Explaining and Justifying the Present Law of Knowing Receipt

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Abstract— The language of 'constructive trusts' is out of fashion. This is particularly so in the body of principles commonly associated with the first limb of *Barnes v Addy*: 'knowing receipt'. This paper articulates a conceptual model of 'knowing receipt', conceiving of it as an equitable wrong such that knowing receipt and dishonest assistance work together as part of a coherent scheme of liability from *Barnes v Addy*. After outlining this theory, this paper goes on to consider the most significant objection to this analysis, namely, that it is inconsistent with the language of 'constructive trusteeship' in knowing receipt. The aim is to show, on the contrary, that this model 'explains' and 'justifies' the language of 'constructive trusteeship' as a general formula for equitable relief in knowing receipt.

* Jesus College, Oxford. I am grateful to the Editorial Board of the OUULJ for their generous feedback on earlier drafts of this article. All errors are my own.

Introduction

Unlike natural science, 'the objects of legal knowledge are not independent of knowledge itself; law is the object of its own science in as much as it can be studied only through concepts and categories created by legal science'.[1] Consequently, any attempt to 'explain' and 'justify' the present positive law must begin with some framework.[2]

Peter Birks sought to erect a framework of the private law through an events-response model, namely, private law obligations arise out of four kinds of causative event: Consent, Wrongs, Unjust Enrichment (UE), and Miscellaneous Other.[3] This framework is controversial.[4] Nonetheless, Birks's taxonomy is arguably useful insofar as it helps to synthesise the mass of private law legal rules and principles.

The question at the heart of this paper is: where does what has come to be called 'knowing receipt' (KR) fall within Birks's taxonomy? The defendant (C) is personally liable to the claimant (B) in KR when:

(i) A holds property on trust for B;[5]

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[1] Geoffrey Samuel, 'English Private Law: Old and New Thinking in the Taxonomy Debate' (2004) 24 OJLS 335, 341.
[2] Edward Rubin, 'Law and the Methodology of Law' (1997) 3 Wisconsin Law Review 521, 542.
[3] Peter Birks, *English Private Law* (OUP 2000) xlii, 1.
[4] Samuel (n 1) 349–354; Joachim Dietrich, 'What Is "Lawyering"? The Challenge of Taxonomy' (2006) 65 CLJ 549; James Edelman, 'Taxonomic Reasoning' at Conference of Judicial College of Victoria and Melbourne Law School (14 March 2014).
[5] *Novoship (UK) Ltd v Mikhaylyuk* [2014] EWCA Civ 908, [2015] QB 499 [89]. It must be noted that property legally and beneficially owned by a

(ii) A transfers B's trust property to C in breach of A's fiduciary duty;[6]

(iii) C beneficially receives B's assets from A;[7]

(iv) At the moment of C's receipt, B continues to have an equitable right ('undestroyed proprietary base') in the assets;[8]

(v) C's state of knowledge of the trust between A and B is such as to make it unconscionable for C to retain the benefit of the receipt.[9]

Part 1 of this paper argues that it is possible to 'explain' and 'justify' KR within the Birksian framework as an equitable Wrong, such that KR and DA work together as part of a coherent scheme of liability from *Barnes v Addy*.[10] Part 2 considers the

company but subject to the fiduciary duties of the directors or others is 'trust property' for the present purposes (*Selangor United Rubber Estates Ltd v Cradock (No.3)* [1968] 1 WLR 1555 (Ch), 1574–1577), as is property held and controlled by a fiduciary agent (*Agip (Africa) Ltd v Jackson* [1991] Ch 547 (CA), 567–568) – cf *Lewin on Trusts* (20th Ed, Sweet & Maxwell 2020) [42-036]. William Swadling ('The Nature of "Knowing Receipt"' in Davies & Penner (eds) *Equity, Trusts and Commerce* (Hart 2019) 305–306) argues that *Criterion Properties Plc v Stratford UK Properties LLC* [2004] UKHL 28, [2004] 1 WLR 1846 'decisively reject[s]' this line of authority such that property subject to fiduciary duties does not suffice for KR. However, *Criterion* has not been taken as authority for this proposition in subsequent cases, and is ratio authority only that the creation by contract of contractual rights does not constitute a 'receipt' of assets for the purposes of KR ([27]).

[6] *Belmont Finance Corporation Ltd v Williams Furniture Ltd (No.2)* [1980] 1 All ER 393 (CA).

[7] *Agip (Africa) Ltd v Jackson* [1990] Ch 265 (Ch), 291–292.

[8] *Byers v Samba* [2021] EWHC 60 (Ch) [38],[111].

[9] *BCCI v Akindele* [2001] Ch 437 (CA) 455.

[10] (1873–74) LR 9 Ch App 244 (CA in Chancery), 251–252.

specific objection that the equitable Wrong model cannot be reconciled with the language of 'constructive trusteeship' widely used in KR. It is submitted, on the contrary, that it is possible to 'explain' and 'justify' the present positive law of KR without jettisoning this language: although the equitable Wrong theory is incompatible with 'true' constructive trusteeship (à la Mitchell & Watterson), it is consistent with the terminology of 'as a constructive trustee' (a general formula for equitable relief).[11] This formula arguably serves the modal function of tying the Wrong of KR to the institution that the law seeks to protect via KR: the original trusteeship.[12]

1. Proposed Justifications for the Exclusionary Rule

Before turning towards the question of where KR falls within the Birksian taxonomy, we must consider methodology.

Drawing on Dworkin, New Private Law scholarship tends to work within the 'interpretivist' mode.[13] Interpretivists aim to go from a large mass of legal information to a tight and

[11] 'Remedies for Knowing Receipt' in Mitchell (ed) *Constructive and Resulting Trusts* (Hart 2010) 133–136.

[12] It is submitted, in other words, that KR involving breach of trust is the core instance of KR, and the KR involving property subject to fiduciary duties is a peripheral instance sharing the same justification.

[13] Andrew Gold, 'Internal and External Perspectives' in Andrew Gold and others (eds) *The Oxford Handbook of New Private Law* (OUP 2021) 10.

coherent theory that 'best' rationalises the law.[14] Standard interpretive criteria for assessing the law are: fit, coherence, morality, and transparency.[15] Birks and Swadling, the two leading theorists on KR, implicitly adopt this interpretivist method and both of their theories prioritise coherence at the expense of doctrinal fit.[16] Consequently, the existing academic models on KR operate essentially within the realm of prescription.

This essay deliberately subverts the interpretivist method by looking at the law through the lens of 'doctrinal scholarship'. The aim of doctrinal scholarship is to 'explain' and 'justify' the 'present law'. There are two methodological claims underpinning this approach. *First*, doctrinal work is vital for understanding what the legal system does.[17] If interpretivist theories ignore the present law (and focus on prescription), it is all the more vital that others do not. *Second*, it is not necessary to resort to interpretivism to coherently explain the present positive law of KR.

The terms (i) 'present law', (ii) 'explaining', and (iii) 'justifying' must now be defined. Following Kocourek, the 'present law' is a narrow hypothesis (based on past law) of what law is about to be applied by the courts.[18] This is not an endorsement of the legal realist thesis.[19] The point is merely that

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[14] Steve Hedley, 'The Shock of the Old: Interpretivism in Obligations' in Charles Rickett and Ross Grantham (eds) *Structure and Justification in Private Law* (Hart 2008) 206; Dworkin, *Law's Empire* (HUP 1986) 45–86.
[15] Stephen A. Smith, *Contract Theory* (OUP 2004) 3–38.
[16] Hedley (n 14) 211–212.
[17] Hedley (n 14) 215.
[18] Albert Kocourek, *Introduction to the Science of Law* (Little, Brown & Co 1930) 12.
[19] Felix Cohen, 'Transcendental Nonsense and the Functional Approach' (1935) 35 CLR 809.

law which *has been* applied is 'past law' and so 'present law' must be that which is *about to be* applied.

A doctrinal model of KR will 'explain' the present law of KR if, in such a way as to make a probable prediction of the outcome and reasoning of a future case, it: (i) provides a reason for the outcome of past cases and (ii) accords with the reasoning in those past cases.

Finally, a doctrinal model of KR will 'justify' the present law if it offers some superior moral reason for why our legal system should formulate KR in accordance with its theory. This is not a question of engagement in moral norms.[20] Justification, on this definition, is about moral norms trumping one another. The definition is deliberately vague because this essay does not seek to beg the question by excluding certain types of moral norms.

A. Consent and Miscellaneous Other

KR does not arise due to a manifestation of Consent (B, the claimant, and C, the defendant, need not have made any sort of agreement for liability in KR to arise). Furthermore, since, it shall be argued, it is possible to locate the present law of KR within the category of Wrongs, no question of whether KR comes within the residual category of Miscellaneous Other events arises.[21]

B. UE Theory of KR

The elements of UE in English law were set down in *Menelaou v Bank of Cyprus Plc*: (i) an 'enrichment' of C; (ii) 'at B's expense'; (iii) in circumstances of an 'unjust factor'; where (iv) C has no

[20] John Gardner, *Law as a Leap of Faith: Essays on Law in General* (OUP 2012) 149–176.
[21] Birks (n 3) xlii.

available 'defence'.[22] For the present, it will be assumed that UE usefully illuminates areas of traditional equity jurisprudence, and that UE is a category which includes all causes of action that satisfy the elements of *Menelaou*.[23]

As applied to KR, Birks contended that by receiving B's assets C has been enriched at B's expense – an explanation which has been endorsed in Jersey and New Zealand.[24] This paper will, nonetheless, submit that the UE model neither explains nor justifies the present positive law of KR in England.

I. Explains

It is argued that the UE theory is deficient for three reasons.

First, as is repeated in the caselaw, KR requires C to have 'knowledge' of A's breach of fiduciary duty.[25] There is no such requirement of 'knowledge' to run a claim in UE: why should knowledge matter if the claim is simply that C has been enriched

[22] [2015] UKSC 66, [2016] AC 176 [18]–[20].

[23] Christopher Douglas Barker, 'Understanding the Unjust Enrichment Principle in Private Law: A Study of the Concept and its Reasons' in Jason Neyers and others (eds) *Understanding Unjust Enrichment* (Hart 2004) 83–84.

[24] Peter Birks, 'Misdirected Funds: Restitution from the Recipient' [1989] LMCLQ 296; *Re Esteem Settlement* [2002] JLR 53; *Powell v Thompson* [1991] 1 NZLR 579.

[25] *El Ajou v Dollar Land Holdings* [1994] 2 All ER 685 (CA) 700; *Re Montagu's Settlement* [1987] Ch 264 (Ch) 276; *Agip (Africa)* (n 7) 291; *Relfo Ltd (In Liquidation) v Varsani* [2014] EWCA Civ 360, [2015] 1 BCLC 14 [1].

unfairly?[26] There is therefore a fundamental difference between the present law of KR and the UE framework. [27]

Speaking within the interpretivist mode, Birks contends, in response, that the modern law of KR is incorrect. In its original formulation in *Barnes v Addy*, KR did not require C to have knowledge of A's breach of fiduciary duty: Lord Selborne LC stated that it is enough for C to be liable in KR when (s)he 'receive[s] and become[s] chargeable with some part of the trust property'.[28] Thus, the requirement of knowledge (as introduced since *Carl Zeiss v Herbert Smith (No.2)*)[29] should be rejected.

The problem with this rebuttal is that, regardless of whether the modern legal position has departed from *Barnes* or whether the departure was erroneous, the UE model cannot explain the present positive requirement of knowledge for KR.[30]

The *second* objection is that UE requires an 'unjust factor'. Birks proposes that the unjust factor present in KR is 'ignorance'; that is, an enrichment is unjust by reason of B being unaware of a transfer of value from himself to C.[31] However, this factor has never been recognised by the courts.[32] Birks may reply that 'ignorance' is the unspoken animating principle behind the

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[26] *Greenwood v Bennett* [1973] QB 195.
[27] Lionel Smith, 'Unjust Enrichment, Property, and the Structure of Trusts' (2000) 116 LQR 412, 412.
[28] *Barnes* (n 10); Birks (n 24) 331–332.
[29] [1969] 2 Ch 276 (Ch) 293.
[30] *BCCI* (n 9) 455; *Criterion Properties* (n 5) [28]–[40]; *Charter Plc v City Index Ltd* [2007] EWCA Civ 1382, [2008] Ch 313 [7]–[8]; *Iranian Offshore Engineering and Construction Co v Dean Investment Holdings SA* [2019] EWHC 472 (Comm) [175].
[31] Birks (n 24) 296–297.
[32] Swadling (n 5) 317–318; *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89 [155].

caselaw. But the Court of Appeal emphasised in *Novoship (UK) Ltd v Mikhaylyuk* that 'receipt [rather than ignorance] of trust property is the gist of [KR]'.[33]

Third, to ground liability in UE, it must be proved that C is 'enriched' 'at B's expense'.[34] It was recognised in *Cressman v Coys of Kensington (Sales) Ltd* that C's acquisition of B's right satisfies this requirement.[35] Yet, as has been noted, C does not receive B's right in KR.[36] Rather, following A's breach of trust, C receives a *legal* right from A not an *equitable* right from B. Therefore, even if a legal right qualifies as 'enrichment', C cannot be 'enriched' 'at B's expense'.

One rebuttal is to claim that legal rights are equivalent to equitable rights in KR. This approach is taken by Lord Reed in *Investment Trust Companies v Revenue and Customs*, where he states that C has been enriched 'at B's expense' because A's property (ie legal right) 'is, in law, the equivalent of [B's] property' (i.e. equitable right).[37] This echoes the view of the Court of Appeal in *Shell UK Ltd v Total UK Ltd*, where the court found it 'legalistic' to deny Shell a right of recovery against Total on the basis that Shell had only an equitable right.[38]

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[33] *Novoship* (n 5) [89].
[34] *Kleinwort Benson Ltd v Birmingham City Council* [1997] QB 380 (CA) 400; Eli Ball, *Enrichment at the Claimant's Expense* (Hart 2016) 99.
[35] [2004] EWCA Civ 47, [2004] 1 WLR 2775 [37].
[36] Swadling (n 5) 318; Smith (n 27) 428–429; Robert Chambers, 'Two Kinds of Enrichment' in Robert Chambers, Charles Mitchell, and James Penner (eds), *Philosophical Foundations of the Law of Unjust Enrichment* (OUP 2009) 250; *Sempra Metals v IRC* [2007] UKHL 34, [2008] 1 AC 561 [119].
[37] [2017] UKSC 29, [2018] AC 275 [48].
[38] [2010] EWCA Civ 180, [2011] QB 86 [132].

The response is twofold. First, it is not correct that legal and equitable property rights are equivalent. This is reflected by the fundamentally different rights/duties of trustee and beneficiary.[39] However, second, *even if* legal and equitable rights can be conceived as equivalent for this purpose, the corollary of Lord Reed's dictum in *Investment Trust Companies* is that KR is not available when B is the object of a discretionary trust because, there, B has a mere *spes* – not an equitable right.[40] This is incorrect as a matter of law: the object of a discretionary trust can claim in KR.[41] Accordingly, Lord Reed's rebuttal should be rejected.

II. Justifies

The UE framework would justify the present law of KR if it offered a moral reason for changing the elements of KR into the requirements for UE in *Menelaou*. It is not claimed here that Birks himself sought to justify the present law on this definition. Rather, it is suggested that, looking at this separate question, Birks's framework fails to provide a moral reason to reform the law. There are two specific objections.

First, the UE model imposes a broader criterion for liability by removing the requirement for knowledge or unconscionability: recipients will be liable in KR (regardless of

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[39] Maitland, *Equity: A Course of Lectures* (1st edn, CUP 1910) 112; Ben McFarlane & Robert Stevens, 'The Nature of Equitable Property' (2010) 4 J Equity 1, 3–5.

[40] *Baker (Inspector of Taxes) v Archer Shee* [1927] AC 844 (HL) 853–856 (Viscount Sumner), 872–873 (Lord Blanesborough); *Gartside v IRC* [1968] AC 55 (HL) 605–606.

[41] *Schmidt v Rosewood Trust Ltd* [2003] UKPC 26, [2003] 2 AC 709 [51]; *Joel v Mills* (1857) 4 K & J 458 (Court of Chancery) 473–476; *Cosser v Radford* (1863) 1 De GJ & S 585 (Court of Chancery); *Lewin on Trusts* (n 5) [41-073], [42-033]; *Goff & Jones: The Law of Unjust Enrichment* (9th edn, Sweet & Maxwell 2016) [6-04].

knowledge) unless C can demonstrate that C has changed their position in reliance on the receipt.[42] However, the UE framework does not identify why this expansion of the range of persons who may be subject to KR is justified. The absence of justification is noticeable given that KR is already a wide cause of action (extending to assets dispersed in breach of fiduciary duty).

One argument in defence of Birks might be that KR should expand because the present law of KR (with the knowledge requirement) leaves a lacuna such that there is a space where no cause of action is available between KR, dishonest assistance for breach of trust (DA), and equitable tracing. This, however, is incorrect. Even if B's trust assets have been dissipated, it is very likely that a claim in DA will be available on the same facts as KR – as was recently argued in *Byers v Samba*.[43]

Another argument in defence of Birks is that the 'change of position' defence (CPD) provides a sufficient antidote to this expansion of liability. In *Lipkin Gorman v Karpnale Ltd*, Lord Goff held that CPD would be available 'to a person whose position has so changed that it would be inequitable in all the circumstances to require him to make restitution'.[44] It is true that Lord Goff goes on to say that CPD is not available to anyone who has 'changed [their] position in bad faith as where [C] has paid away the money with knowledge of the facts entitling [B] to restitution'.[45] Nevertheless, since fault (knowledge or unconscionability) is not

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[42] This point is stressed by Nourse LJ in *BCCI v Akindele* (n 9) 456.
[43] *Byers* (n 8) [108]. Despite the different requirements, it is very common for both KR and DA to be run concurrently: *Twinsectra Ltd v Yardley* [2002] UKHL 12, [2002] 2 AC 164; *Williams v Central Bank of Nigeria* [2014] UKSC 10, [2014] AC 1189; *Group Seven Ltd v Notable Services LLP* [2019] EWCA Civ 614, [2020] Ch 129; *Novoship* (n 5).
[44] [1991] 2 AC 548 (HL) 579–80.
[45] ibid 580.

required by the UE model of KR, it is possible that CPD would be useful.[46]

Even if the defence is available, there are two further criticisms. First, the UE framework renders KR claims more arguable by shifting the weight from establishing the elements of UE to establishing a defence to UE. The consequence is that the burden moves from the claimant towards the defendant. It is not clear that this shift is justified. Birks would (presumably) say that a person who stands possessed of another's assets should have the burden of justifying their ownership of them. Yet, the counterargument is that this change would be 'commercially unworkable' because it would vastly increase commercial parties' exposure to litigation.[47]

Second, Birks's proposal can only ever be partially persuasive because it fails to engage with the social costs of reform. For example, the scope of 'inequitability *in all the circumstances*'[48] remains unclear. The result is that those advising commercial parties under the UE theory will be unable to provide certainty. Even if some elements of the present law of KR (e.g. knowledge) have not settled, it does not make sense to reform one area of legal ambiguity for another.[49]

The *second* specific objection to the UE model is that (on Birks's account) UE is based on the claim that C's enrichment at the expense of B is unjust given certain factors.[50] It was argued above that the UE theory cannot explain KR because there is no

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[46] *BCCI* (n 9) 456.
[47] ibid.
[48] *Commerzbank AG v Price-Jones* [2003] EWCA Civ 1663 [39] (emphasis added).
[49] Swadling (n 5) 311–314.
[50] Peter Birks, *Unjust Enrichment* (OUP 2005) 3–5.

enrichment of C 'at B's expense' in KR; C receives a legal right from A not an equitable right from B. It follows that, together with this descriptive problem, there is no justification for applying UE to the facts of KR because there is no enrichment at B's expense. In other words, the fundamental moral basis for UE is absent in cases of KR.

Birks dismissed the absence of enrichment 'at B's expense' as a 'technicality'.[51] But in law technicality is everything. Stevens has come to Birks's aid on the basis that no defendant would raise this objection for they would be admitting liability in conversion.[52] However, there are two reasons that defendants would raise this objection. *First*, conversion requires an intentional exercise of exclusive control over the trust property, whereas the receipt in KR can be wholly passive (even on the UE model).[53] Thus C is not necessarily liable for conversion if (s)he is liable on the UE theory of KR. *Second*, even if C were liable for so conversion, C would be admitting liability to a different party since conversion only attaches to A's legal right.[54]

C. 'Wrong' Theories of KR

Birks's next category is 'Wrongs'. Birks defines a 'Wrong' as 'no more nor less than a breach of legal duty owed to a plaintiff'.[55]

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[51] Peter Birks, 'Property and Unjust Enrichment: Categorical Truths' [1997] NZLR 623, 654–655.

[52] Robert Stevens, 'Three Enrichment Issues' in Andrew Burrows and Lord Rodger of Earlsferry (eds) *Mapping the Law: Essays in Memory of Peter Birks* (OUP 2006) 62–64.

[53] *Walgrave v Ogden* (1590) 1 Leon 224; Simon Douglas, 'The Nature of Conversion' (2009) 68 CLJ 198, 214–217; Swadling (n 5) 328.

[54] *MCC Proceeds Inc v Lehman Brothers International (Europe)* [1998] 4 All ER 675 (CA).

[55] Peter Birks, 'The Concept of a Civil Wrong' in David G. Owen (ed) *The Philosophical Foundations of Tort Law* (OUP 1997) 33.

This is a necessary condition.[56] This account of concepts is contestable.[57] Nonetheless, since the controversy requires more space than this paper has, Birks's definition will be accepted on its own terms.

I. Inconsistent Dealing

Drawing on Millett J in *Agip (Africa),*[58] Swadling suggests that KR should be interpreted as an equitable Wrong called 'inconsistent dealing' (ID).[59] The elements of ID were stated in *Lee v Sankey*: C is liable for ID when C knowingly deals with money held under a trust inconsistently with that trust.[60] Interpreting the Birksian definition of a 'Wrong' through a Hohfeldian rights-based analysis, the fact of receipt thus generates a duty-right jural relation between B and C such that C comes under a primary duty to B not to deal inconsistently with the property.[61] C's duty corresponds with a claim-right in B that C does not deal inconsistently. It is the breach of this primary duty owed by C to B that constitutes an 'inconsistent dealing'. Breach of this primary duty then generates secondary entitlements, namely B's power to

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[56] John Gardner, 'Torts and Other Wrongs' 39 (2011) FSULR 1, 25.
[57] Ludwig Wittgenstein, *Philosophical Investigations* (G.E.M Anscombe, P.M.S. Hacker and Joachim Schulte trs, Wiley-Blackwell 2009) §66; George Lakoff, *Women, Fire and Dangerous Things: What Categories Reveal about the Mind* (University of Chicago Press 1987) 16–17.
[58] *Agip (Africa)* (n 7) 291.
[59] Swadling (n 5) 304; *Fistar v Riverwood Legion and Community Club Ltd* (2016) 91 NSWLR 732 [45]. In a good illustration of the interpretivist method, whereas Millett J clearly distinguishes between ID and KR as distinct heads of liability (291), Swadling suggests that Millett J is 'best' read as saying that KR is a sub-species of ID (308–309).
[60] (1872–73) LR 15 Eq 204 (Court of Chancery) 211.
[61] Wesley Newcomb Hohfeld, 'Some Fundamental Legal Conceptions as Applied to Judicial Reasoning' (1913) 23 YLJ 16, 30.

sue C for ID – which may result in an order for equitable accounting.[62]

Whereas Birks's UE theory of KR straddles prescription and description, Swadling's interpretation of the present law of KR is more prescriptive. Accordingly, Swadling should be read not as attempting to explain the present law of KR within the ID model but as contending that the present law of KR would be better justified if it were subsumed under the law of ID as set out in *Lee*.[63] The argument in this section is that the ID model does not justify the law of KR because it fails to offer a compelling reason to reformulate the law of KR in accordance with this theory. There are two specific objections.

First, Swadling argues that one of the benefits of analysing KR as a form of ID is that this reading removes the need for receipt to be 'beneficial'.[64] In the context of KR, 'beneficial' means that the recipient is *not* a mere conduit or passive custodian for another, such that they may justifiably be held accountable in Equity.[65] This argument has two sides.

On the one hand, Swadling states that Millett J's motivation for introducing the beneficial receipt requirement in *Agip (Africa)* was the protection of banks from KR.[66] However, he notes, since banks always give value in exchange, they would usually be Equity's darlings. The beneficial receipt requirement therefore does no work in this context. There are two replies. First, the bona fide purchaser for value without notice defence is

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[62] Stephen A. Smith, *Rights, Wrongs, and Injustices: The Structure of Remedial Law* (OUP 2019).
[63] *Lee* (n 59).
[64] Swadling (n 5) 329.
[65] *Agip (Africa)* (n 7) 291–292.
[66] Swadling (n 5) 314.

only available when the bank does not have knowledge of breach of trust – in such a case, the bank could not be liable for KR anyway.[67] Accordingly, *pace* Swadling, the beneficial receipt requirement does have a real function insofar as it prevents banks with knowledge of breach being liable for KR.[68] Second, *even if* Swadling's criticism *did* run in the specific context of banking, the objection is too narrow because the consequence of abolishing the beneficial receipt requirement would be to overturn the global custody regime for intermediated securities, which presently depends on bare custodians not being liable.[69]

The second side of Swadling's argument against the beneficial requirement is his claim that this requirement can produce 'bizarre results'.[70] Imagine that A holds shares on trust for B. In breach of trust, A transfers those shares to C to hold on trust for D. C will not be liable for KR even if (s)he has actual knowledge of the breach because his/her receipt is not 'beneficial'. It is doubtful whether this result is as 'bizarre' as Swadling thinks it is. First, it is unclear why C should be liable for KR in circumstances where C is prevented by law from enjoying that property. Second, it is equally unclear why Swadling would want to distort the law of KR when, there are sufficient remedies for this type of situation – C may already be liable for DA, the

[67] *Tourville v Naish* (1734) 3 P Wms 307; *Snell's Equity* (34th edn, Sweet & Maxwell 2019) [4-027]–[4-039].

[68] Gleeson argues that this should still not be the case because a bank does not merely 'hold' moneys paid into a bank account with it; it uses them ('The Involuntary Launderer: The Banker's Liability for Deposits of the Proceeds of Crime', in Peter Birks (ed) *Laundering and Tracing* (OUP 1995) 126–127).

[69] Ben McFarlane, 'Intermediated securities: taking stock' (2016) 31 JIBFL 359.

[70] Swadling (n 5) 314–315.

trust assets may be traceable, and B would have a claim against D in KR if D knew of A's breach of trust.[71]

The *second* specific objection against Swadling is that the corollary of claiming that KR is a species of ID is that the 'gist' of the action is no longer receipt but C's breach of duty to deal with the property consistently with the trust.[72] It follows that the ID theory narrows the scope of liability such that C is only liable for a breach of a duty to deal – not for receiving the assets.

Swadling claims that this contraction of liability has the advantage of removing a claim for KR when rights are lost without fault on C's part.[73] Consider the example of the individual C who innocently received assets they subsequently discovered were trust assets. C takes steps to prevent the assets being dispersed but the assets are stolen.[74] For Swadling it would not be just to hold C liable for KR in such circumstances. There are two responses. First, hard facts make bad law: adopting the ID model is more undesirable than finding C liable in such a case because it would allow C to escape liability on facts such as *Relfo Limited (In Liquidation) v Varsani*.[75] Second, it would be possible to create a

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[71] *Bracken Partners Ltd v Gutteridge* [2003] EWCA Civ 1875, [2004] 1 BCLC 377 [12]–[16].

[72] *Novoship* (n 5) [89]. It is also worth noting, in this regard, the ocean of judicial dicta to the effect that the liability is to return assets as soon as they are received: *Independent Trustee Services v GP Noble Trustees* [2012] EWCA Civ 195, [2013] Ch 91 [81]–[82]; *Arthur v Attorney General of the Turks and Caicos Islands* [2012] UKPC 30, [37]; *Williams (n 43)* [31].

[73] Swadling (n 5) 329.

[74] *National Bank of New Zealand Ltd v Waitaki International Processing (NI) Ltd* [1999] 2 NZLR 211 228–229.

[75] *Relfo* (n 25).

specific defence for such particular circumstances without altering the requirements of KR.[76]

II. Equitable Wrong

This section contends that KR is best analysed as a *sui generis* equitable Wrong such that KR and DA work together as part of a coherent scheme of liability from *Barnes v Addy*. The specific worry that the equitable Wrong theory is inconsistent with the language of 'constructive trusteeship' in KR is handled in Part B of this paper.

On the Birksian definition of a Wrong, the equitable Wrong analysis is as follows: the fact of knowing receipt generates a duty-right jural relation between B and C such that C comes under an immediate and primary duty to B either to return the trust property *in specie* or to pay its current value. C's duty corresponds with a claim-right in B that C does either return the trust property *in specie* or to pay its current value. C is liable for the equitable Wrong of KR when C breaches this primary legal duty. Breach of this primary duty then generates secondary entitlements, namely B's power to sue C.[77]

(1) Explains

The equitable Wrong model explains the present law of KR (in such a way as to make a probable prediction of the way a future case would be decided) because it accords with the reasoning of past cases about KR and provides a reason for outcomes in those cases. There are four points to note.

First, treating KR as its own *sui generis* equitable Wrong allows us to respect the substantive requirements of KR: there is

[76] *National Bank of New Zealand Ltd* (n 73).
[77] Smith (n 61).

no need to deny the positive requirements of knowledge and beneficial receipt.[78]

Second, the substantive analysis of the courts (although obiter) supports the equitable Wrong analysis. In *Macmillan Inc v Bishopsgate Investment Trust Plc (No.3)*, Millett J states that, in a claim of restitution for a Wrong, B relies on 'an equity … [following a] breach of fiduciary or other obligation…which may in appropriate circumstances give rise to a constructive trust'.[79] This passage was recently approved – but distinguished – as an analysis of KR in *Byers v Samba*[80] and echoed in *FM Capital Partners Ltd v Marino (No 2)*.[81] On this reading, as is stated by Fancourt J in *Byers*, C's 'obligation' to B arises because C has received B's property in the knowledge that it belongs to B.[82] Consequently, a duty-right jural relation arises between B and C such that C has a secondary duty either to restore the trust property *in specie* or to pay its current value.

Third, the formal wording of the courts' analysis accords with the equitable Wrong model. For example, in *Fiona Trust & Holding Corp v Privalov*, Andrew Smith J states that KR is a 'wrong'.[83] In *FM Capital Partners Ltd v Marino* (No 1), both counsel argued, and Cockerill J was prepared to assume, that KR 'was not a "pure unjust enrichment" claim but a claim relating to a wrong'.[84] Finally, in *OJSC Oil Co Yugraneft v Abramovich*

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[78] *Re Montagu* (n 25).
[79] [1995] 1 WLR 978 (Ch) 988–989.
[80] *Byers* (n 8) [77]-[82].
[81] *FM Capital Partners Ltd v Marino (No 2)* [2018] EWHC 2905 (Comm) [66].
[82] *Byers* (n 8) [110].
[83] [2010] EWHC 3199 (Comm) [69], [159]. Such language is also present in *Hotel Portfolio II UK Ltd (In Liquidation) v Ruhan* [2020] EWHC 233 (Comm) [2].
[84] [2018] EWHC 1768 (Comm) [455], [482].

Christopher Clarke J concluded that the *lex fori* could not be the appropriate choice of applicable law because KR is an 'equitable wrong'.[85]

Fourth, the equitable Wrong view brings symmetry to KR and DA. In *Barnes v Addy*, Lord Selborne LC held that KR and DA are the only two causes of action which, when successful, render C liable as a 'constructive trustee'.[86] Subsequent cases have rationalised KR and DA as two 'limbs' for the same test of whether liability should be imposed on a third party following breach of trust.[87] DA has been explained as an 'equitable wrong' since *Dubai Aluminium Co*.[88] However, this label has not been applied to KR at the highest level. If KR and DA are indeed two limbs of the same test, then the equitable Wrong analysis brings coherence back to the caselaw.

One objection to the equitable Wrong model of the present law of KR is that there is no ratio authority in support of this theory, nor is there authority above the High Court. There are two responses. *First*, a rough search of Westlaw indicates that few cases on KR have progressed beyond the High Court since 2000.[89] In this context, in terms of ascertaining the present law of

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[85] [2008] EWHC 2613 (Comm) [178]–[179], [262].
[86] *Barnes* (n 10) 251–252.
[87] *Williams* (n 43) [9]; *Montagu* (n 25) 271; *Farah* (n 32) [112].
[88] *Dubai Aluminium Co Ltd v Salaam* [2002] UKHL 48, [2003] 2 AC 366 [9], [104].
[89] A search of Westlaw using the Subject/Keyword 'knowing receipt' indicates that, since 2000, 9 cases have reached the Court of Appeal and 1 to the Privy Council: *Varma v Atkinson* [2020] EWCA Civ 1602, [2021] Ch 180; *Arcadia Petroleum Ltd v Bosworth* [2016] EWCA Civ 818; *Otkritie International Investment Management Ltd v Urumov* [2015] EWCA Civ 1578; *Jemai v Otkritie International Investment Management Ltd* [2015] EWCA Civ 766; *Relfo* (n 25); *Gabriel v Little* [2013] EWCA Civ 1513; *Arthur* (n 71);

KR, the number of dicta in support of the equitable Wrong model (and the absence of contrary dicta) is significant. *Second*, it is worth pointing out that to the extent that the equitable Wrong theory is not supported by ratio authority, neither is Birks's or Swadling's interpretation of the law of KR.

(2) Justifies

The crux of the issue in relation to justifying the equitable Wrong model of KR is what makes the knowing receipt of property a 'Wrong'. Why, in other words, does the law intervene when C interferes with B's property in this way? This paper submits that the Wrong in knowing receipt is C's knowledge of A's breach of trust.[90] When C chooses to beneficially retain B's trust assets with such knowledge, a primary duty-right jural relation is generated between B and C. The moral justification for this jural relation arising is that C has chosen to intrude into the autonomy of B by interfering with B's trust assets and infringe B's rights to freedom and equality in a fundamental way.[91] C is therefore liable via the secondary duty either to restore the trust property *in specie* or to pay its current value.[92]

Uzinterimpex JSC v Standard Bank Plc [2008] EWCA Civ 819; *City Index Ltd v Gawler* [2007] EWCA Civ 1382, [2008] Ch 313; *MT Realisations Ltd (In Liquidation) v Digital Equipment Co Ltd* [2003] EWCA Civ 494. No cases have reached the House of Lords or Supreme Court.

[90] *BCCI* (n 9) 455; *Byers* (n 8) [110]; *Williams* (n 43) [31]; Matthew Conaglen & Amy Goymour, 'Knowing Receipt and Registered Land' in Mitchell (ed) *Constructive and Resulting Trusts* (Hart 2010) 172; cf fn 5 on purely fiduciary claims for KR.

[91] David Owen, 'Philosophical Foundations of Fault in Tort Law' in David Owen (ed) *The Philosophical Foundations of Tort Law* (OUP 1995) 220–223.

[92] It must be noted that there are (at least) three cases (*Belmont Finance* (n 6) 419; *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch) [1577];

Even if it is possible to justify KR in this way, one might still wonder whether it is necessary to have a separate head of liability, given the likelihood of C being liable for DA and an equitable tracing claim. The reply is that even though claims in DA and KR often overlap, there are occasions in which neither DA nor equitable tracing are available on facts where KR would be available and where moral theory would argue for a claim.[93] A theoretical example might be where C is not liable for dishonest assistance or equitable tracing because – although C beneficially received B's assets with knowledge of A's breach of trust – C's receipt of the assets did not 'assist' the breach and the assets have subsequently been stolen such that they cannot be traced.[94] In such a situation, KR is the only means to imposing liability upon C.

2. The Constructive Trust Debate

Part 1 of this paper articulated a conceptual model of KR as an equitable Wrong. Part 2 considers the objection that this model cannot be reconciled with the language of 'constructive trusteeship' widely used in KR.[95] This paper does not suggest (à la Mitchell & Watterson) that the knowing recipient, C, is a 'true' constructive trustee. Rather, the formula of 'being liable to

Akita Holdings Ltd v Attorney General of the Turks and Caicos Islands [2017] UKPC 7 [2017] AC 590 [17], [37]) in which the language of accounting is used to describe a claim in KR. However, if the Narrow Argument (*infra*) is correct, the language of accounting cannot be right.

[93] Cf fn 43.

[94] *Brinks Ltd v Abu-Saleh (No.3)* [1996] CLC 133 149; *Twinsectra* (n 43) [107].

[95] *Montagu* (n 25) pass.

account as a constructive trustee' is defended on the basis that it ties the Wrong of KR to the original trusteeship.

A. Explains

I. The Broad Argument

The Broad Argument is so called because it is an argument against the use of the language of 'constructive trusteeship' *generally* (as opposed to specifically in relation to KR). It is necessary to rebut this argument because the general language of 'constructive trusts' is essential for the formula 'as a constructive trustee' to retain its meaning.

Swadling contends that the terminology of 'constructive trusteeship' is a 'fiction' which should be replaced with a formula for C to 'pay money'.[96] According to him:

> (i) The question is whether orders to pay money or convey particular rights are properly described as trusts.[97]
>
> (ii) To answer this question, we require an accurate definition of a trust.
>
> (iii) For this purpose, an express trust can be treated as the central instance of a trust.[98]

[96] William Swadling, 'The Fiction of the Constructive Trust' (2011) 64 CLP 399, 405–406. NB Swadling never defines 'fiction'.
[97] ibid 405.
[98] ibid 407.

(iv) A necessary (but not invariably sufficient) condition of an express trust is that 'one person [C] hold[s] rights for another [B] or for a purpose'.[99]

(v) The constructive trusteeship of KR does not involve C holding rights for B or for a purpose.[100]

(vi) Therefore, a knowing recipient is not a trustee.

The Broad Argument hinges on identifying a core 'stick' in the bundle of 'trust' rights/duties. Swadling is not claiming that the presence of this core stick is a sufficient condition for a trust. His assertion is that this duty/right is necessarily present in the core instance of the trust. Since this duty/right is not present in the constructive trust such a trust cannot be a core instance of the trust.

There are two responses to Swadling. *First*, it is worth noting the scope of the argument. Swadling sets out to prove that a 'constructive trust' is not a trust.[101] However, this is not something the argument can establish. The most that Swadling can say is that a 'constructive trust' is not a central instance of a trust, *not* that a 'constructive trust' is not a trust at all.

The *second* objection has two parts. If, on the one hand, Swadling nominates 'holding rights for another or for a purpose' as the core stick of a trust in order to exclude 'constructive trusts', then Swadling is guilty of begging the question.

If, alternatively, Swadling was looking for a right/duty that is present in express, resulting, constructive, and bare trusts, and settled on 'holding rights for another or for a purpose'

[99] ibid.
[100] ibid.
[101] ibid 405–406.

because it was (at least) present in express, resulting, and bare trusts, then, with respect, Swadling has forgotten the primary duty to account to the beneficiary.[102] This duty has a better claim to being the core stick because it is present in constructive trusts as well as express, resulting, and bare trusts.[103] The duty to account derives from the overall duty of the trustee to give primacy to the 'performance interest' of the beneficiary under the trust.[104] It ensures performance of the trust and distinguishes the institution of the trust from torts, which impose secondary duties of compensation in lieu of performance.[105]

II. The Narrow Argument

The Narrow Argument is an objection to the language of 'constructive trusteeship' particularly in relation to KR. If the core stick in the bundle of trust rights/duties is the primary duty to account, the following paradox arises: when the law labels C (the knowing recipient) a true 'constructive trustee' it signals that C has a primary duty to account to B for which no breach of legal duty is required. Nevertheless, the equitable Wrong analysis above was that KR was a Wrong for which breach of primary duty was required. It is impossible to maintain both.

The reply is that, even if the core stick in the trust bundle is the duty to account, as a matter of positive law the knowing

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[102] *Libertarian Investments Ltd v Hall* [2014] 1 HKC 368 [167]-[172]; *Ultraframe* (n 90) [1513].

[103] Swadling (n 94) 408; *Lewin on Trusts* (n 5) [8-011], [41-002]. This contention is supported by an abundance of judicial dicta: *Williams* (n) [9], [55]; *Paragon Finance plc v DB Thakerar & Co* [1999] 1 All ER 400 (CA) 409.

[104] Luisa Ho & Donal Nolan, 'The Performance Interest in the Law of Trusts' (2020) 136 LQR 402, 402.

[105] ibid 420–421.

recipient (C) is not labelled a true 'constructive trustee'.[106] There are cases in which this terminology is used.[107] But the weight of authority supports a different formula: namely that C is liable '*as* a constructive trustee'.[108] This has been clear since *Barnes v Addy* where Lord Selborne LC states that the knowing recipient is 'not properly [a] trustee' In other words, the Narrow Argument is a false dichotomy: the courts do not say that C is a true 'constructive trustee' and they do not, therefore, ascribe the primary duty to account to C. With the formula 'as a constructive trustee', the courts merely liken the knowing recipient, C, *to* the 'constructive trustee' such that C is liable *as* or *like* a 'constructive trustee'.

B. Justifies

With the Broad and Narrow Arguments out of the way, the question remains: why do the courts persist in saying that C must account 'as a constructive trustee'? The reason is likely historical. Though the Courts of Equity did not have a general power to make money awards, they did have the ability to make them against defaulting trustees.[109] The Courts therefore used the language of 'as a constructive trustee' as a 'formula for equitable relief'.[110]

The main argument against this formula is that if the language is a historical accident which does not refer to C's and

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[106] Mitchell & Watterson (n 11) 130–132.
[107] Cf fn 90; cf Swadling (n 94) 412.
[108] *Paragon Finance* (n 101) 409; *Williams* (n 43) [31]; *Montagu* (n 25) pass; *Byers* (n 8) [41]; *Uzinterimpex* (n 87) [37], [38], [42]; *Gawler* (n 87) [7]; *Arthur* (n 71) [34]; *Selangor* (n 5) 1582; Swadling (n 94) 412–413; *Lewin on Trusts* (n 5) [8-012].
[109] Swadling (n 94) 412.
[110] *Selangor* (n 5) 1582.

B's actual jural relation it is 'meaningless and superfluous and…apt to confuse'.[111] Consequently, the language should be replaced with a simple formula for C to 'pay money' to B.[112] This paper contends, on the contrary, that the language does more good than harm because it ties the Wrong of KR to the original trusteeship. On this view, linking back to the equitable Wrong analysis in Part 1, the label of 'as a constructive trustee' has a *modal* (rather than *substantive*) function in that it morally justifies the imposition of liability on C by the *way* in which C commits the Wrong.

There are two aspects to this modal function. *First*, the formula serves a justificatory function in that it provides a moral justification for the source of C's liability in KR, namely, C's commission of the Wrong of deliberate and knowing interference with the original trusteeship. The label therefore reflects the extent to which Equity supervises the original trust between A and B.[113] This justificatory aspect is lost with Swadling's proposed 'order to pay money' formula because that proposal makes no distinction between KR liability and, for example, an action on a debt or action for breach of contract.

Second, the formula serves a communicative function insofar as it tells C that civil wrongs do not pay. Equity likens C to A in order to convey the Court's moral opprobrium towards C's behaviour. To that extent, the formula operates like the label of 'punitive' or 'exemplary' damages.[114] This communicative aspect is lost on Swadling's suggestion because an 'order to pay money' does not convey any sense that C has committed a

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[111] Andrew Burrows, *The Law of Restitution* (OUP 2012) 418.
[112] Swadling (n 94) 405–406.
[113] *Morice v Bishop of Durham* (1805) 10 Ves Jr 522, 539–540.
[114] *Broome v Cassell & Co Ltd* [1972] AC 1027 (HL) 1073 (Lord Hailsham LC).

particular Wrong involving the breach of the original trust. Thus understood, the language of 'constructive trusteeship' is arguably apt to justify rather than 'confuse'.[115]

There are two further objections against the formula. *First*, the caselaw makes clear that a KR claim can be grounded *either* on a duty of true 'trusteeship' and receipt of trust assets *or* a dissipation of assets in breach of fiduciary duty: how can the language of 'constructive trusteeship' serve a modal function if there was no trust in the first place?[116] One response is that, even if there was properly no trust, property subject to fiduciary duties is regarded for the purposes of KR as 'trust property'.[117] In other words, the peripheral instance of KR involving property subject to fiduciary duties shares the same justification as the core instance of KR based on breach of trust.[118] Thus the label of 'as a constructive trustee' is appropriate.

Second, one might argue that we do not need the (contested) terminology of 'constructive trusteeship' to perform this modal function: the court could label the knowing recipient, C, a 'custodian' or 'steward' of the assets. The problem with this suggestion is that it no longer ties C to the original trust; the original trust was not a 'custodianship' or a 'stewardship', it was a

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[115] Burrows (n 110).

[116] Cf fn 5.

[117] ibid.

[118] As *Lewin on Trusts* (n 5) [8-018]) notes this is more than a fiction. Fiduciaries (A) with possession or control of B's property are in an analogous position to true trustees because (although property is not vested in A) they claim no personal interest in it, and are treated as if they were true trustees, including their accountability for abusing the trust and confidence reposed in them. It is also worth noting that such fiduciaries were called express trustees before 1890, and for the purposes of the Limitation Act 1980 they are in the same position as trustees duly appointed with the trust property vested in them.

'trusteeship'.[119] Hence, C can only be likened to a 'trustee'. The question then arises: why is C liable 'as a *constructive* trustee' not 'as a trustee'? One reason is that C differs from a trustee in that C has not voluntarily subjected themselves to trust duties; rather, as in a 'constructive trust', the duty to account has been imposed by law by reason of C's conduct.[120]

Conclusion

This paper makes two contributions to the existing literature. The *first* contribution is as an analysis of the law of KR through the lens of doctrinal scholarship, as opposed to interpretivism. It has been suggested – in the mode of doctrinal scholarship – that it is possible to explain and justify the present positive law of KR within the Birksian taxonomy as an equitable Wrong such that KR and DA work together as part of a coherent scheme of liability from *Barnes v Addy*.

The *second* contribution is the suggestion that it is possible to 'explain' and 'justify' the present positive law of KR without excising the language of 'constructive trusteeship': although the equitable Wrong theory is incompatible with 'true' constructive trusteeship (à la Mitchell & Watterson), it is consistent with the terminology of 'as a constructive trustee' (a general formula for equitable relief).[121] It was argued that the formula 'as a

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[119] On occasion, the courts do use the language of 'custodial duties' as a synonym for 'trust' duties: *AIB Group (UK) plc v Mark Redler & Co Solicitors* [2014] UKSC 58, [2015] AC 1503 [39]; *Arthur* (n 71) [37].

[120] *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669 (HL) 705.

[121] Mitchell & Watterson (n 11).

constructive trustee' served the valuable modal function of tying the Wrong of KR to the institution that the law seeks to protect via KR: the original trusteeship.