Civil Liability for Money Laundering

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CIVIL LIABILITY FOR MONEY LAUNDERING

“International fraud is a growth business. Electronic transfer of funds; the widespread use of nominee companies and offshore accounts; the increased sophistication of legitimate financial transactions; and the reluctance of bankers and professional men to inquire into their clients’ affairs; all contribute to the ease and speed with which fraudsters can transfer substantial sums from one country to another and conceal their source and the identity of those who control them.”

1. Introduction

If a person is the victim of fraud he will wish to recover the money that he has lost. In such a case it will be scant comfort that the fraudsters are apprehended and tried by a criminal court. Neither will it help him if a bank or financial institution through which the funds were successfully laundered is fined or prosecuted for a failure to carry out proper identity checks, or to report suspicious transactions to the Serious Organised Crime Agency (“SOCA”). He is out of pocket and wants his money back.

There will be a claim against the original wrongdoers. However, in practice, fraudsters tend to be impecunious, or else disappear taking their gains with them, preferably to a jurisdiction without an extradition treaty or whose courts will not permit recovery of the proceeds of crime. Hence attempts by victims to recover their money from third parties alleged to be implicated in the fraud, or to have facilitated it in some way. Banks and other financial institutions are prime targets for such claims. There are many reasons for this. First, the theft and concealment of large sums of money will almost inevitably involve payments being made through such institutions. It is therefore relatively easy to allege that a bank or other financial institution was involved in laundering the proceeds. Secondly, such institutions have “deep pockets” and are therefore worth pursuing for the large sums involved. Finally, unlike the original wrongdoers, they have a fixed location, and cannot disappear to avoid judgment being entered against them.

The purpose of this Paper is to provide an overview of the civil law claims that may be made against a bank or financial institution that is alleged to have assisted in laundering the proceeds of fraud. The focus is on fraud, as opposed to other forms of money laundering, as only such claims have given rise to civil actions for damages. This is unsurprising as in other forms of money laundering there is unlikely to be a victim capable of bringing a civil claim, or else the person will be involved in the underlying criminal conduct. Thus in the case of drug money laundering, individual drug users cannot sue a bank that is alleged to have laundered the proceeds of drug dealing both on the grounds that the drug users have suffered no financial loss and also because they are party to the underlying criminal activity. Similarly, in the case of terrorism, the victims of terrorist attacks are unlikely to be able to establish a claim against financial institutions alleged to have held money under terrorist control owing to the lack of any nexus or causal link between holding such funds and subsequent terrorist atrocities. In the case of other crimes there is unlikely to be any causal link between the use of a bank account and the underlying criminal conduct.

This paper does not cover the disgorgement of the profits of criminal conduct under the confiscation regime established by the Proceeds of Crime Act 2002 (“POCA”). Instead the focus
is on claims under the general law. The conclusion is that the civil law has generally provided an effective tool for the recovery of the proceeds of money laundering, and is therefore a significant source of potential liability for banks and financial institutions.

1.1 Some important distinctions

A victim of fraud has a wide range of potential claims open to him, depending on what happened to his money and the involvement of the persons alleged to have participated in laundering it. These include claims in tort for conversion, conspiracy and unlawful interference in trade as well as claims in restitution on the basis that the defendant has been unjustly enriched. Equity provides personal remedies against third parties that interfere with trust property (which includes money stolen by directors or employees from a company). The type of claim that a claimant may bring depends on the facts of the case (Did the defendant receive the money? Was such receipt for his own account or for the account of others? Did he assist in paying it to third parties? Was he dishonest in doing so?) and the type of remedy that the claimant wants (Are damages sufficient or does the claimant need a proprietary remedy, for example because the defendant is insolvent?).

In understanding the potential liability of a bank or financial institution, it is necessary to make a few distinctions at the outset as these determine the nature of the remedy that a claimant may obtain. The most important are those between common law rights and equitable causes of action, and between personal rights and property rights.

1.1.1 Common law and Equity

The nature of the rights that may be asserted at common law and in Equity are often different. Briefly, Equity was a body of rules developed by the Court of Chancery in England before 1873 to correct, supplement and reform the common law. It did this by modifying the effect of certain legal rules (e.g., by holding that it was unconscionable in certain cases for a plaintiff to rely on common law rights), and by developing new remedies (e.g., rescission, specific performance, specific delivery). The characteristic institution of Equity is the trust, and when Equity wishes to impose liability on a person it typically does so by declaring that person to be a trustee, or else treating him as if he were a trustee (i.e., as a constructive trustee).

1.1.2 Personal and property rights

This distinction is often crucial. Property rights are rights in relation to a thing (a res). The distinguishing characteristic of property rights is that they are enforceable against the world generally. A person that interferes with property rights will incur liability to the owner of the property. Personal rights, on the other hand, are rights against a particular person or a class of persons. An example of a property right is ownership of land. An example of a personal right is a debt which gives the right to sue the debtor for non-payment. Property rights may also give rise to personal rights. Thus, if D deceives me into transferring my shares in company X to him then he will be personally liable to me in the tort of deceit for interference with my property rights.
The most important characteristic of property rights is that they endure. They will not normally be defeated by a third party’s interference with my property. Thus, if D steals my car and sells it, I can recover the car, or its value, from a purchaser from D. Further, and of particular relevance in a money laundering context, property rights will not be lost if the defendant becomes insolvent. So long as I can still identify my property (or, in certain cases, its traceable proceeds) I will be entitled to recover it, or its value, even if the defendant is insolvent. If, on the other hand, my property has been dissipated or destroyed then I will be limited to a personal claim for damages.

There are reasons other than priority in insolvency why a claimant may wish to assert a property right. Thus, if a fraudster has invested my money successfully, I may wish to strip him of his gains. If I have a proprietary interest in the money used to make the investment I may do so. Equally, there may be procedural advantages in bringing a proprietary claim. If the property is located within England, the defendant may be prevented by an injunction from dissipating the property until the claim is heard. Thus, banks may be subjected to an order preventing them from permitting transactions on an account which is alleged to be subject to a constructive trust.

1.1.3 Common law and equitable property rights

At common law there are two types of property right. You either own something outright or you have a security interest in it. The range of security interests is limited (e.g., a mortgage, a pledge, a lien). In general, at common law ownership follows possession, and remedies for interference with legal rights are usually based on interference with possession. As possession is open and transparent, liability for interference with legal rights is generally strict.

Equity was able, through the institution of the trust, to recognise a much wider range of property rights. The main technique was to say that although a person may have legal ownership of property it is subject to the beneficial interest of another person. In this way Equity carved a wide range of equitable interests out of the legal title. It follows that the holder of the legal title may be subject to claims from a number of other persons who are or claim to be beneficially interested in the property. In the case of a bank account, the legal owner is the account holder. However, in Equity the account may be subject to a number of third party interests in favour of persons beneficially entitled to the money.

The consequence of this is that equitable interests in property are often hidden, and it may be difficult for persons dealing with the legal owner to discover them. Hence the law has developed protections for persons dealing with the legal owner, of which the most important is that an equitable interest cannot be enforced against a purchaser from the legal owner who acts in good faith without notice of such equitable interests (the bona fide purchaser rule). For the same reason, Equity generally requires either “fault” or “notice” before imposing liability on a person for interference with equitable rights. A person who receives property subject to another’s equitable rights is not, without more, liable to the beneficiary, even if the person deals with the property in such a way as to cause the equitable interest to be lost. This is expressed in the maxim that Equity operates on the “conscience” of the legal owner. This distinction between the traditional fault-based approach of Equity, and the strict common law position, will be seen in the different remedies that the common law and Equity make available for money laundering.
1.1.4 Common law and equitable remedies

The common law provides a range of remedies for interference with legal rights. However, they normally only give rise to personal rights (i.e., a right to damages for interference with the right). As the law now stands, a person is not able to assert a direct common law claim to identifiable property other than land, although the court has a discretionary power to order the return of specific property that has been misappropriated. However, even if a person is not seeking a proprietary remedy he may need to show that he had a common law proprietary right at a point in time in the past in order to bring a personal claim against the defendant (e.g., a claim for damages for conversion depends on the defendant having had title to the property when the defendant interfered with it. However, the claimant need not still own the property when the action is brought).

Equity, on the other hand, provides both personal and proprietary claims in respect of misapplied property. If the victim can identify his property (or its traceable proceeds) in the defendant’s hands then he may be able to assert a direct proprietary claim. Such a claim will be available even if the defendant is insolvent as property rights are not defeated by insolvency. Equity also provides personal remedies against persons that interfere with equitable rights although, as stated above, such claims currently require proof of fault. Thus, a defendant will be liable if he dishonestly assists in a breach of fiduciary duty, or if he “knowingly” receives property that is beneficially owned by other people. The standard of knowledge required for these causes of action is controversial and it has been argued that a person should be strictly liable for interference with equitable property rights. It is unclear whether the law will develop in this direction, although if it did, this could have significant consequences in expanding the potential liability of financial institutions that receive money which represents the proceeds of crime.

1.2 Organisation of this paper

This paper provides an overview of the main claims that can be brought to recover the proceeds of fraud. To set the context, the next section describes, briefly, the duties that a bank or financial institution owes to its customer, and how this interrelates with the institution’s potential criminal liability for money laundering. The third section deals with common law claims and covers liability for conversion, deceit, conspiracy, unlawful interference in trade as well as for money had and received. The latter term is used, instead of the more common term restitution, as there exist a wide range of different causes of action that may lead to restitution. In this section the focus is solely on the common law personal claim to reverse unjust enrichment.

The fourth section deals with equitable causes of action. This addresses the liability of persons who assist in a breach of trust or fiduciary duty. The section also analyses the liability of banks and financial institutions for the receipt of moneys paid away in breach of trust or fiduciary duty. The fifth section considers property claims where the victim is able to assert continuing ownership of his property. The final section describes the circumstances in which a person whose property has been misapplied may assert rights in substitute assets that were acquired with the proceeds of his property.
2. The financial institution and its customer

The duties of a bank or other financial institution to its customer are briefly described below. There is a potential conflict between the institution’s duty to its customer (e.g., to honour a cheque, to transfer funds, to sell shares, etc.) and its potential liability to third parties for money laundering if it suspects that its customer may be acting unlawfully. The dilemma for the institution (in addition to the difficult questions it will face in relation to its potential liabilities under statute) is whether to comply with its customer’s instructions, and hence potentially expose itself to liability to third parties, or else refuse to do so and so risk action against it by its customer.

2.1 Duties of a banker to its customer

The primary duty of a banker is to comply with the terms of a customer’s mandate. This is a contractual duty and a bank will incur liability for breach of contract if it fails without a proper reason to give effect to its customer’s instructions. A bank is therefore exposed to a claim for damages if it refuses to repay a deposit, or to honour cheques drawn on an account. Alliott J. stated the traditional law as follows: (1) the bank is entitled to treat the customer’s mandate at its face value save in extreme cases; (2) the bank is not obliged to question any transaction which is in accordance with the mandate, unless a reasonable banker would have grounds for believing that the authorised signatories are misusing their authority for the purpose of defrauding their principal or otherwise defeating his true intention; (3) it follows that if a bank does not have reasonable grounds for believing that there is fraud it must pay; (4) mere suspicion or unease do not constitute reasonable grounds and are not enough to justify a bank in failing to act in accordance with a mandate; (5) a bank is not required to act as an amateur detective. This analysis must now be read subject to a bank’s duties under POCA.

2.2 Other financial institutions

Although the case law has mainly been concerned with the duties of bankers, other financial institutions can face the same dilemma. A stock broker, fund manager or financial advisor owes contractual duties including a duty of care to its customers, and will be liable to its customers for breach of contract if it fails to give effect to the terms of its customer agreement. If, however, the customer is using the financial institution to carry out a fraud, or to launder the proceeds of crime, then it may incur liability to the victims for facilitating the fraud. In such a case the institution will need to assess the likelihood of the risk, and then reach a judgement in the same way as a bank would.

2.3 Money laundering offences and the position of the financial institution

A further concern is the possibility of criminal liability where a financial institution suspects wrongdoing. A financial institution must not give effect to instructions from its customer if to do so would involve the institution committing a money laundering offence.
Under the statutory money laundering offences financial institutions, and banks in particular, can find themselves in the difficult position of having to notify SOCA of a suspicion about a customer, and to avoid committing a primary assistance offence by giving effect to that customer’s instructions, whilst at the same time seeking to avoid committing a tipping-off offence as a result of refusing to deal in accordance with the customer’s mandate.

Under the POCA it is an offence for a bank to enter into or become concerned in an arrangement known or suspected to facilitate by whatever means the acquisition, retention, use or control of criminal property:

“Thus a bank would commit an offence if it allowed ordinary banking business to be conducted in respect of funds suspected to be criminal property unless the bank had made an authorised disclosure under s. 338 and received the appropriate consent under s. 335.”

It is no defence to a charge of money laundering that the bank was contractually obliged to obey its customer’s instructions. In such circumstances the court said in *K. Ltd. v. National Westminster Bank plc (Revenue and Customs Commissioners and another intervening)*:

“If the law of the land makes it a criminal offence to honour the customer’s mandate in these circumstances there can, in my judgment, be no breach of contract for the bank to refuse to honour its mandate and there can, equally, be no invasion (or threatened invasion) of a legal right on the part of the bank such as is required before a claimant can apply for an injunction”.

It follows that absent relevant consent it is illegal for the bank to process transactions on the customer’s account. The difficulties that arose under previous legislation where customers sued their bank for non-performance of the terms of the mandate have accordingly been resolved in favour of the bank.

The practical effect of a bank suspecting money laundering and reporting its suspicions to SOCA is therefore to suspend the bank’s obligations to its customer under the mandate. It is not necessary for the bank to have to justify its suspicion through providing evidence. Nor will the court permit the cross-examination of an employee who entertained such suspicion. In the court’s view, the existence of suspicion is a subjective fact. There is no requirement that there should be reasonable grounds for the suspicion. It may be doubted whether this legislation has struck a fair balance between the interests of the Government in the suppression of financial crime and the rights of individuals to access their accounts and perform financial transactions without proof of actual wrongdoing.

3. Common law claims

This section sets out certain common law causes of action that are available to the victim of fraud. Apart from money had and received, these claims are likely to be mainly relevant to the original wrongdoers, as opposed to a bank or financial institution. They will therefore be considered briefly. The reason for considering them is that the liability of a bank or other financial institution is normally predicated on the existence of wrongdoing by the primary offender.
3.1 Conversion

Conversion is the unlawful appropriation of another person’s property, whether for that party’s own benefit or for the benefit of a third party. A defendant guilty of conversion is liable to pay damages equal to the value of the property converted. There is also a statutory power to order the return of the property where an award of damages would not be an adequate remedy. This is unlikely to be relevant in a money laundering context, as the claimant will be adequately compensated through repayment of the money with interest.

3.1.1 Types of conversion

Conversion covers the deliberate taking, receipt, purchase, sale, disposal or consumption of another’s property. Anyone who without authority receives or takes possession of another’s goods with the intention of asserting some right over them, or deals with them in a manner inconsistent with the right of the true owner is prima facie guilty of conversion.

3.1.2 What property can be converted

Conversion applies to interference with the ownership of chattels and money, but not things in action. It follows that it is impossible to bring a claim in conversion for the misappropriation of a debt, or of money held in a bank account, as these are things in action. This seriously restricts the use of the tort of conversion in combating money laundering, as this will usually involve the making of payments into and out of bank accounts. However, it may be possible to bring a claim in conversion in respect of a misappropriated banker’s draft, a cheque or a bill of exchange. Definitive bearer securities and money market instruments held in physical bearer form may also be converted. This will not be possible, however, if the instruments are dematerialised, or are held through an intermediary or a clearing system.

As conversion is based on an interference with property rights, it is only possible to maintain a claim if it can be shown that the defendant converted identifiable property. This presents a practical difficulty in the case of money as it will be very difficult to identify through whose hands individual notes and coins have passed (although each bank note has a unique serial number it is very uncommon to keep a record of this number and to trace its subsequent ownership). Further, even if it is possible to show that the claimant’s notes and coins ended up being paid across the counter of X Bank, it is likely that the claimant’s title to the money will by then have been lost. This is because the original owner’s title to money is extinguished once it has been paid as currency to a third party acting in good faith.

3.2 Deceit

It is in the nature of fraud to induce persons to part with their money by false representations. Most frauds will involve at some stage the making of dishonest statements. Examples include fraudulent representations in a company prospectus, ponzi schemes, boiler rooms, etc.
Deceit involves the making of a false statement which is intended to be relied on and is relied on by a person to his detriment. The statement must also be made fraudulently. A statement is made fraudulently if it is made knowingly, without belief in its truth or recklessly, careless whether it be true or false. It follows that a statement believed to be true, no matter how implausible, is not fraudulent. (In such circumstances, a person may be liable for negligence, although in this case it will be necessary to show the existence of a relationship of sufficient proximity between the parties.\textsuperscript{33})

A person who has lost money or other property as a result of fraud may sue the fraudsters for deceit. If he has been induced by fraud to enter into a contract he will also be able to avoid the contract and recover any money or property transferred under it.\textsuperscript{35} The problem with a claim in deceit, however, is that it only lies against the parties to the fraud. A bank or financial institution used by fraudsters will not be liable unless the institution itself has made fraudulent statements or was a willing party to the fraud.

\subsection*{3.3 Conspiracy}

A conspiracy consists “in the agreement of two or more to do an unlawful act, or to do a lawful act by unlawful means”\textsuperscript{36}. Conspiracy is also a criminal offence. There are two separate forms of the tort, although in practice only “unlawful means conspiracy” is likely to be relevant in this context as money laundering is necessarily an illegal activity.

The first type of conspiracy is an agreement to do an unlawful act causing loss (“unlawful means conspiracy”). There must be an agreement, combination or understanding between the parties to do the relevant acts. However, the conspirators need not all join in at the same time, nor need they have exactly the same aim in mind.\textsuperscript{37} In \textit{Commissioners of Revenue and Customs v. Total Network Services SL}\textsuperscript{38} the House of Lords held that criminal conduct could constitute unlawful mean, provided that it was the means of intentionally inflicting harm. That was so whether or not that conduct, on the part of an individual, would be civilly actionable. It follows that provided the conspiracy is directed at the victim and the unlawful conduct is the means of intentionally harming him, he will be able to sue in conspiracy. Money laundering is, of course, criminal conduct. Other crimes that could be relevant include a conspiracy to defraud, fraud under the Fraud Act 2006, insider dealing and market manipulation.\textsuperscript{39}

The second type of conspiracy involves an agreement to use lawful means to harm the claimant. In this case, it is necessary to show that the \textit{predominant} purpose of the conspirators is to injure the victim.\textsuperscript{40}

The tort of conspiracy may provide a remedy against the underlying wrongdoers. Indeed, there may be procedural and other advantages to a claimant in bringing a claim in conspiracy, rather than relying on individual unlawful acts.\textsuperscript{41} Further, “[t]o allege a conspiracy to defraud may describe the events in the fairest and most sensible way”.\textsuperscript{42} However, it is unlikely to provide a remedy against banks or financial institutions unless they are actively party to the fraud. A bank or financial institution that negligently fails to appreciate that its customers are intent on fraud will not be liable as a co-conspirator. Whether it can be liable in Equity as a constructive trustee is considered in the next section.
3.4 Unlawful interference in trade

This is a further claim that may be brought against the underlying wrongdoers. It is unlikely to be relevant to a bank or financial institution. The tort consists of (1) wrongful interference with the actions of a third party in which a claimant has a financial interest and (2) an intention thereby to cause loss to the claimant. The essence of the tort “is deliberate interference with the plaintiff’s interests by unlawful means”. In this context the “unlawful means” must be civilly, as opposed to criminally, actionable.

3.5 Money had and received (restitution)

The final common law claim is the action for money had and received. This claim exists to reverse a defendant’s unjustified enrichment. It is therefore available to reverse the enrichment of the original wrongdoers although in practice there will be a range of other causes of action available. It is also available against third parties that are unjustly enriched. Thus it is possible in this way to recover misapplied money from an innocent donee. Equally, a bank or financial institution that beneficially receives stolen money will be liable unless it can rely on a relevant defence. It is therefore a significant potential source of liability for banks and financial institutions.

A person is liable if (1) he has been enriched; (2) that enrichment was at the expense of the plaintiff; (3) there is no legal reason for him to retain the enrichment; and (4) no defence is available. A person will always be enriched by the payment of money. This applies as much to a bank or financial institution as to any other person who receives the proceeds of crime. This is because money that is paid into a bank account becomes the property of the bank. However, as is explained below, a bank may be able to invoke the defences of “ministerial receipt” or change of position where it has received money and has accounted for it to its customer.

The making of a mistaken payment, or the non-consensual transfer of funds, are paradigm examples of enrichment “at the expense of the plaintiff”. A large body of case law has developed setting out the situations in which the defendant may not retain an enrichment (referred to as “unjust factors”). These include payments made by mistake, under duress, as a result of an unconscionable bargain, or straightforward cases of theft. In practice it will be easy in a money laundering context to show that the misapplication was induced by an unjust factor, thereby triggering a **prima facie** obligation on the recipient to repay.

Where the money has passed through one or more bank accounts, or through payments made via a clearing system, then the original debt represented by the bank account will have ceased to exist. If the claimant wishes to bring a claim against a recipient whose account is credited with the proceeds of the fraud, he will need to rely on the doctrine of tracing to show that the money that ended up in the defendant’s account represents the proceeds of the money taken from his account. Tracing is considered in the final section of this paper.

It should be noted that unlike equitable claims (see below), liability at common law for money had and received is strict. It follows that a defendant will be liable from the moment of receipt. It is no defence that the defendant did not know or suspect that the money was stolen. A bank
or financial institution may therefore be liable even if it acts in complete good faith in crediting a customer's account with money that turns out, on examination, to represent the proceeds of crime. Neither need the bank still retain the money, or any traceable proceeds, at the time that the claimant brings his action. This is because the bank’s liability is a personal liability to make restitution for value that it should never have received as opposed to a property claim or a claim for damages for wrongdoing. Equally, a defendant may be liable even though the account holder became legally entitled to the money. This is illustrated by *Lipkin Gorman v. Karpnale*.

A partner in a firm of solicitors drew a number of cheques on the firm’s client account in order to fund his gambling. It was held that as the partner had actual authority to draw cheques on the client account he became entitled to the drafts. Nonetheless, the club at which the stolen money was gambled away was held liable in restitution (money paid under a wager being treated under English law at the time as a gift by the unsuccessful gambler to the club).

### 3.5.1 Defences

Given the scope of potential liability where a customer pays money into his account that represents the proceeds of crime, it is important for financial institutions to know the circumstances in which they will be able to rely on defences to mitigate the scope of this *prima facie* liability. Unfortunately, this area of law is complex and is likely to be subject to further refinement by the courts.

#### (i) Ministerial receipt

It is a defence for an agent that has received money in his capacity as agent if he has paid it over to his principal before acquiring notice of a third party’s claim to the money. In this case, the third party must sue the principal and the agent drops out of the picture. This is referred to as “ministerial receipt” as the agent receives the money as minister for his principal. The same principle applies to banks that receive money as agent for their customer. However, so long as the account between the bank and its customer is provisional, and is capable of being reversed, the bank is not able to rely on the defence. In *Kleinwort & Sons v. Dunlop Rubber* the House of Lords indicated that there needed to be some element of detriment before a bank could rely on this defence. Merely crediting a customer’s account was not enough as in that case the bank “had only got to run a pen through some private entries in their own books and the matter then would have stood in precisely the same position as it stood in before the mistake was made.”

However, once payment over to the customer has taken place then the defence will be available. In *Agip (Africa) Ltd v. Jackson* the defendant accountants set up a shelf company to facilitate the laundering of money stolen from the claimants. A cheque was fraudulently altered resulting in payment being made to the shelf company. The defendants received the money through their client account and then paid it on to the beneficiaries of the fraud overseas. The defendants were sued, amongst other claims, for money had and received. The court held that they had received the money as agent for the ultimate beneficiaries in accordance with whose instructions they had paid it on. They were therefore not liable for money had and received. Millett J. said that they “must be treated as being in the same position as an agent who has accounted to his principal. Money paid by mistake to such an agent cannot afterwards be recovered from the agent but only
from the principal". Equally, where the bank has altered its position on the faith of the payment then it will be able to rely on the defence.

(ii) Change of position

This is a defence "available to a person whose position has so changed that it would be inequitable in all the circumstances to require him to make restitution". In Lipkin Gorman, referred to above, the liability of the club to repay money stolen from the solicitors’ client account was limited to the club’s net winnings. As the club had paid out in respect of those bets that were successful it would be inequitable to require the club to repay to the solicitors the gross sum gambled away by the dishonest partner.

In the case of a bank or financial institution, the defence should be available where the bank has made payments to, or to the order of, a customer and the bank is no longer able to reverse those entries. Where a bank can, without detriment, reverse a credit entry to reflect the fact that it has made restitution to the claimant, the defence of change of position will not be available.

(iii) Bona fide purchase

Bona fide purchase is also a defence to a claim for money had and received. The effect of the defence is to give the purchaser a better title than the seller himself possessed. The circumstances in which a bank can raise bona fide purchase in respect of moneys credited to an account are, however, unclear. There is no authority on whether payment into an overdrawn account will support a defence of bona fide purchase by the bank. However, there would appear to be no reason in principle why such a defence should not be available, and the defence is recognised in respect of equitable claims. Where the account is in credit, the possibility of the bank being able to rely on this defence by crediting its customer’s account was rejected, albeit without detailed discussion, by Lords Templeman and Goff in the House of Lords in Lipkin Gorman.

4. Equitable claims

This section describes equitable claims that may be made against banks and financial institutions. After briefly setting out the remedies available against defaulting fiduciaries, the two main remedies for dishonest assistance and knowing receipt will be examined.

4.1 Remedies against defaulting fiduciaries

In the case of fraud against a company the wrongdoers, if directors or senior employees, are likely to owe fiduciary duties to the company. It follows that a company whose property has been misapplied will, in all probability, have a claim against the principal wrongdoers for breach of fiduciary duty. The identification of a breach of fiduciary duty is important if the victim wishes to bring a claim in Equity against third parties (e.g., a financial institution) for having assisted in that breach of duty. This is because such a claim will only be available where there has been a breach of fiduciary duty. It follows that where all that is alleged (or can be proved) is negligence
or a breach of contract then there will be no claim against a third party in Equity for dishonest assistance or for knowing receipt in "laundering" the proceeds.

Company directors are in a fiduciary relationship with the company. The same applies to agents of the company. Employees and managers may also owe fiduciary duties if they are in a position of trust and confidence and are given particular powers or discretions such that the company is in a position of vulnerability towards them.

The law imposes a number of duties on fiduciaries of which the most important are the following: (1) a fiduciary must not place himself in a position where his own interest conflicts with that of his beneficiary (the "no conflict" rule); (2) a fiduciary must not profit from his position at the expense of his beneficiary (the "no profit" rule); and (3) a duty of confidentiality. In the case of company directors, the scope of the directors' duties is further subject to modification under company law and is often restricted by the company's constitution. This falls outside the scope of this paper. However, as a general matter, company directors are required to exercise their powers in good faith to promote the success of the company, to exercise independent judgement, to obey the company's constitution and not to place themselves in a position where there is a conflict between their duties to the company and their personal interest.

If directors or employees of a company perpetrate a fraud on the company they will incur personal liability for breach of fiduciary duty as well as any criminal liability. Although in most cases the directors or employees will be acting dishonestly there is no requirement that this is the case for a director to incur liability. Thus in *Belmont Finance Corporation v. Williams*, directors honestly believed that a takeover was at a fair price and in the interests of the company. However, although honest, as the directors had used the company's own money, in breach of the prohibition on financial assistance in the Companies Act, they were found to have acted in breach of fiduciary duty. Equally, if a director has a personal interest in a transaction and fails to disclose it, then this will be a breach of duty even if he otherwise considers the transaction to be beneficial to the company.

On the other hand, mere negligence by the directors or employees in the performance of their duties is not a breach of fiduciary duty.

Where a director acts in breach of fiduciary duty he will be personally liable to the company for any losses caused by the breach. In the case of a director misapplying the company's property he will be liable to repay that money. If he has made a profit from the breach of duty then he will be liable to account to the company for the profit. Further, any property acquired by him that is derived from the misapplied funds will be held by him on a constructive trust for the company. The rules on tracing (see below) determine when property is "derived" from other property. Examples of a breach of fiduciary duty include a director receiving payments from the company that have not been properly authorised, misusing confidential information disclosed to him in his capacity as director to personally profit at the expense of the company, or the theft of the company's property which is then invested in an asset that increases in value.
4.2 Liability for dishonest assistance

Equity provides a remedy against third parties that assist in a breach of trust or fiduciary duty. Such persons are said to be liable as “constructive trustees”. However, this is merely a label and there is no requirement that the assistant receives or holds any property that has been misapplied.71 Neither is such a person a trustee in the proper sense, and he does not owe fiduciary duties to the victim of the breach of trust. His liability is instead to make good the loss that his assistance has caused.72

Originally, a claim was available only against those who “assist with knowledge in a dishonest and fraudulent design on the part of the trustees”.73 There were therefore two separate requirements. First, the breach of trust had to be “dishonest” and “fraudulent”. It followed that if the fiduciary had not acted dishonestly then the third party would escape liability no matter how dishonest he had been himself.74 Secondly, the third party had to have acted with “knowledge” of the relevant breach of trust. What amount of knowledge was required remained controversial, although broadly two lines of authority developed. Under the first line of cases, a person would be liable if he had actual or constructive notice of the breach of trust.75 A separate line of authority insisted on something more, requiring either actual knowledge of the breach of trust, or at least a want of probity on the part of the third party.76 This was generally equated with dishonesty.77

This controversy seemed to be resolved by the judgment of the Privy Council in Royal Brunei Airlines v. Tan.78 The Privy Council decided that it was not necessary that the breach of trust or fiduciary duty be dishonest or fraudulent. It was sufficient that the third party had assisted in the breach of duty. Secondly, the standard of liability for the third party is one of dishonesty:

“dishonesty is a necessary ingredient of accessory liability. It is also a sufficient ingredient. A liability in Equity to make good resulting loss attaches to a person who dishonestly procures or assists in a breach of trust or fiduciary obligation. It is not necessary that, in addition, the trustee or fiduciary was acting dishonestly, although this will usually be so where the third party who is assisting him is acting dishonestly.”79

It is therefore necessary to show: (1) a breach of trust or fiduciary duty; (2) assistance; (3) dishonesty; and (4) a sufficient causal connection.

4.2.1 A breach of trust or fiduciary duty

There must be a breach of trust or fiduciary duty.80 It is unclear whether the breach must involve a misapplication of property.81 In the context of money laundering this is irrelevant as laundering the proceeds of fraud will inevitably involve the misapplication of property.82

4.2.2 Assistance

Again this is unlikely to give rise to much difficulty in practice. A bank that launders the proceeds of crime is assisting in the relevant breach of fiduciary duty. This is because a breach of fiduciary duty involving the misapplication of money is not fully implemented until the funds have
been successfully concealed. In appropriate cases the receipt of money may also amount to assistance. Whether the bank has acted dishonestly is another matter.

4.2.3 Dishonesty

This is the area that has given rise to most difficulty in practice. In establishing a requirement for dishonesty Lord Nicholls seemed to lay down a “jury” test. In *Royal Brunei* he explained it as follows:

“acting dishonestly, or with a lack of probity, which is synonymous, means simply not acting as an honest person would in the circumstances. This is an objective standard. ... The standard of what constitutes honest conduct is not subjective. Honesty is not an optional scale, with higher or lower values according to the moral standards of each individual. If a person knowingly appropriates another's property, he will not escape a finding of dishonesty simply because he sees nothing wrong in such behaviour.

In most situations there is little difficulty in identifying how an honest person would behave. Honest people do not intentionally deceive others to their detriment. Honest people do not knowingly take others’ property. Unless there is a very good and compelling reason, an honest person does not participate in a transaction if he knows it involves a misapplication of trust assets to the detriment of the beneficiaries. Nor does an honest person in such a case deliberately close his eyes and ears, or deliberately not ask questions, lest he learn something he would rather not know, and then proceed regardless.”

A person is liable if he fails to act in the way that an honest and reasonable person would have acted in the circumstances. This does not mean that the person’s knowledge or beliefs are irrelevant. If a defendant believes that the transaction concerned is legitimate then it is not dishonest to proceed unless an honest man would have appreciated that it was fraudulent. Thus in *Heinl v. Jyske Bank* the defendant escaped a finding of dishonesty in respect of a complex money laundering scheme where he transferred funds through different accounts on the instructions of a rogue. He admitted that he did not know the purpose of the transactions and acted simply on the orders of the rogue. As all the transfers were effected at the same bank, nothing was being concealed. On the facts this would appear a generous finding, although the principle is surely sound.

In *Twinsectra v. Yardley* the House of Lords held that a subjective approach must be taken to the question of dishonesty. For a person to incur liability for dishonest assistance:

“it must be established that the defendant’s conduct was dishonest by the ordinary standards of reasonable and honest people and that he himself realised that by those standards his conduct was dishonest.”

Subsequently, in *Barlow Clowes International v. Eurotrust International Limited* the Privy Council considered that the House of Lords had not intended to reach such a conclusion:
“Their Lordships accept that there is an element of ambiguity in these remarks which may have encouraged a belief, expressed in some academic writing, that the Twinsectra case had departed from the law as previously understood and invited inquiry not merely into the defendant’s mental state about the nature of the transaction in which he was participating but also into his views about generally acceptable standards of honesty. But they do not consider that this is what Lord Hutton meant. 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.”

The Privy Council approved the approach of the trial judge that:

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

Further:

“Such a state of mind may consist in knowledge that the transaction is one in which he cannot honestly participate (for example, a misappropriation of other people’s money), or it may consist in suspicion combined with a conscious decision not to make inquiries which might result in knowledge.”

In the view of the Privy Council it seems that a person may be “dishonest” as a result of making a mistake as to what ordinary people regard as honest, or simply by giving no thought to the matter.

This raises an apparent conflict of authority between the House of Lords and the Privy Council. In Abou-Rahma v. Abacha [2007] All E.R. (C) 827 Arden L.J. considered that the Court of Appeal (and by implication other courts) should follow the Privy Council. Rix L.J. and Pill L.J. held that it was not necessary to resolve this issue. In Mullarkey v. Broad Lewis J. at first instance followed Arden L.J. However, in Attorney General for Zambia v. Meer, Care & Desai Peter Smith J. considered the discussion in Abou-Rahma to be obiter dicta and adopted the view of Lord Clarke M.R., writing extra judicially that:

“‘the test is an objective one, but an objective one which takes account of the individuals in questions characteristics’. I agree (as he really said) it is not appropriate to draw analogies with other areas. He went on to say: it is a test which requires a court to assess an individual’s conduct according to an objective standard of dishonesty. In doing so, the court has to take account as to what the individual knew; his experience, intelligence and reasons for acting as he did. Whether the individual was aware that his conduct fell below the objective standard is not part of the test.”

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Peter Smith J. considered that the majority and minority in *Twinsectra* had been at cross purposes and "did not believe that there was anything other than a misunderstanding as between the effect of the various judgments in *Twinsectra* which spawned a huge unnecessary debate". In his view "[e]ssentially it is a jury question as to dishonesty to be assessed in the light of all the material". This test was also followed by Teare J., with the agreement of counsel, in *Markel International Insurance Co Ltd v. Surety Guarantee Consultants Ltd*.94

If a bank knows that funds are being transferred to conceal their origin, then absent special facts, it will act dishonestly. In other cases, the transaction is likely to appear as a legitimate transition. It is only if the institution is put on inquiry that there will be any duty to inquire. In such a case, as Millett J. stated in *Agip*:

"Mr Jackson and Mr Griffin are not to be held liable for the misapplication of the plaintiffs’ funds because they failed to make inquiries which would have discovered the fraud, but because they dishonestly assisted in the misapplication. Their failure to make the inquiries which honest men would have made to satisfy themselves that they were not engaged in furthering a fraud is merely the evidence from which their dishonesty is inferred."95

4.2.4 A causal connection

The defendant’s actions must have some causative effect. However, in this case it "is no answer, either to say that he only participated in a part of a chain of events all of which led to the breach of trust, or to assert that the breach of trust would probably have occurred without his assistance".96 In an earlier case, it was held that a wife who accompanied her husband on trips to Switzerland to launder the proceeds of the Brinks Mat gold robbery did so in her spousal capacity and did not render any material assistance to the underlying money laundering operations.97

4.3 Liability for knowing receipt

The second head of equitable liability is for "knowing" receipt. As will become clear, both the role and scope of this claim remain subject to debate, and it is likely that the law will be subject to reconsideration and possible reformulation in the future. This cause of action has been one of the main means of pursuing banks and financial institutions which are alleged to have become involved in money laundering schemes.

The requirements for liability under this heading are “first, a disposal of [the claimant’s] assets in breach of fiduciary duty; second, the beneficial receipt by the defendant of assets which are traceable as representing the assets of the plaintiff; and third, knowledge on the part of the defendant that the assets he received are traceable to a breach of fiduciary duty”.98

4.3.1 Breach of fiduciary duty

The requirement is the same as for dishonest assistance. In practice, it is unlikely to be difficult to show a breach of duty where the claimant’s money has been paid away for an unauthorised purpose. Examples include a partner using partnership property to pay his private debts99 or an agent using the proceeds of sale of his principal’s property to discharge his personal overdraft.100
4.3.2 Beneficial receipt

The defendant must have received the claimant’s property (or other property that represents the traceable proceeds of the claimant’s property) beneficially.\(^{101}\) If the defendant never received any property, or did so as agent, then he can only be liable for dishonest assistance. Whilst this requirement is easy to state it is more difficult to assess when in fact it is met. “[A] defendant must have received [the property] in his or her own right, must have enjoyed the property beneficially. There is, thus, no cause of action in knowing receipt against a person who holds trust property merely as agent for a third party.”\(^{102}\) The difficulty that has arisen in practice is in determining whether a bank that is sued for knowing receipt received the money beneficially (in which case it may be liable) or as agent for its customer (in which case the claimant must sue the bank’s customer).

It is well established that the relationship between a bank and its customer is that of debtor and creditor.\(^{103}\) It follows that where money is paid into an account, the money becomes the bank’s own money and the customer is entitled to be repaid an equivalent sum in accordance with the terms of the mandate. It could therefore be argued that in all cases where money is paid into a bank account, the bank receives the money beneficially with the result that the bank is potentially liable if it turns out that the money was misappropriated.\(^{104}\) In fact, the courts have refused to endorse such an approach because it would impose extensive potential liability on banks.

In most cases the courts have drawn a distinction between the situation where money is paid into an account in credit and where money is paid into an overdrawn account. In the former case, the bank is considered to receive the money as agent with the result that the victim must sue the account holder, and not the bank, for knowing receipt. Where the account is overdrawn, however, the bank is said to receive the money beneficially and so is potentially liable. Millett J. explained the distinction as follows “[t]he essential feature … is that the recipient must have received the property for his own use and benefit. This is why neither the paying nor the collecting bank can normally be brought within it. In paying or collecting money for a customer the bank acts only as his agent. It is otherwise, however, if the collecting bank uses the money to reduce or discharge the customer’s overdraft. In doing so it receives the money for its own benefit.”\(^{105}\) Thus a bank will receive money paid into an account as agent when the account is in credit. Where, however, the account is overdrawn the bank is treated as having received the money beneficially.\(^{106}\)

4.3.3 Is the crediting of an overdrawn account always beneficial receipt?

The distinction referred to above is clear and, however arbitrary it may be, is capable of giving a clear answer and provides a measure of protection to banks. However, a number of commentators have argued that the protection is insufficient and that mere receipt of money into an overdrawn account should not amount to beneficial receipt. There should be something more before a bank can incur liability for knowing receipt. Suggested requirements are that the bank was pressing for payment\(^ {107}\) or that there was some conscious act of appropriation by the bank in reducing the overdraft.\(^ {108}\)
Either suggestion is difficult to accept. It is strange that a bank’s liability should turn on whether or not it was pressing for payment. The bank’s position is the same regardless of whether or not it was pressing for payment. Equally, a requirement that the bank make a conscious appropriation is problematic as a bank has little choice in whether or not to credit a payment made to an overdrawn account.

4.3.4 Credits made in foreign currency

There is some authority that a different rule applies depending on whether the account is credited in the same currency or in a different currency. In Polly Peck v. Nadir the defendant caused large sums of the plaintiff company’s money to be transferred to a company, IBK, controlled by him. IBK then deposited the money in an account with Midland Bank in the name of the Central Bank of Northern Cyprus (the “Central Bank”). In exchange, the Central Bank credited two accounts of IBK in Northern Cyprus. One of the accounts was denominated in sterling and the other in Turkish lira. It was argued for the plaintiff that the Central Bank was liable for knowing (i.e., dishonest) assistance or, alternatively, for knowing receipt. At first instance Millett J. was inclined to consider the case as one of knowing assistance. This is consistent with his judgment in Agip, as the Central Bank had credited the account of IBK in Northern Cyprus and had therefore given value for the deposit. On appeal Scott L.J. in the Court of Appeal drew a distinction between the sterling and the lira deposits. In respect of the sterling deposits, the Central Bank received the money as banker and therefore as agent for its customer, IBK. In respect of the lira deposits the position was different as “the Central Bank was exchanging Turkish lira for sterling and became entitled to the sterling not as banker for IBK but in its own right. IBK became entitled to the Turkish lira”.

The Court of Appeal therefore treated the credits in respect of Turkish lira in the same way as if the bank had sold goods (or travellers cheques) to IBK in exchange for the sterling deposits. The bank had not received the money as agent but beneficially. This approach has been criticised by most commentators. It is inconsistent with the modern approach that views foreign currency as money and not as a commodity. It also fails to recognise that the bank had given full value for the Turkish lira deposits in the same way as it had with the sterling deposits. In Nimmo v. Westpac Blanchard J. did not “pretend to understand the point of distinction”. The better view is that it makes no difference whether the account is credited in domestic currency or in a foreign currency.

4.3.5 The level of knowledge required

The defendant must “know” that the property is attributable to a breach of trust or fiduciary duty. What level of knowledge will suffice? Clearly, a bank with actual knowledge will be liable. Equally, if the institution believes the money to be stolen, or deliberately closes its mind to this fact, it will be liable. Such behaviour is dishonest. Where there has been more controversy is whether a defendant that acts carelessly can be liable as a knowing recipient.

Broadly, two approaches can be seen in the cases. On the one hand, many cases have insisted on conscious wrongdoing, or dishonesty, for the recipient to be liable. The contrary view, that constructive knowledge, or negligence, suffices for liability, has also attracted judicial support, although the trend of authority in recent years was in favour of requiring conscious
wrongdoing. The whole issue was reconsidered by the Court of Appeal in *B.C.C.I. (Overseas) Ltd v. Akindele*\(^{116}\) where the court concluded 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”\(^{117}\)

It is questionable whether a test formulated in such abstract terms will survive as it is difficult to see how an appeal to “unconscionability” will enable the court to give predictable answers.\(^ {118}\)

A number of the difficulties with the new test were discussed by the High Court in *Criterion Properties v. Stratford*.\(^ {119}\) As the judge explained:

“[I]t is clear … that the single test of unconscionability now applicable in knowing receipt cases is intended to be something different from the ‘dishonesty by an objective standard’ test applicable in a knowing assistance case. It is not obvious, simply as a matter of the language being used, whether making out a case of unconscionability (in the sense of the recipient’s conscience being affected) is supposed now to be easier, or harder, to make out than a case of … dishonesty. The latter is unquestionably an objective standard, albeit with subjective elements. But ‘unconscionability’ might be thought to be a wholly subjective standard.”

The judge concluded that unconscionability is a lower standard than dishonesty:

“That accords with one’s intuition: a person who has actually received stolen goods should be more vulnerable to being held accountable to the true owner for their value than someone whose actions have merely facilitated the theft … In my judgment, therefore, what *Belmont* and *Akindele* decide for present purposes is that actual knowledge of circumstances which make the payment a misapplication is sufficient to bind the conscience of the recipient. What is left open and undecided by either of these cases is the case where the recipient knows of circumstances which may on the one hand make the payment a misapplication but which may on the other hand be consistent with perfect propriety. Such a case might be determined on its particular facts by the principle that a party to a commercial agreement should not be fixed with notice simply because in a loose sense he has been put on inquiry. Close examination of the particular facts might in such a case be necessary.”

On appeal, the Court of Appeal stated that “the purpose of the new formulation was to give greater flexibility for the application of common sense in commercial situations”.\(^ {120}\) The court stressed each case had to be viewed in the context of the commercial relationship between the parties. The case was appealed to the House of Lords\(^ {121}\) which held that the dispute turned on ordinary principles of agency law. Knowing receipt was accordingly not relevant. However because of its inherent uncertainty, it is unlikely that the unconscionability standard will be accepted by the House of Lords or Privy Council when the issue arises for decision in a future case. That said, judges at first instance have so far been able to apply *Akindele* without difficulty.\(^ {122}\)
4.3.6 Should liability be strict?

A number of influential academic commentators have argued that the requirement for knowledge, or fault, on the part of the recipient should be abolished, and that a recipient of misapplied money should be strictly liable subject to defences. The result would be that a bank that receives money beneficially would be liable even if it neither knows nor ought to have known that the money was stolen. This argument, if accepted, would significantly increase the potential liability of banks and financial institutions. It would then be for an institution that receives the proceeds of crime honestly to raise a defence to the claim. Suggested defences include change of position, ministerial (i.e., non-beneficial) receipt and bona fide purchase. These defences were considered, briefly, above when discussing claims for money had and received.

There have been signs that a number of judges in the higher courts favour a strict liability approach. Courts have on several occasions accepted that the basis of knowing receipt is restitutionary. In El Ajou v. Dollar Land Holdings Millett J. stated that “I do not see how it would be possible to develop any logical and coherent system of restitution if there were different requirements in respect of knowledge for the common law claim for money had and received, the personal claim for an account in Equity against a knowing recipient and the equitable proprietary claim”. The Royal Court of Jersey has accepted the argument for strict liability. However, the contrary view has been expressed, both academically and by the judiciary.

5. Proprietary remedies

A victim may wish or need a proprietary remedy. The reasons for doing so include obtaining priority in an insolvency, taking the benefit of an increase in the value of an asset that represents the traceable proceeds of misapplied property, or an order for specific delivery of property. As mentioned above, proof of a proprietary interest may also be necessary to bring a claim in conversion or to provide the basis for a tracing claim. As in other areas of the law, it is necessary to distinguish between common law and equitable claims.

5.1 Common law proprietary claims

The range of remedies available at common law is very limited. This follows from the limited class of third party rights that exist at common law. Basically, at common law you either own something or you do not. A common law proprietary claim is therefore a claim to ownership of the asset. Further, common law property rights are generally protected indirectly by a claim in tort for interference with ownership (i.e., conversion). Such claims lead to a money judgment against the defendant but do not give title to any property in the defendant’s possession. It follows that the scope for common law proprietary remedies is quite limited.
For example, a bank balance is a chose in action representing a debt owed by the bank to the account holder. It can therefore be owned and be subject to a proprietary claim. However, as a debt owed by the bank it ceases to exist if the money is repaid to the account holder, or if the funds are transferred (properly or not) to third parties. Thus the effect of misapplication of the money will be that the original property will cease to exist.\textsuperscript{132} Whether the victim can assert common law or equitable rights in the proceeds is a matter for the law of tracing.

Money and bearer securities are negotiable instruments. It follows that they may be the subject of a common law claim although any proprietary rights will be lost once the money has passed as currency, or the bearer instrument has been acquired by a holder in due course.\textsuperscript{133}

5.2 Equitable proprietary claims

Unlike the common law, Equity has never had any difficulty in protecting proprietary rights directly. If I receive property in which you have a beneficial interest, then generally I will hold that property on a constructive trust. Fault, or notice, is irrelevant in this context, and the difficulties that the courts have faced in analysing the knowledge requirement in cases of knowing receipt do not apply. Similarly, if I buy property that is subject to an equitable proprietary interest then I will hold it subject to such interest unless I am \textit{a bona fide} purchaser for value. Of course, such rights are precarious as a person without knowledge or notice of the claimant’s rights is generally free to deal with such property and will not incur liability for doing so.

It follows that if money to which I am beneficially entitled is diverted to a third party then I will be able to follow that money and assert any continuing proprietary rights I have against any recipient other than a third party who acquired it for value and without notice.\textsuperscript{134} Equally, Equity is able to recognise lesser proprietary interests than full ownership. Thus a person who has a lien or charge over property will be able to assert the same right against a recipient of the property.

Where property has been obtained by fraud then the court may impose a constructive trust in favour of the victim.\textsuperscript{135} If the fraudster did not hold the property on constructive trust, the victim would have to prove alongside ordinary creditors because the assets would belong to the fraudster and therefore be available for such creditors.\textsuperscript{136} This underlines the importance of being able to bring a proprietary claim.

6. Tracing

This section describes the circumstances in which a person is able to assert a proprietary interest in a substitute asset that was acquired with the proceeds of the claimant’s property. In almost all cases involving the misapplication of money it will not be possible to identify the original notes to assert a continuing proprietary right to them as there will be no record of the serial numbers and the money will in any event have passed as currency. Further, in the case of the diversion of funds from a bank account there is no “transfer” of property; rather the debt owed by the bank to the customer whose account is debited is reduced or extinguished and in its place a new debt is created, either at the same bank, or another bank, in favour of the recipient of the money.\textsuperscript{137} In this case, the person whose account has been debited will need to trace the value represented by the debit from his account to the recipient’s account.\textsuperscript{138}
Often, a person will seek to trace in order to assert a proprietary right in an asset. Thus, in *Jones v. Jones* the creditors of a bankrupt partnership were able to assert that money that had been wrongfully taken by a partner from the firm, and given by him to his wife to engage in a successful speculation in commodities futures, was an asset of the partnership. The wife had paid the proceeds of the speculation into a new bank account opened for that purpose. The court declared that the bank account belonged to the partnership’s creditors.

However, it is not invariably the case that tracing will be used to support a proprietary claim. Thus if the claimant seeks to bring a personal claim which depends on his having had a proprietary interest at some point in the past then he will need to trace the money until receipt by the defendant. Examples are a claim for money had and received or for knowing receipt.

Traditionally there have been two different tracing rules: one at common law and another in Equity. It has been suggested by the House of Lords that the maintenance of two different sets of rules is unprincipled and that the same requirements should apply to common law and equitable tracing. Such a development seems likely to occur when a suitable case reaches the higher courts. However, at first instance, the courts continue to apply the traditional rules.

### 6.1 The nature of tracing

Tracing is a process, not a legal remedy. It “is the process by which the plaintiff traces what has happened to his property, identifies the persons who have handled or received it, and justifies his claim that the money which they handled or received (and if necessary which they still retain) can properly be regarded as representing his property.” It “identifies the traceable proceeds of the claimant’s property. It enables the claimant to substitute the traceable proceeds for the original asset as the subject matter of his claim. But it does not affect or establish his claim. That will depend on a number of factors including the nature of his interest in the original asset.”

Generally, a claimant will seek to assert the same rights or interest in the substitute asset that he had in respect of the original asset. Thus, if the claimant owned the original asset he will be entitled to ownership of all (or part) of the asset representing the traceable proceeds depending on the amount of his contribution to the substitute asset. In *Foskett v. McKeown* the defendant misused the claimants’ money to pay part of the premiums on his life assurance policy, and subsequently committed suicide. The beneficiaries under the policy were his children. The amount of the claimants’ money that had been wrongfully paid in premiums was significantly less than the percentage share of the total death benefit paid out by the insurance company that had been paid for by those premiums. The House of Lords held that the claimants could trace their money into the payment made by the insurance company and were entitled to a proportionate share of the proceeds of the policy.

### 6.2 Tracing at common law

Tracing at common law enables a person to assert proprietary rights in a substitute asset. It may also be necessary to trace at common law to bring a claim for conversion or for money had and received. Common law tracing is traditionally subject to a number of important limitations. As these limitations do not apply to equitable tracing a plaintiff will only rarely seek (or be able) to trace at common law.
First, a person cannot trace through a mixed substitution. The common law “could only appreciate what might almost be called the ‘physical’ identity of one thing with another. It could treat a person’s money as identifiable so long as it had not become mixed with other money. It could treat as identifiable with the money other kinds of property acquired by means of it, provided that there was no admixture of other money”. It follows that it is impossible at common law to trace money through a bank account when that account is credited with both the claimant’s money and money from some other source. Equally, if money is paid across the counter to a bank then it will not be possible to trace at common law against the bank as the individual notes and coins will have been mixed with other money.

Secondly, it is not possible to trace money through a clearing system. This is because when money is paid through a clearing system it is inevitably mixed with other money.

Thirdly, there is some authority that there must be a physical substitution with the result that the common law cannot trace through a telegraphic transfer. In this case there is only a “stream of electrons”. Tracing is, however, possible in respect of payments made by cheque provided that no mixing occurs.

None of these limitations apply in Equity. Common law tracing does, however, have one advantage over equitable tracing in that there is no requirement that there exists a fiduciary relationship between the parties. Thus in the case of straightforward theft, the better view is that a plaintiff can only trace at common law. Equally, where tracing is being used to support a claim in conversion or for money had and received, the plaintiff will be able to trace his value provided that it can be shown that the defendant received it through a series of clean substitutions. Thus in Lipkin Gorman the solicitors were able to trace the money stolen from the firm’s client account and gambled away at the defendant club as there had been no mixing of money, and the defendants were treated as donees (the gambling contracts then being void).

6.2 Tracing in Equity

A person may wish to trace in Equity in order to assert equitable ownership of, or a lien over, property held by the defendant. If the defendant has disposed of the property so as to leave no traceable proceeds, then the claimant may trace his property to receipt by the defendant in order to bring a claim for knowing receipt.

The merit of equitable tracing is its flexibility. There is no restriction on the types of assets that may be traced or on the transactions through which the tracing process may be conducted. However, under the traditional rules equitable tracing has one major limitation. This is the requirement that there must be a fiduciary relationship. This requirement has been subject to extensive criticism, and it is unlikely that it will survive examination by the House of Lords. It is, however, readily satisfied in most cases of corporate fraud, as the theft of a company’s money will almost inevitably involve a breach of fiduciary duty on the part of the company’s employees or agents.
The requirement for a fiduciary relationship will be met in three situations. The first is where the property already belongs in Equity to the claimant (e.g., the theft of trust property). The second is where the property is misappropriated by a person in a fiduciary relationship with the claimant (e.g., the embezzlement of a company’s property by a director). Thirdly, the requirement will also apparently be satisfied where the recipient receives the property subject to a constructive trust arising as a result of the receipt of the property.

Unlike the common law, Equity will permit a person to trace through a mixture, and has developed detailed rules to determine the ownership of mixtures of value. These rules differ depending on whether the claimant is tracing against a person who wrongfully created the mixture or against an innocent third party whose money was mixed with the claimant’s. Unsurprisingly, the rules are more onerous when tracing against a wrongdoer.

For banks and financial institutions the equitable tracing rules are a potent source of liability. This is because banks and financial institutions will frequently receive money or other property beneficially (e.g., shares or money market instruments) that become mixed with the bank’s own property. Thus whenever cash is paid over the counter to a bank the money becomes mixed with the bank’s money, bringing the equitable tracing rules into play. The same applies if a bank receives a telegraphic transfer, clears a cheque or buys shares from a customer. If the original money was subject to third party equitable interests, the bank or institution may be at risk of a claim for knowing receipt or dishonest assistance. If the claimant’s original property is still held by the bank, then it may be at risk of a proprietary claim for a constructive trust over that property.

6.3.1 Tracing against a wrongdoer

Where the claimant’s money is mixed with the money of a wrongdoer, then the interests of the wrongdoer are subordinated to those of the innocent contributor. This principle has a number of aspects.

First, if it is not possible to identify the share of the mixture contributed by the claimant and by the person who wrongfully created the mixture, then the claimant is entitled to the whole. In the case of money this is unlikely to be the case unless the relevant records have been destroyed. Any doubt as to the size of the parties’ shares will also be resolved against the wrongdoer.

Secondly, an innocent contributor is entitled, at his option, to claim either a proportionate share of the mixture, or else a lien for the amount of his contribution. If the asset has risen in value then the claimant will seek a proportionate share. If, on the other hand, the asset has depreciated, the claimant will want a charge over any remaining value. This could be relevant where the claimant’s money has been used to acquire an asset, for example, land or shares that have fallen in value.

Thirdly, any losses are borne in the first instance by the wrongdoer, that is, drawings are deemed to be made against the wrongdoer’s share. Although said to be a presumption of honesty, this is in fact a rule of law and it is not open to a wrongdoer to argue that he intended to dissipate the claimant’s share.
Fourthly, an innocent contributor can trace out of the mixture into any other asset that was acquired with the proceeds of the mixture. In *Re Oatway* a trustee mixed £3,000 of trust money with £4,000 of his own. The money was frittered away apart from £2,137 which was used to buy shares. The court held that the beneficiary could claim the shares as representing £2,137 of the trust moneys. The rest of the money had necessarily been dissipated. Thus if a money launderer mixes money in his account and then buys shares that rise in value, the defrauded victim can trace his value through the account into the shares and then claim, at his choice, either ownership or a lien over the shares. Where the proceeds are used to acquire a number of assets, then the victim can choose whichever of those assets he wishes to trace into.

Fifthly, where money is withdrawn from the account and subsequent payments are made into the account the claimant is restricted to the lowest intermediate balance. This can be illustrated by *Roscoe v. Winder*. The defendant collected a debt owed to the plaintiff and wrongfully paid it into his own account. He subsequently made withdrawals leaving a balance of £25 before making further deposits leaving a credit balance at his death of £358. The plaintiff claimed the £358. The court held that he could only identify £25 as the proceeds of the debt. The withdrawals from the account meant that the rest of the plaintiff’s money had been dissipated. The result will only be different if it can be shown that subsequent payments into the account were intended by the payer to make good previous withdrawals. This is hardly likely to occur in the case of money laundering. The result may operate harshly but is the necessary consequence of the rule that property rights must be rights in respect of something. If the thing is destroyed, or the account ceases to hold any value, then there is nothing left which the claimant can identify as representing his property. Neither will the court engage in an artificial exercise of combining different accounts that are in credit with an overdrawn account to create a notional credit balance into which a person can trace.

6.3.2 Tracing against innocent third parties

The rules are different in this case as there is no reason to subordinate the interests of third parties to those of the claimant. All have contributed to the mixture and as against each other none is a wrongdoer. This is most likely to be the case where the claimant’s value is mixed with the property of a bank or financial institution. Equally, where value is mixed by a third party in an account held with a bank, the account holder may find that he is subject to a tracing claim by persons who allege that their value was mixed in the account.

The basic rule is that where the value of several persons has been mixed, then each is entitled to a proportionate share. As between themselves, they have a joint co-ownership interest. This is a property right that can be enforced against the bank where the money is held (although not in the bank’s own insolvency).

More difficult questions arise when money has been withdrawn from the account.
6.3.3 Withdrawals by a wrongdoer from the mixture

If the money is held in a deposit account then the parties will share rateably in proportion to their contributions. Any withdrawals will result in the shares of each of the contributors being reduced rateably, although in this case the contributors may be able to trace into any value acquired with the proceeds of a withdrawal e.g., a purchase of shares.\textsuperscript{169}

A different approach has been taken in respect of money held in a current account. In this case, the courts have generally applied the “first in, first out” rule in \textit{Clayton’s Case}\textsuperscript{170}. This is a presumption, derived from banking practice, that where money is paid out of an active bank account the first money paid in is the first to be paid out. The effect is to prioritise the last claimant whose money is paid into the account, and who will therefore be paid in full (if sufficient value remains). The same rule has been applied by the courts in the case of the mixing of the claimant’s money with the money of an innocent donee (e.g., money given by a money launderer to his wife or children). In this case as both the donee and the victim of the fraud are innocent of any wrongdoing the “first in, first out” rule applies, and not the harsher rule where the mixing was with the wrongdoer’s own money.

\textit{Clayton’s Case} provides a solution to a factual problem of how to allocate losses in an active bank account. However, its rough and ready nature, and its prioritising of the claims of later contributors, has lead to it being widely criticised.\textsuperscript{171} It “apportions a common misfortune through a test which has no relation whatever to the justice of the case”.\textsuperscript{172} Recently, in \textit{Barlow Clowes International Ltd v. Vaughan}\textsuperscript{173} the Court of Appeal, whilst accepting its correctness as a general rule, held it to be inapplicable on the facts of the case.

A large number of investors had paid money to Clowes to invest in various mutual funds. Few investments were actually made and a significant percentage of the money was dissipated by Clowes to fund a lavish lifestyle. At first instance the judge decided that \textit{Clayton’s Case} applied. On appeal, the court decided that if the application of the rule would be impractical, or would result in injustice, or would be contrary to the intention of the investors, it would not apply if an alternative method of distribution was available. In the case the court decided that the remaining proceeds should be divided amongst the investors \textit{pari passu} without regard to the order in which contributions were made.

6.3.4 Withdrawals by innocent contributors

If neither party is a wrongdoer, the better view is that a contributor to the mixture is entitled to withdraw his share. The effect of such a withdrawal is that the mixture is separated (unless the claimant takes more than his share) with the result that any further losses will be apportioned amongst those whose contributions remain mixed.\textsuperscript{174} “A volunteer who mixes what turns out to be trust money with his own can surely ‘unmix’ it subsequently if he thinks fit to do so. And as the operation of Equity is directed to preventing the volunteer doing what is unconscionable, surely it would be unconscionable for the volunteer who, for his own purposes, has earmarked the trust money to assert that what he has earmarked is not trust money”.\textsuperscript{175} A similar result has been reached in recognising the effectiveness, for tracing purposes, of the internal allocation of funds through ledgers.\textsuperscript{176}
6.3.5 Tracing into payment of a debt (“backward tracing”)

A further problem is the effect on tracing where the claimant’s value is used to pay a debt (or, which is the same thing, is paid into an overdrawn bank account). In *Re Diplock* the Court of Appeal held that where money was used to pay a debt then the “debt was extinguished” leaving no traceable proceeds.\textsuperscript{177}

This approach has been convincingly criticised by Smith.\textsuperscript{178} In his view, when money is used to pay a debt then the claimant should be able to trace into whatever value was acquired in return for incurring the debt. A debt is simply deferred payment. Thus when payment of the debt is made, the proceeds of the payment are whatever was originally acquired in consideration for the debt. This is an attractive argument and avoids the conclusion reached in *Re Diplock* that where the claimant’s money is used to pay an existing debt then the claimant’s value is treated as having disappeared with the result that the defendant remains unjustly enriched.\textsuperscript{179}

However, the courts have so far been unwilling to accept this analysis, and unless the matter is reconsidered by the House of Lords, the position laid down in *Re Diplock* remains the law.

*Bishopsgate Investment Management v. Homan*\textsuperscript{180} concerned the theft of pension fund moneys by Robert Maxwell. The moneys were paid into accounts of Maxwell Communications Corporation (“M.C.C.”) that either were, or subsequently became, overdrawn. The Court of Appeal held that equitable tracing could not be pursued through an overdrawn account. Neither was it possible to trace misappropriated money into assets acquired before the money was received as *ex hypothesi* it cannot be followed into something which existed and so had been acquired before the money was received and therefore without its aid”.\textsuperscript{181} There was therefore no causal connection between the purchased asset and the theft.

At first instance Vinelott J. accepted that there may exist circumstances where there was a close connection between a particular misappropriation of Bishopsgate’s money and the acquisition by M.C.C. of an asset. One instance was where an asset was acquired by M.C.C. with moneys borrowed from an overdrawn (or loan) account where, when the borrowing was incurred, it was intended that it would be repaid by misappropriations of Bishopsgate’s money. A second example was where moneys misappropriated from Bishopsgate were paid into an overdrawn M.C.C. account in order to reduce the overdraft so as to make finance available, within the overdraft limits, for M.C.C. to purchase some other asset.

Dillon L.J. stated in the Court of Appeal that “if the connection [the judge] postulates between the particular misappropriation … and the acquisition by M.C.C. of a particular asset is sufficiently clearly proved, it is at least arguable, depending on the facts, that there ought to be an equitable charge in favour of [Bishopsgate] on the asset in question of M.C.C.”.\textsuperscript{182} Leggatt L.J. disagreed, considering that it was never possible to trace through an overdrawn bank account. Henry L.J., unhelpfully, agreed with both judgments.

Subsequently, in *Foskett v. McKeown*,\textsuperscript{183} Scott V.-C. considered “the point as still open”, and stated that “I do not regard the fact that an asset is paid for out of borrowed money with the borrowing subsequently repaid out of trust money as being necessarily fatal to an equitable tracing claim.
6.4 The future of tracing

The above analysis has been based on the existence of two separate sets of tracing rules, one for tracing at common law and one in Equity. However, the justification for maintaining two separate sets of tracing rules, each with their own limitations, has increasingly been challenged. Smith, in his study of the law of tracing, concludes that the development of two different sets of rules was unjustified in principle and based on a misinterpretation by the courts of the relevant case law. Birks has argued in favour of the amalgamation of the two sets of rules distinguishing clearly between tracing (a process of identification of what has happened to property) with claiming (asserting ownership rights in property). The real difference, he argues, lies not in the process of tracing but in the nature of rights that a person can assert. If a claimant has a common law right then tracing will give rise to common law remedies, whereas if the claimant’s interest in the property is equitable then equitable remedies will be available.

In Foskett v. McKeown, Lord Steyn cited with approval Birks’ analysis. Lord Millett considered that “there is nothing inherently legal or equitable about the tracing exercise. There is thus no sense in maintaining different rules for tracing at law and in Equity. One set of tracing rules is enough …. There is certainly no logical justification for allowing any distinction between them to produce capricious results in cases of mixed substitutions by insisting on the existence of a fiduciary relationship as a precondition for applying Equity’s tracing rules”. It is considered that when a suitable case reaches the House of Lords (or, possibly, a bold Court of Appeal) the view that there is a single law of tracing will prevail. However, until this happens, it will continue to be necessary to refer to the traditional rules.

7. Conclusion

Money laundering is a menace. The civil law can play an important role in combating laundering and enabling the victims of fraud to recover moneys taken from them. For banks and other financial institutions, the existence of civil remedies for money laundering provides an additional source of liability to that imposed by the criminal and regulatory regimes. In the case of major fraud, this liability is likely to significantly exceed the amount of any fine imposed by a court, or by regulators, as a bank that becomes involved in money laundering may be fixed with liability for the whole amount of the fraud together with interest and costs. The successful bringing of a civil claim against a bank or a financial institution may also be the trigger for subsequent criminal or regulatory action. It is therefore essential for institutions to have in place appropriate procedures to identify and deal with suspicious transactions, and then to know what steps to take where they suspect that a customer may be involved in fraud.
ENDNOTES


2 In Baden Delvaux v. Société Générale Pour Favoriser le Développement du Commerce (1993) 1 W.L.R. 509 fraudsters succeeded in extracting over $100 million from various mutual funds. A significant amount of this was siphoned off to Costa Rica through a number of unauthorised investments made by the funds, including investments in companies connected with the president of Costa Rica. When the fraud was discovered the wrongdoers fled there. In Polly Peck v. Nadir (No. 2) [1992] 4 All E.R. 769 the defendant was accused of stealing large sums of money from Polly Peck and diverting them to northern Cyprus. Before trial, he jumped bail and fled there.

3 Contracts for the sale of drugs are illegal and in buying drugs the purchaser will commit the offence of possession under the Misuse of Drugs Act 1971. The principle that money paid for drugs is irrecoverable follows from the wider principle that money paid under an illegal or immoral contract cannot be recovered: Holman v. Johnson (1775) 1 Cowp. 341, 343.

4 A bank that assisted in planning terrorist attacks would be liable as a joint tortfeasor. However, should such a situation ever arise the appropriate response would be criminal prosecution of those involved, withdrawal of authorisation and seizure of the funds under terrorist control.

5 Whether Equity provides a remedy for assistance in a breach of fiduciary duty not involving the misapplication of trust funds is controversial. See the cases referred to in note 81 below.


7 There are exceptional cases where a person would incur direct personal liability. Further, where Equity acted in its concurrent or auxiliary jurisdiction in support of common law claims there was no need to rely on an actual or notional trust. An example of the former is Equity’s jurisdiction to grant rescission for fraud. An example of the latter is the equitable remedy of discovery (now available in all proceedings under the Civil Procedure Rules).

8 This derives from Roman law. See Gaius’ Institutes 1.8 and Justinian’s Institutes 1.2.12.38.

9 Many exceptions exist.


12 The range of encumbrances that can be created on land are ignored for these purposes (e.g., an easement or profit à prendre).

13 Armon v. Delamirie (1721) 1 Stra. 505.

14 There are exceptions. In the case of land, the true owner could always seek to recover the land itself. Equally, a person with a better claim for possession (the owner) could recover against a person with a more limited right (for example, a thief or a purchaser from the thief).

15 Hollins v. Fowler (1875) L.R. 7 H.L. 757 (conversion) and Lipkin Gorman v. Karpnale [1991] 2 A.C. 548 (money had and received).

16 Westdeutsche Landesbank Girozentrale v. Illegitimate London Borough Council [1996] A.C. 669, 705. There are historical reasons for this as it enabled Chancery judges to state that they were not negating the relevant common law rule, but precluding the defendant from relying on it if it would be unconscionable to do so.

17 Chase Manhattan Bank v. Israeli-British Bank [1981] Ch. 105. Again there are exceptions (e.g., preferences, transactions entered into at an undervalue or in fraud of creditors). These are not relevant in the present context.


24 Ibid p. 912e.


26 Clerk & Lindsell on Torts, 19th ed., 2006, para. 14-02. The essence of the wrong was the unauthorised dealing with the claimant’s chattel so as to question or deny his title to it ibid para. 17-06.


29 This is the definition of “goods” under section 14 of the Torts (Interference with Goods) Act 1977.
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OBG Ltd. and another v. Allan and others; Douglas and another v. Hello! and others (No. 3); Mainstream Properties Ltd. v. Young and others [2007] 4 All E.R. 545.

In the (unlikely) event of the custody arrangement involving a bailment of physical instruments, the bailee may be guilty of conversion if he misappropriates the claimant’s property, or detinue if he fails to return it.

Derry v. Peek (1889) 14 App. Cas. 337, 376.

Derry v. Peek (1889) 14 App. Cas. 337, 376.


Unless the right to rescind has been lost, e.g., because third parties have acquired rights in property transferred under the agreement.


Kuwait Oil Tanker v. Al Bader [2000] 2 All E.R. (Comm.) 271, Court of Appeal, para. 111: “it is not necessary for the conspirators all to join the conspiracy at the same time, but we agree with the judge that the parties to it must be sufficiently aware of the surrounding circumstances and share the same object for it properly to be said that they were acting in concert at the time of the acts complained of”.

[2008] 2 W.L.R. 711.

It is unclear if market abuse would constitute “unlawful conduct” if it did not involve the commission of an insider dealing or market manipulation offence.


Where the conspiracy is effected outside of England, a claim in conspiracy may simplify the conflict of laws analysis as the claimant will rely on the single tort of conspiracy rather than sue separately in respect of each of the individual unlawful acts carried out pursuant to the agreement. It will also enable liability to be imposed on those parties to the underlying agreement who do not carry out any of the illegal acts e.g. a mafia boss or leader of a crime syndicate.


OBG Ltd. and another v. Allan and others; Douglas and another v. Hello! Ltd. and others; Mainstream Properties Ltd. v. Young [2008] A.C. 1, 31G.


OBG Ltd. and another v. Allan and others; Douglas and another v. Hello! Ltd. and others; Mainstream Properties Ltd. v. Young (No. 3) [2008] A.C. 1.

Banque Financière de la Cité v. Parc (Battersea) Ltd [1999] 1 A.C. 221.

Kelly v. Solaris (1841) 9 M. & W. 54.


Bavins Junior & Sons v. London & South Western Bank Ltd [1900] 1 Q.B. 270.


[1990] Ch. 265.

Ibid. p. 288.


Moore, Restitution from Banks, unpublished D. Phil. thesis, Oxford University, 2000, p. 140.


See sections 171, 172, 173 and 175 of the Companies Act 2006. The consequences of a breach of duty are the same as applied to the corresponding equitable rules: section 178 of the Companies Act 2006.
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Barnes v. Addy (1874) L.R. 9 Ch. App. 244, 251–52.


Agip, supra.


Dishonesty not involving a misapplication of property may attract criminal liability. However, such behaviour (e.g., deceiving or bribing a public officer to act contrary to his duty) does not involve money laundering. Deceit causing loss, but not involving the misapplication of property, is actionable at common law.


Despite the fact that the Court of Appeal found that he had lied serially on oath.


Averted to by the Court of Appeal in [2008] E.W.C.A. Civ. 1007. 31st July 2008 although the case was decided on factual issues.


Claims Against Professionals: Negligence, Dishonesty and Fraud [2006] 22 Professional Negligence 70.

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95 [1990] Ch. 265, 296.
105 Millett, Tracing the Proceeds of Fraud (1991) 107 L.Q.R. 70, 83 n. 46. For tentative support see Westpac Banking Corp. v. MM Kembla [2001] 2 N.Z.L.R. 298, 316–17, where the court concluded that "[t]his area of the law is marked by present confusion".
106 Moore, Restitution from Banks, unpublished D. Phil. thesis, Oxford University, 2000, p. 221.
107 Ibid., p. 213.
114 Ibid. p. 301.
115 Which is why it was rejected in the case of dishonest assistance by Lord Nicholls.
116 [2002] 2 B.C.L.C. 151, 171 per Hart J.
118 [2004] 1 W.L.R. 1846.
120 Millett, Tracing the Proceeds of Fraud (1991) 107 L.Q.R. 71, 82.


But not Jersey. See note 119 above.


Miller v. Race (1758) 1 Burr. 452.


Westdeutsche Landesbank Girozentrale v. *Islington London Borough Council* [1996] A.C. 669, 715. The better view is that such a trust is not automatic, and that where property is obtained under a contract induced by fraud the contract remains valid and enforceable until the victim seeks to rescind it: see *Shalson v. Russo* [2005] Ch 281, 317–318. See also *Reese River Silver Mining Company Ltd. v. Smith* (1869) L.R. 4 H.L. 64 and *Newbigging v. Adam* [1886] 34 Ch. D. 582.


[1997] Ch. 159.

*Shalson v. Russo* [2005] Ch 281, 314–315. In Jersey the Royal Court has expressed the view that the rules of equitable tracing should apply to all tracing actions. In *re Esteem Settlement and the Number 52 Trust* [2002] J.L.R. 53, 97; transcript para. 190. It must be admitted that Jersey law is not based on English common law and differs in significant respects from it.

*Boscawen v. Baja* [1996] 1 W.L.R. 328, 334 per Millett L.J.

*Foskett v. McKeown* [2001] 1 A.C. 102, 128 per Lord Millett.


*Re Diplack* [1948] Ch. 465, 518.


*Agip Ltd v. Jackson* [1990] Ch. 265, 286. This “requirement” was not considered by the Court of Appeal on appeal.


In Australia it has been held that a thief is a trustee and owes fiduciary duties: “where money has been stolen, it is trust money in the hands of the thief and he cannot divest it of that character” *Black v. S. Freeman & Co.* (1910) 12 C.L.R. 105, 110. In *Westdeutsche Landesbank Girozentrale v. Islington London Borough Council* [1996] A.C. 669, 715 Lord Browne-Wilkinson opined that the victim could trace in Equity on the basis that the thief was subject to an immediate constructive trust in favour of the victim. However, the better view is that this is not the law in England. See *Shalson v. Russo* [2005] Ch. 281, 317. As Rimer J. pointed out, a thief ordinarily acquires no property in what he steals. Accordingly, he cannot be a trustee of it. “The fact that, traditionally, Equity can only trace into a mixed bank account if [the precondition that there exists a fiduciary relationship] is satisfied provides an unsatisfactory justification for any conclusion that the stolen money must necessarily be trust money so as to enable the precondition to be satisfied. It is either trust money or it is not. If it is not, it is not legitimate artificially to change its character so as to bring it within the supposed limits of Equity’s power to trace: the answer is to develop those powers so as to meet the special problems raised by stolen money”.


Agip (Africa) Ltd v Jackson [1990] Ch. 265, 290.


Chase Manhattan Bank v Israeli-British Bank [1981] Ch. 105. The correctness of this case has been doubted, and it seems inconsistent with established principles.


Foskett v McKeown [2001] 1 A.C. 102, 132 per Lord Millett.

Re Hallett’s Estate (1880) 13 Ch.D. 696.

[1903] 2 Ch. 356.

[1915] 1 Ch. 62.


Re Tilley’s Will Trusts [1967] Ch. 1179.

Re Hallett’s Estate (1880) 13 Ch.D. 696.

Re Diplock [1948] Ch. 465.

(1816) 1 Mer. 572. See Re Diplock [1948] Ch. 465.


Re Walter J Schmidt & Co. (1923) 198 F. 314, 316 per Learned Hand J.


[1948] Ch. 465, 552.


1948] Ch. 465, 549.


Although cf. Rotherham, “The Metaphysics of Tracing”, pp. 122–25 in Rotherham, Proprietary Remedies in Context, 2002. According to Rotherham “Tracing should be available in this context only if the transactional link in question is likely to indicate that that part of the defendant’s estate that is available for distribution in bankruptcy continues to be swollen at the plaintiff’s expense”.

[1995] Ch. 211.

Ibid. p. 221 per Leggatt L.J.

Ibid. p. 217.

Ibid. 1998] Ch. 265, 283–84.

See at p. 289 (Hobhouse L.J.) and p. 296 (Morritt L.J.).


Ibid. p. 113.

Ibid. p. 128.


This appears already to be the law in Jersey: In re Esteem Settlement and the Number 52 Trust [2002] J.L.R. 53, 97; transcript para. 190.
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IMPORTANT NOTE: This memorandum is intended as an introductory guide. It should not be relied upon as a substitute for legal advice.

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