optional scale' with higher or lower values according to the standards of each individual. Accordingly, dishonesty is measured on an objective standard with subjective considerations.

B. Twinsectra– A subjective test or a combined test?

It appears that the House of Lords in *Twinsectra* have adopted a different interpretation of 'dishonesty' from that of Lord Nicholls. Lord Hutton who delivered the leading judgment concluded that the test of dishonesty involves a combined objective-subjective test that requires the Court to ask this: first, whether an honest person would have done what the third party did and if the answer is yes, then second, whether the defendant appreciated that fact.

In the course of his Lordship's judgment, Lord Hutton considered three possible standards of dishonesty: purely subjective, purely objective and the 'combined test', and concluded that Lord Nicholls in *Royal Brunei Airlines* clearly meant for the 'combined test' to be applied.

Respectfully, while Lord Hutton is right in stating that the test is a 'combined test', his Lordship has erred in his application of the test. Lord Nicholls in considering the subjective elements (e.g knowledge, experience and intelligence) to be relevant in assessing whether the defendant has come up to the standard of an honest man, but in no way relevant to decide whether the defendant would have appreciated that he has acted against the dishonest standard for that will be allowing the defendant to set his own standard of dishonesty.

Unfortunately, the majority of the House of Lords did not appreciate this point. Lord Hoffman in support of Lord Hutton further stated that the dishonest state of mind meant "consciousness that one is transgressing ordinary standards of behavior", which means that the defendant has to be conscious that he has fallen below the standard of an honest and reasonable man.

As a result, the majority's approach in *Twinsectra* has brought the test for dishonest assistance in line with the criminal law test for dishonesty laid down in *R v Ghosh*[46] despite Lord Nicholls' disapproval of the same in *Royal Brunei Airlines*.

Lord Millett who delivered the dissenting judgment objected to the majority's formulation and pointed out that there is "no trace in Lord Nicholls' opinion" of the requirement of the defendant's awareness that he was acting contrary to what an honest man would do. The decision in *Twinsectra*, being the decision of the House of Lords was binding upon all English courts. In its aftermath, *Twinsectra* was subjected to heavy criticisms by legal commentators as the subjective test has raised the barrier for knowledge far too high in order for one to establish accessory liability.

C. Clarification of the Law Post-Twinsectra

The Privy Council was given the opportunity to clarify the law in *Barlow Clowes International v Eurotrust International*[47] *(Barlow Clowes*), and did not disappoint. In *Barlow Clowes*, Lord Hoffman admitted that the majority in *Twinsectra* was ambiguous as to their application of Lord Nicholls' dishonesty test. His Lordship was of the opinion that on deeper examination of Lord Hutton's speech in *Twinsectra*, there was in fact no requirement that the defendant must have reflection as to the normally acceptable standards. Rather, what Lord Hutton really meant was that the defendant is required to possess knowledge of the transaction that will render his participation contrary to the normally acceptable standards. Lord Hoffman observed that Lord Hutton's conception of 'knowledge' refers to knowledge of the transaction and not knowledge that the defendant has fallen below the ordinary standard of dishonesty.

Lord Hoffman stopped short of saying that the majority of the House of Lords have simply erred. Instead, his Lordship stated that the majority in *Twinsectra* did not attempt to alter Lord Nicholls' formulation in *Royal Brunei Airlines* and that *Twinsectra*'s formulation was ambiguous but no different from *Royal Brunei Airlines*. This left the door open for the lower courts in England to apply the correct approach in *Barlow Clowes* and inject clarity into the English law without having to depart from precedent.

The opportunity to clarify the English law position on this issue was duly taken up by the English Court of Appeal in *Abou-Rahmah v Abacha*[48] (*Abou-Rahmah*). Taking a rather pragmatic approach, Arden LJ accepted that *Twinsectra*, being the House of Lords decision, was binding on the Court of Appeal. Her Ladyship, however, saw no difficulty in applying *Barlow Clowes* as it did not involve a departure from the House of Lords' decision in *Twinsectra*. The role *of Barlow Clowes*, according to her Ladyship, was merely to clarify the speeches of Lord Hutton and Lord Hoffman in *Twinsectra*. Therefore, it was open for the Court of Appeal to apply *Barlow Clowes*' interpretation of *Twinsectra* and *Royal Brunei Airlines*.

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46 [1982] 3 WLR 110.

47 [2005] UKPC 37.

48 [2006] EWCA Civ 1492 (CA).

As such, one may conclude that the test of dishonesty in English law in relation to dishonest assistance is no longer uncertain due to the clarification given by the Privy Council in *Barlow Clowes*. The case confirms that under English law, the standard of dishonesty is objective (and not a mixed test), and the defendant's awareness or actual knowledge of the dishonest standard is immaterial. Across the causeway, the Singapore Court of Appeal in *George Raymond Zage III v Ho Chi Kwong* has likewise adopted this approach:

> [F]or a defendant to be liable for knowing assistance, he must have such knowledge of the irregular shortcomings of the transaction that ordinary honest people would consider it to be a breach of standards of honest conduct if he failed to adequately query them.

The clarification of the test for dishonesty is indeed welcoming. It is worth noting that the subjective dishonesty test in criminal law introduced by *R v Ghosh*[49] has recently been overturned in the UK Supreme Court.[50] This reaffirms that the subjective dishonesty test has no place in English law.

D. The Subjective Dishonesty Test Adopted by the Federal Court

In Malaysia, the Court of Appeal in *Kuan Pek Seng @ Alan Kuan v. Robert Doran & Ors*[51] has precisely taken the same view in *Barlow Clowes* and *Abou-Rahmah*, by accepting that *Twinsectra* does not alter the objective dishonesty test propounded by Lord Nicholls in *Royal Brunei Airlines*. Jeffrey Tan FCJ (sitting as a judge at the Court of Appeal) said as follows:

> [59] … what Lord Hutton said in *Twinsectra* has now been restated and reinterpreted in *Barlow Clowes International Ltd (in liquidation) and others v Eurotrust International Ltd and others* [2006] 1 WLR 1476, where it was accepted by Lord Hoffman, who delivered the judgment of Their Lordships, 'that the test whether a person was consciously dishonest in providing assistance[,] required him to have knowledge of the elements of the transaction which rendered his participation contrary to ordinary standards of honest behavior'. At p 1481, Lord Hoffman explained that 'the reference to 'what he knows would offend normally accepted standards of honest conduct' meant only that his knowledge of the transaction had to be such as to render his participation contrary to normally acceptable standards of honest conduct. It did not require that he should have had reflections about what those normally acceptable standards were'. Arden LJ in *Abou-Rahmah v Abacha* [2006] EWCA Civ 1492, has now endorsed *Barlow Clowes* as representing the current English law.

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49 [1982] 3 WLR 110.

50 *Ivey v Genting Casinos UK Ltd t/a Crockfords* [2017] UKSC 6.

51 [2013] 2 MLJ 174.

However, just as one thought that the dust has settled in *Kuan Pek Seng*, the Federal Court in a later case took a different approach by interpreting *Twinsectra* as introducing a subjective test. In *CIMB Bank Bhd v Maybank Trustee Bhd*[52] Arifin Zakaria CJ observed that Twinsectra has introduced the concept of subjective dishonesty:

> [145] The above principle was extended by *Twinsectra Ltd v Yardley and others* [2002] 2 All ER 377 (HL), when it introduced the two-fold tests of an objective and subjective test
>
> …
>
> [146] In a gist, a new test was introduced by *Twinsectra*, in that the concept of subjective dishonesty became a requirement in a breach of trust situation.

In his judgment, Arifin Zakaria CJ did not refer to or consider the judgment of Jeffrey Tan FCJ in *Kuan Pek Seng*.

Recently in *Malaysian International Trading Corporation Sdn Bhd v RHB Bank Berhad,*[53] the Federal Court re-affirmed the interpretation adopted in *CIMB Bank Bhd v Maybank Trustee Bhd* that *Twinsectra* has introduced the element of subjective dishonesty. It is noted that *Malaysian International Trading Corporation Sdn Bhd v RHB Bank Berhad*[54] is a case on constructive trust, and not dishonest assistance. Nonetheless, the Federal Court made the following observation:

> That was the basic principle alluded to prior to the development of the law of constructive trust whenever parties asserted the existence of a constructive trust. In sequence, *Carl Zeis Stiftung v Herbert Smith & Co (No. 2)* [1969] 2 All ER 377 and *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 3 All ER 97 started the development and was eventually extended to *Twinsectra Ltd v Yardley And Others* [2002] 2 All ER 377. The new approach saw the introduction of a two-fold test of an objective and subjective test. This test which demands the additional subjective honesty ingredient was approved by *CIMB Bank Bhd v Maybank Trustees Bhd & Other Appeals* [2014] 3 CLJ 1.

The Federal Court did not, in its two decisions, clarify what 'subjective' dishonesty entails i.e. whether it requires one to establish that the defendant appreciates what he was doing was dishonest according to normally acceptable standards, or that he has actual knowledge of the conduct that is alleged to be dishonest. To the best of my knowledge, there is no reported High Court, Court of Appeal or Federal Court judgment that has addressed this point at the time this article was written.

The upshot is that the Malaysia courts remain bound by the "subjective dishonesty" test adopted by the Federal Court. However, as the Federal Court has not given a definitive definition of "subjective dishonesty", it is open for courts to adopt the approach in *Barlow Clowes* and *Abou-Rahmah* i.e. by interpreting subjective dishonesty to mean

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52 [2014] 3 MLJ 169.

53 [2016] 2 CLJ 717.

54 [2016] 2 CLJ 717.

that the defendant has knowledge of the dishonest transaction and not knowledge that the defendant has fallen below the ordinary standard of dishonesty. It is hoped that the Malaysian courts will seize the opportunity to clarify this aspect of the law when the opportunity arises.

V. CONCLUSION

The current state of law for knowing receipt and dishonest assistance in Malaysia remains unsatisfactory.

In *Akindele,* Nourse LJ has propounded the single test of knowledge for knowing receipt, which entails the law to consider whether "[t]he recipient's state of knowledge must be such as to make it unconscionable for him to retain the benefit of the receipt." This test has now been adopted in most major common law jurisdictions. However, in Malaysia, the Court of Appeal in *Ooi Meng Khin* and *Rozali Ismail* has blurred the lines between actual knowledge, constructive knowledge, and unconscionability, contrary to the approach in *Akindele*. Given the lack of clarity as to what amounts to 'unconscionability' in recipient liability, Malaysian courts should follow the approach taken in Australia, and reinstate the Baden test for recipient liability.

As for dishonest assistance, English law has adopted the test of objective dishonesty. The Malaysia courts remain bound by the 'subjective dishonesty' test adopted by the Federal Court. However, as the Federal Court has not given a definitive definition of 'subjective dishonesty', it remains open for Malaysian courts to interpret subjective dishonesty to mean that the defendant has knowledge of the dishonest transaction and not knowledge that the defendant has fallen below the ordinary standard of dishonesty.