The Interrelated Liability in Equity of Financial Institutions Used in the Furtherance of Fraud

Hon Mr. Justice David Hayton[1]

Three bases for liability in equity

When claimants bring common law claims for deceit and conspiracy against fraudsters who have used a financial institution in the furtherance of their fraud, the claimants usually have recourse to one or more of three possible claims in equity against that institution. Such claims in equity are based on a breach of a fiduciary obligation. Such a duty is owed not just by a trustee to his beneficiaries, but by a director to his company, by a partner to his fellow partners, by a co-venturer to its co-venturers, and, indeed, by a person to any other person in whose interests he has undertaken to act with priority over his own selfish interests or with equal priority to such interests.

(1) The claimant may have a *proprietary* claim against assets of the fraudster held by the institution that will afford the claimant priority in the insolvency of the fraudster. To ascertain the extent of this proprietary claim, the equitable process of tracing is available to trace the value of relevant assets into substituted assets held by the institution and against which there can be a proprietary remedy as owner or chargee. Where a claimant's money has been mixed with other moneys (as in moneys deposited with banks) so it is impossible to establish ownership of particular money, the claimant recovers his money by way of a charge over the mixed moneys.[2] Such

[1] M.A., LL.D. (Cantab), LL.B., LL.D. (Newcastle Univ.), Justice of the Caribbean Court of Justice, Bencher of Lincoln's Inn. In preparing this paper delivered at the 27th International Symposium on Economic Crime, Jesus College Cambridge on Sept 5 2009, I easily persuaded myself of the views herein which are open to change with the benefit of full forensic argument

[2] *El Ajou v Dollar Land Holdings plc* [1993] 3 All ER 717 at 735-736, [1994] *2* All ER 685 at 701.

charge, however, only covers the lowest intermediate credit balance in the account since the receipt of the relevant money[3], so no claim can lie if the account had since fallen into debit, the moneys have been dissipated eg in paying off unsecured debts.[4] Exceptionally, if the moneys had been spent purchasing an asset for the fraudster who then sold the asset and paid the proceeds into the account, a claim will lie against such proceeds.

(2) Where the claimant cannot recover the whole of his loss from a fraudster's account with a financial institution, he may have a *personal* claim to monetary compensation against the institution itself if (a) it received his traceable assets for its own benefit, and not as agent, and (b) its state of knowledge of the receipt being in breach of a fiduciary duty is such as to make it "unconscionable" for it to retain the benefit of the receipt. Unconscionable behaviour includes, but is not limited to, dishonest behaviour since it encompasses "commercially unacceptable conduct."[5]

(3) Alternatively, the claimant may have a *personal* claim against an institution if he can prove that it had dishonestly assisted in a breach of fiduciary duty.

A defendant financial institution involved in a breach of a fiduciary duty is made liable in the same liberal way as a trustee is made liable. It is thus said to be liable as a constructive trustee.[6]

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[3] *Roscoe v Winder* [1915] 1 Ch 62, *Bishopsgate Investment Management Ltd v Homan* [1995] Ch 211.

[4] A proprietary subrogation claim may be made in the case of a secured debt, the claimant taking advantage of the security of the paid-off secured creditor: *Cheltenham & Gloucester plc v Appleyard* [2004] EWCA Civ 291 at [32] – [44]; *Primlake Ltd v Matthews Assocs* [2006] EWHC 1127 at [337] –[340].

[5] *HSBC v 5th Avenue Partners Ltd* [2008] EWCA Civ 851 at [14]

[6] On this further see C Mitchell and S. Watterson "Remedies for Knowing Receipt" in C Mitchell (ed) *Constructive and Resulting Trusts,* Hart Publishing, Oxford, 2009, which provides a useful framework for the issues discussed herein.

Receipt of wrongfully transferred fiduciary assets: proprietary and personal liability

If an institution still has the fiduciary assets or the traceable substitutes for such assets, it simply has to restore them or their value to the defrauded claimant unless having the defence that it was a bona fide purchaser for value without notice of the claimant's rights.[7] Notice extends beyond actual notice to constructive notice which is notice of those matters that would have come to a person's knowledge if such inquiries and inspections had been made as ought reasonably to have been made by him.[8] Actual or constructive notice of an agent is imputed to the principal.

If the institution was an innocent recipient ignorant of the claim till it was made, it must return the assets or their value to the claimant as soon as satisfied that the claim is a good one. Until then it must merely keep the assets safe and, if money, in a safe "on demand" interest-bearing account, it seems.[9] If the assets had innocently been dissipated on the instructions of the fraudster so as to be untraceable, then the institution is free from liability.[10]

Once the institution's knowledge of its receipt having been in breach of a fiduciary duty makes it unconscionable to retain the assets, it is under a primary core obligation to restore the assets immediately to the defrauded claimant.

It will be unconscionable to retain the assets if the institution had actual knowledge of the assets being wrongfully transferred fiduciary assets or would have had such but for wilfully

[7] Change of position is not a defence to a simple proprietary claim, only to an unjust enrichment claim, normally by nullifying or reducing the extent of unjust enrichment. An equitable allowance, however, may be made for expenditure made in good faith on improvements to the traced property.

[8] Constructive notice is well developed in the conveyancing context, but is difficult to establish in the commercial context except where despite a clear (as opposed to a speculative) suspicion of wrongful conduct a recipient deliberately or recklessly frails to make the inquiries an honest reasonable person would make.

[9] *Evans* v *European Bank Limited* [2004] NSWCA 82,

[10] *Primlake Limited v Matthews Associates* [2006] EWHC 1127 (Ch) [2007] 1 BCLC 366 at [336]; *Allan v Rea Brothers Trustees Limited* [2002] EWCA Civ 85, (2002) 1 ITELR 627 at [52] – [55]. There is, however, an unorthodox view (discussed later) that there should be a strict liability for the received property as an unjust enrichment but the defence of change of position may well prevent there being an enrichment to a greater or lesser extent.

shutting its eyes to the obvious or but for wilfully and recklessly failing to make such inquiries as an honest and reasonable person would make or, it seems, if it had knowledge of circumstances which would indicate the breach of a fiduciary duty to an honest and reasonable person[11] - so that the morally obtuse cannot escape by failure to recognize an impropriety that would have been apparent to an ordinary person applying the standards of such persons.

A lower threshold than dishonesty will suffice where there is commercially unacceptable conduct. In *Belmont Finance Corporation v Williams Furniture (No 2)*[12] X sold shares in X Ltd to Belmont, a subsidiary of City, for £500,000 under an arrangement whereby he could use £489,000 of the proceeds to buy the share capital of Belmont from City in breach of the Companies Act prohibition on a company providing financial assistance for purchase of its own shares. Mr James, the directing mind of Belmont and City, genuinely believed this to be a good lawful commercial proposition for Belmont without having any good grounds for such belief, an independent valuer later valuing the shares in X Ltd at the relevant time as worth only £60,000. Belmont went into liquidation and its receiver sought inter alia, to make City personally liable to repay Belmont the £489,000 it had received from Belmont. Although the Court of Appeal accepted the judge's finding that Mr James, the directing mind of City, had not been dishonest, it found that Belmont's directors as fiduciaries had misapplied the £489,000 and City had received the money with full knowledge of the circumstances. Thus City was personally liable as constructive to repay to Belmont the money with simple interest at 1% above Bank Rate.

[11] *Farah Constructions Pty Limited v Say Dee Pty Limited* [2007] HCA 22, (2007) 230 CLR 89; *Barlow Clowes International Limited v Eurotrust International Limited* [2005] UKPC 37,[2006] 1 WLR 1476.
[12] [1980] 1 All ER 393, CA.

It was this case that the Court of Appeal relied upon in *Bank of Credit and Commerce International (Overseas) Ltd v Akindele*[13] to hold that a defendant would be liable where his state of knowledge made it "unconscionable" to retain the benefit of the received fiduciary assets. The defendant was a prominent Nigerian businessman and tribal chief who was a valued high-net-worth client of the BCCI group. In July 1985, to help cover up internal problems, directors of a subsidiary persuaded the defendant to invest $10 million in exchange for 250,000 shares in the holding company on the basis that on request, after two years and before five years, the subsidiary company would arrange sale of those shares at a price giving the defendant an annual return of 15% compound interest. Blank transfer forms signed by the sellers of the shares were held by the subsidiary to put into the defendant's name only after five years or upon the defendant stating he would hold the shares for more than five years. The defendant's interest was in the 15% compound interest annual return, not caring why the subsidiary wished to arrange things like this for its own reasons and not knowing of the fraudulent arrangements within the group to shore up the price of the holding company's shares.

In December 1988, pursuant to his request, the defendant received $16.67 million at a time when he was aware of some bad press publicity relating to alleged irregularities within the BCCI group.

On liquidation of the subsidiary, its liquidator claimed $6.67 million with interest. The trial judge held that the defendant's conduct when making the loan at a high 15% rate of compound interest in the above circumstances had not involved him in any dishonesty, even though evidence showed that 9% compound interest was otherwise the best rate available as a sound investment. Nor had the defendant been dishonest in getting the $16.67 million due to him

[13] [2001] Ch 437. The "unconscionable" test has since been applied many times by the Court of Appeal (eg *City Index Ltd v Gawler* [2007] EWCA Civ 132, [2008] Ch 313 at [8] and [32]) and the High Court.

paid out to him in 1988, not knowing anything of the fraudulent machinations within the BCCI group that had actually enabled the payment to be made to him.

The Court of Appeal dismissed the appeal, holding that the trial judge had erred in requiring dishonesty but that on his factual findings there was not enough evidence to make it unconscionable for the defendant to retain the $6.67 million.

In the case of financial institutions where employees should be well-versed in the due diligence required by anti-money-laundering regulations it ought to be more difficult to escape liability by arguing that one's suspicions were not aroused and therefore one was not reckless in failing to make further inquiries.

While the normal rule[14] is that the knowledge of one employee cannot be added to the knowledge of another employee so as to provide a hypothetical employee with enough knowledge to he regarded as acting dishonestly on behalf his employer, it may well be that if there was a glaring or reckless failure in the employer's due diligence system that prevented the knowledge of two employees having aggregated in one actual employee, then the employer's attempt to retain relevant assets could be regarded as unconscionable, so that, in essence, it cannot benefit from its own reckless behaviour.

Where a financial institution receives fiduciary moneys but unconscionably retains them, it must not only restore the moneys to the defrauded claimant: it must also as constructive trustee account from the date of the unconscionable retention for the interest it in fact earned or, if this is unascertainable, interest at a compound rate reflecting what be presumed to have been earned.[15]

[14] *Galmerrow Securities Limited* v *National Westminster Bank plc* [2002] WTLR 125 at 151-152.
[15] *Primlake Limited v Matthews Associates* [2006] EWHC 1127 (Ch), [2007] 1 BCLC 366 at [344]. See also general discretion in *Sempra Metals Limited v IRC* [2007] UKHL 34, [2008] 1 AC 561.

To the extent that the moneys cannot be restored to the claimant interested therein as a chargee via the tracing process because dissipated after the date of unconscionable retention so as to be untraceable, the institution will have to account for the missing moneys as if it had been trustee of them for the claimant-beneficiary.

As a substitute for the institution as constructive trustee not having performed its primary obligation as trustee to account for and transfer the received moneys to the claimant-beneficiary, the institution has to pay to the claimant-beneficiary a sum ascertained via an accounting process, in particular, by falsifying the account.[16] This means that the actual account of what the institution did with the claimant-beneficiary's money is struck out as false, leaving an account showing the institution as notionally having retained the money. If, however, the money happened to have been used to purchase a traceable asset eg gold, vested in the institution which has appreciated in value the beneficiary will choose not to falsify the account, so that the gold remains a trust asset held for the beneficiary and the expenditure in buying it will be allowed. If that gold has been sold and the proceeds dissipated the beneficiary can falsify the sale so that the institution is regarded as still the owner of that appreciated asset and so liable for its value, especially if it has appreciated in value since the sale. If the asset has depreciated since the sale then one falsifies what was done with the sale proceeds so that the institution is liable for the amount of the proceeds.

A bank has a defence to the claim for knowing receipt or unconscionable retention if it received the money not for its own benefit but as agent. As Moore-Bick LJ stated in *Uzinterimpex JSC v Standard Bank plc*[17] "Liability to account as a constructive trustee on the grounds of knowing receipt of trust property depends on receipt by the defendant of trust

[16] On which see *Ultraframe (UK) Limited v Fielding* [2005] EWHC 1638 (Ch) at [1513].
[17] [2008] EWCA Civ 819 at [38] – [39].

property otherwise than in a ministerial capacity with the necessary degree of knowledge … a person who receives property merely as an agent has no interest of any kind in it himself and must simply account to his principal for it. Receipt by him is the equivalent of receipt by the principal."

Surprisingly, it is not yet clear when a bank receives money for its own benefit and not as agent. Can one say that money received by a bank to be credited to its customer's account always becomes the bank's beneficial property because the customer lends it back to the bank or has it set off against the customer's overdraft so the bank ends up using the money as its own beneficial property[18] e.g. in lending it on to others in the course of its business?

This ultimately is the position, but the position needs a closer analysis. Where a cheque drawn on P's bank is paid into Q's bank account the paying and collecting bank pay and receive the money as agent. The collecting bank becomes full owner of the money but is under an immediate obligation of corresponding amount to Q. In fulfilling its agency role the collecting bank separately accounts for the payment to Q by crediting his account with the payment[19] so as to increase the credit therein or to reduce the debt if the account is overdrawn. The bank technically is then a purchaser for value from Q and will normally be a bona fide purchaser without notice.[20] It ought not to matter whether the customer's account happens to be in credit or overdrawn,[21] though there are some dicta[22] indicating that "if the collecting bank uses the money to reduce or discharge the company's overdraft … it receives money for its own benefit" but not otherwise.

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[18] *Foley* v *Hill* (1848) 11 HLC 28.
[19] *Global Distributions Inc v Bank of Nova Scotia* [2009] SCC 15 at [63]
[20] See footnote 8 above
[21] *Continental Caoutchouc and Gutta Percha Company v Kleinwort Sons & Company* (1904) 90 LT 474 at 476 per Collins MR; *British North American Elevator Company v Bank of British North America* [1919] AC 658 at 663.
[22] *Agip (Africa) Limited v Jackson* [1990] Ch 265 at 292.

These dicta have been much criticized on the lines indicated above and in *Uzinterimpex* Moore-Bick LJ considered[23] that there was "a good deal of force" in such criticism but did not need to decide the issue. It so happened that the bank as agent and security agent and trustee in respect of a syndicated loan, received money in a blocked Transaction Account to pay its own fees and expenses and the amounts due to members of the syndicate (including itself) for repayment of the loan. Thus, it received money for its own benefit, but he held that it did not have sufficient knowledge to make its receipt and retention of the money unconscionable.

If the criticism is correct then a collecting bank receives money as agent and not as principal for its own benefit, so that it is not personally enriched by the received moneys for which it has to account to its customer as soon as it receives the moneys. In these circumstances it can only be made personally liable as a constructive trustee if it dishonestly assisted in a breach of fiduciary duty. This liability does not depend upon receipt of assets traceable to the victim of a fraud. A defendant is liable if it dishonestly assisted in a breach of fiduciary duty whether by passing on assets received or by making phone calls or sending emails or faxes to help the wrongdoing fiduciary find someone to whom the assets can be transferred eg to try to launder the assets.

Before going on to deal with liability for dishonest assistance it is, however, necessary to consider the position if a collecting bank is regarded as receiving money as a principal if the money is used towards reducing the customer's overdraft. In such circumstances the bank is enriched so that one needs to consider if, as some have argued, liability can be collapsed into a straightforward strict restitutionary liability to account for unjust enrichment subject to a defence of bona fide change of position, instead of the claimant having to prove that the state of

[23] [2008] EWCA Civ 819 at [40].

knowledge of the receipt of assets having been in a breach of fiduciary duty is such that it would be unconscionable for liability to be escaped.

Any scope for developing a strict restitutionary approach against recipients of misapplied fiduciary property*?*

Lord Nicholls,[24] Lord Millett[25] and Lord Walker[26] in *obiter dicta* or in published papers have suggested that the time has come to move away from the personal liability to account as a constructive trustee and to treat a claim against a defendant recipient of misapplied fiduciary property as a personal restitutionary claim based on unjust enrichment. Thus, the defendant is strictly liable for the amount of his enrichment unless he can prove that he has so changed his position that he is no longer enriched at all or only to a lesser extent than at the time of the receipt.

Nourse LJ in *Bank of Credit and Commerce International (overseas) Limited v Akindele*[27] made it clear that such a development would have to come from the House of Lords. Moreover, would it be commercially sensible to put the defendant on the back foot, having to make full disclosure of relevant documents and then try to raise the defence of change of position, taking account of the volume of litigation this approach would be likely to generate. This would be good for lawyers but not for businessmen.

[24] *Royal Brunei Airlines v Tan* [1995] 2 AC 378 at 382, *Criterion Property plc v Stratford UK Property llc* [2004] UKHL 28 at [4], and in "Knowing Receipt: The Need for a New Landmark" in W. Cornish et al (eds) *Restitution: Past, Present and Future* (1998) at 231`.

[25] *Twinsectra Limited v Yardley* [2002] AC 164 at 194, *Dubai Aluminium Company Limited v Salaam* [2003] 2 AC 366 at [87].

[26] "Dishonesty and Unconscionable Conduct in Commercial Life" (2005) 27 Sydney LR 187 at 202.

[27] [2001] Ch 437 at 456.

In Australia a bold New South Wales Court of Appeal tried to introduce such a strict restitutionary approach but, on appeal, it was shot down in flames by an irate High Court of Australia in *Farah Constructions Pty Limited v Say Dee Pty Limited.*[28]

It is most unlikely that the UK Law Lords in the new Supreme Court will be as brutal as the High Court of Australia if strict restitutionary liability, subject to the defence of change of position or bona fide purchaser of a legal title without notice, is put forward as a new basis of liability. Such an argument has some attractive logic and a superficial simplicity as did the argument in the House of Lords in *Douglas v Hello! Limited* that the strict liability for conversion of chattels should extend to choses in action. Such extension, however, was rejected 3:2 and rightfully in my opinion. After all, the life of the law has not just been logic but experience.

Legal ownership of land and chattels has at its core possession and the corresponding crucial right to possession which, in a civilized society, merit protection in their own overriding right, irrespective of any fault in a defendant happening to be the current actual possessor. This is not the case for choses in action or for equitable interests in fiduciary assets owned by others. Equity has at its core the imposition of liability only upon those whose consciences are sufficiently affected but then has developed, as has been seen, special extensive liberal rules to ensure a proper substitutive performance of the obligations of a fiduciary. There is, in my view, no justification for strengthening equitable rights any further.

Personal liability for dishonest assistance in a breach of fiduciary duty

[28] [2007] HCA 22, (2007) 230 CLR 89. See D. Hayton "Lessons from Knowing Receipt Liability and Unjust Enrichment in Australia" (2007) 21 Trust LI 55.

While liability for knowing or unconscionable receipt and retention is a primary liability akin to that of an express trustee, liability as a dishonest assistant is a secondary liability[29] duplicating the liability of the fiduciary whose breach of fiduciary duty was assisted. Thus, once there is proof of some causative dishonest assistance making the breach of fiduciary duty easier to achieve, the focus is on the loss or damage resulting from the breach of fiduciary duty which was assisted. There is no need to show that the assistance caused a particular loss[30] and an assister cannot escape liability by saying he only participated in a small part of a chain of events involved in the breach of fiduciary duty or that the breach would probably have occurred without his assistance.[31] Where the dishonest assistant makes a profit for himself or a corporate *alter ego* then he is personally accountable to pay the profit over to the beneficiary of the fiduciary duty.[32]

In ascertaining whether the defendant *dishonestly* assisted in a breach of fiduciary duty one has to assess his conduct in the subjective light of what he actually knew or clearly suspected at the relevant time but by the objective standard of whether he was simply not acting as an honest person should in the circumstances [33] - he does not have to be proved to have been subjectively conscious that he was transgressing ordinary standards of honest behaviour.

Before a defendant can be found to have been acting dishonestly he must be shown to have known that the person he was assisting was not entitled to do what he was doing or to have had a clear suspicion that this was the case yet deliberately failed to inquire further in order to

[29] *Ultraframe (UK) Limited v Fielding* [2005] EWHC 1638 (Ch) at 1506.
[30] *Casio Computer Limited v Sayo* [2001] EWCA Civ 665 at [15].
[31] *Balfron Trustees Limited v Peterson* [2001] IRLR 758 at 761.
[32] *Ultraframe (UK) Limited v Fielding* [2005] EWHC 1638 (Ch) at [1561] et seq.
[33] *Barlow Clowes International Limited v Eurotrust International Limited* [2005] UKPC 37, [2006] 1 All ER 338.

avoid having confirmation of his suspicions.The defendant does not need to know what particular breach of fiduciary duty he was assisting.[34]

A surprising case where the Court of Appeal, unlike the trial judge, gave the defendant the benefit of the doubt is *Att-Gen for Zambia v Meer, Care & Desai.*[35] Meer was a South African, born in 1940, who had qualified as a lawyer in Zambia in 1968 and worked there before working in London 1982 -1986 as an in-house lawyer and becoming an English solicitor in 1987. He became a partner in a firm of London solicitors and he and his firm escaped liability because he was "a middle aged naïve person"[36] who was "very foolish" and "far from competent".[37] "It did not occur to him that anything was or might be wrong or suspicious"[38] when allowing the firm's client account to be used as a bank account for disbursing over $9 million from 1995 to 2001. He "did not really understand what was involved in money laundering".[39] His client was a company run by his Zambian friend, Mr Kabwe, who had introduced him to the Director General of the Zambian Security & Intelligence Services. He believed the large disbursements related to the work of the Security & Intelligence Services. The Court seems to have been influenced by the fact that he had acted as Nelson Mandela's lawyer and, when under investigation by the Law Society, Nelson Mandela had given him a reference as "scrupulously honest, meticulous, truthful and discreet".

Nowadays, when there is so much awareness by legal, accountancy and banking professionals of money laundering, such a professional will normally be disbelieved if claiming

[34] *Ultraframe (UK) Limited v Fielding* [2005] EWHC 1638 (Ch) at [1506], *HMRC* v *Livewire Telecom Limited* [2009] EWHC 15 (Ch) at [103].
[35] [2008] EWCA Civ 1007
[36] At [263]
[37] At [294]
[38] At [296]
[39] At [267]

that he did not have a clear suspicion that particular conduct might amount to money laundering. In the case of a large corporate defendant, however, there are particular difficulties over whether it can be said to have a dishonest state of mind because it knows relevant facts: relevant responsibilities and knowledge will often be fragmented and dispersed among many employees rather than be vested in one person with whom the company can be identified under the rules of attribution discussed in *Meridian Global Funds Management Asia Limited v Securities Commission.*[40] It may well be the case that employee X knows that a customer is not entitled to do something because that would be a breach of some fiduciary duty but that employee Y, who assists that customer in some activity involving a breach of such duty, did not have X's knowledge. The problem then[41] is that one cannot "conclude that the corporation has acted dishonestly because had the two employees pooled their information it would have become apparent that an act was dishonest."

Limitation Act 1980 s. 21

If a financial institution cannot escape personal liability for knowing or unconscionable receipt (eg by pleading no unconscionable receipt or receipt merely as agent) or cannot escape personal liability for dishonest assistance (eg by pleading no dishonesty as where no relevant employee had the relevant dishonest mind), then it may fall back upon section 21 (3) of the Limitation Act 1980 which bars an action "brought after the expiration of six years from the date on which the right of action accrued." This was recently made clear by Lord Hoffmann (with whom the other judges agreed) in the Hong Kong Final Court of Appeal case *Peconic Industrial*

[40] [1995] 2 AC 500.
[41] *Galmerrow Securities Limited v National Westminister Bank plc* [2002] WTLR 125 at 151-152.

Development Limited v *Lau Kwok Fai*[42]when rejecting the application of the Hong Kong provisions identical to section 21(1).

This states that no limitation period applies to "an action by a beneficiary under a trust, being an action

(a) in respect of any fraud or fraudulent breach of trust to which the trustee was a party or privy: or

(b) to recover from the trustee trust property or the proceeds of trust property in the possession of the trustee, or previously received by the trustee and converted to his use."

Lord Hoffmann, relying on English case law[43], pointed out that these provisions apply only to fiduciaries like trustees, directors and partners who have voluntarily taken on fiduciary responsibilities towards the claimant beneficiary but not to non-fiduciaries who have constructive trusteeship thrust upon then because of their involvement with fiduciaries.

In respect of these non-fiduciaries, section 32 of the 1980 Act states that where the action is based upon the fraud of the defendant or any fact relevant to the claim has been deliberately concealed[44] from the claimant by the defendant, the six years limitation period does not begin to run until the "plaintiff has discovered" the fraud or concealment "or could with reasonable diligence have discovered it." The phrase "reasonable diligence" denotes an objective standard and the claimant bears the onus of proof of showing that what he actually did does establish that with "reasonable diligence" he could not have discovered the fraud at all or not before a

[42] [2009] HKFCA 16.
[43] Endorsing *Cattley v Pollard* [2007[Ch 353 in its application of the views of Millett LJ in *Paragon Finance Ltd v Thakerar* [1999] 1 All ER 400 and Lord Millett in *Dubai Aluminium Co Ltd v Salam* [2002]UKHL 48, [2003} 2 AC 366 at 404. Contrary dicta of Evans-Lombe J in *Statek Corporation v Alford* [2008] EWHC 32 (Ch) are erroneous.
[44] "Deliberate commission of a breach of duty in circumstances in which it is unlikely to be discovered for some time amounts to deliberate concealment of the facts involved in that breach of duty": s 32(2).

particular period. Because it is the *claimant* who is supposed to have shown reasonable diligence there is scope for looking at the personal characteristics and resources of the claimant, but must he be assumed to have had only the staff and resources which he actually had, though bearing in mind he can be expected to have recourse to outside specialist expertise where reasonable diligence requires this?

In *Peconic* the issue did not arise because the claimant bank had access to adequate resources and expertise to make any investigations which reasonable diligence would have suggested. Lord Hoffmann thus left open[45] whether the appropriate test was the objective test put forward by Millett LJ (as he then was) in *Paragon Finance plc v DB Thakerar & Company*[46] : "How a person carrying on a business of the relevant kind would act if he had adequate, but not unlimited, staff and resources and were motivated by a reasonable but not excessive sense of urgency."

You may wonder why we should be astute to accord a defendant the statutory protection he seeks: why not take the claimant as you find him, especially where his resources have been substantially diminished by fraud, so that less protection is accorded to shysters? As Lord Hoffmann makes clear[47], the reason is that the purpose of the legislation is to avoid investigating whether the defendant had actually behaved fraudulently or unconscionably once a period of time has elapsed which could well prejudice his ability to fight off the charge. This may allow a shyster to escape liability but this is the price society has to pay for having a clear general rule. To construe the provisions against a defendant on the assumption that he is a shyster begs the question. Thus the question as to what the claimant could with reasonable diligence have

[45] *Peconic* at [32], though from [29] he would appear to favour the test of Millett LJ.
[46] [1999] 1 All ER 400 at 418.
[47] *Peconic* at [29]

discovered must be considered impartially, irrespective of how the merits might be perceived, especially when liability depends upon actually ascertaining a dishonest or unconscionable state of mind.

The moral is to avoid limitation problems by making proper thorough inquiries once it is discovered that a loss has been suffered. This did not happen in *Peconic* when a mainland bank, the Agricultural Bank of China, discovered in July 1993 that there were grounds for thinking that it had been defrauded by Greatasia Ltd, a Hong Kong company. The bank had set up with one Chio a joint venture company, Peconic, which from October 1991 to January 1992 had bought adjacent parcels of land from Greatasia for HK$515 million, though only shortly beforehand Greatasia had bought the land for a mere HK$151 million, as discovered by the bank in July 1993. The land without any available planning permission was only worth in the region of HK$70 million, so there was a clear loss of over HK$400 million. Chio had not put up his agreed 25% stake and ultimately had only an 0.84% stake in Peconic. In July 1993 it was also known that Chio in September 1991 had made reckless or what could turn out to be dishonest representations that there should be a quick re-sale for a profit in the region of HK$200 million to one of several interested Taiwanese businessman or, otherwise a large profit from building a golf course or, later from residential development. In fact, due to an adjoining Nature Reserve no planning permission was possible for development. Until July 1993 the bank had let Peconic be run by Chio and a bank manager, Chen, who were its directors. Both of them fled the jurisdiction to avoid legal proceedings brought against them in1999.

In August 2002 legal proceedings were also brought against Danny Lau and his law firm, seeking to make Danny liable for dishonest assistance in Chio's breach of fiduciary duty to Peconic. In December 1998 the Independent Commission Against Corruption had made the bank

aware for the first time that it had actually been defrauded by Chio, Elsie and Danny, amongst others.

Danny and the law firm claimed the proceedings were time-barred because Peconic could with reasonable diligence have discovered his involvement before August 1996. All that Peconic had done was in the latter half of 1993 to ask a law firm to get the conveyancing files from Peconic's conveyancing solicitors and advise further in the light of what they found. They reported nothing suspicious.

Danny had acted as lawyer for Chio and Elsie Chan, his long-standing film and TV celebrity girl friend, and for Greatasia and, with Chio, had represented to the bank that one Poon was beneficial owner of Greatasia while Chio and Elsie were beneficial owners, as Danny well knew. Indeed, he had drafted the indemnity they had given to Poon against any possible liabilities arising from Poon's involvement.

The directors of Greatasia, however, were Chio's brother's common law wife and Elsie's mother, whose names and addresses were on a public register. Six receipts given by Danny to Peconic's conveyancing solicitors for purchase moneys for parcels of land were in the name of Elsie as Danny's client. All Hong Kong knew how close were Chio and Elsie as a couple regularly featuring in the media. These last three factors were held to show that Peconic could with reasonable diligence have discovered Danny's involvement before August 1996. Thus its action was barred. Its lack of curiosity was most surprising in view of the size of its losses.

To avoid loss claims becoming barred- and to avoid suffering losses in the first place, of course- always have a curious inquiring mind.