Armstrong v Winnington Networks Ltd
[2013] Ch 156

Summary

The defendant traded EU allowances (EUAs), allowing companies to emit carbon dioxide above a certain level. Conmen sent the claimant power company, which owned a certain number of EUAs – held in an account with the German administrator of the EUA scheme – a 'phishing' email that purported to be from the administrator, asking them to verify the details of this account. The claimants responded to the email – note that it is almost unbelievable that they did this – and as a result the conmen obtained access to the claimant's EUA account. The conmen then approached the defendant – who traded in EUAs – saying that they had 21,000 EUAs to sell. The defendant agreed to buy them from the conmen for almost 300,000 euros. The conmen then accessed the claimant's EUA account, and transferred 21,000 EUAs across to the defendant. The defendant then paid the conmen the agreed sum for the EUAs, and subsequently sold them onto a third party.

When the claimant discovered what had happened, the claimants sued the defendant. There were two primary bases of claim. First, the claimants argued that they were entitled to bring a proprietary restitutionary claim at common law against the defendant on the basis that the defendant had received property to which the claimants had legal title. Secondly, the claimants argued that they could bring a claim for knowing (or unconscionable) receipt against the defendant on the basis that when the EUAs were transferred to the defendant, the claimants had an equitable interest in those EUAs.

Stephen Morris QC decided the case at first instance. He held:

(1A) (at [273]) that whether the claimants could bring the first or second claim depended on what happened to legal title to the EUAs when the conmen obtained control over the claimants' EUA account. If the conmen acquired legal title to the EUAs when they transferred them across to the defendant, then the claimants could not bring the first claim against the defendant because the EUAs that the defendant received would not have belonged to the claimants at common law. However, he held (at [274]) that in that case, the claimants might be able to bring their second claim (a claim in knowing/unconscionable receipt) against the defendant, on the basis that – as per Lord Browne-Wilkinson's judgment in *Westdeutsche Landesbank* – the conmen would have held the EUAs on a constructive trust for the claimants.

(1B) (at [276]) that when the conmen gained control over the claimants' EUA account, they acquired *de facto* ministerial control over the claimants' EUAs, and that meant that the conmen had '*de facto* legal title' at common law to the EUAs. So if the claimants were to make a claim against the defendant, it could not be a proprietary claim at common law, but rather a claim for knowing/unconscionable receipt.

(2A) (at [132]) that the receipt of trust property would be 'unconscionable' if 'on the facts actually known to [the] defendant, a reasonable person would either have appreciated that the transfer was probably made in breach of trust or would have made inquiries or sought advice which would have revealed the probability of the breach of trust' (at [132]).

(2B) (at [278] that the defendant had acted unconscionably in receiving the EUAs transferred to them by the conmen: while the defendant had 'no knowledge of the "phishing" fraud nor...that the EUAs were "stolen", I am satisfied that [the defendant was] actually aware there was a possibility that [the transferors] did not have title to, or authority to sell, the EUAs and that they consciously and deliberately "closed their eyes" to that risk or possibility.' Accordingly, the judge held the defendant personally liable to the claimants for the value of the EUAs that the defendant received.

(3A) (at [94]) that if he were wrong on point (1B), and the claimants' remained legal owners of the EUAs throughout, authority (in the shape of *Lipkin Gorman* v *Karpnale*, *Jones (FC)* v *Jones*, and *Foskett* v *McKeown*) indicated that a proprietary restitutionary claim would be available against the defendant for the value of the EUAs received by the defendant, subject to the defendant being able to raise a defence of *bona fide* purchase without notice.

(3B) [at [288]) that given his conclusions at [278] as to the defendant's state of knowledge in receiving the EUAs transferred to it by the conmen, the defendant could not raise a defence of *bona fide* purchase without notice to any proprietary restitutionary claim that the claimants could make against the defendant.

Comments

There is a lot wrong with the decision in this case. Let's go through the problems with it:

(1) The idea of there being a proprietary [restitutionary] claim at common law against someone who has received property that belongs to you at common law is a tawdry piece of nonsense. (I have square bracketed the phrase 'restitutionary' in the above sentence as it is completely redundant, and worse confusing because it makes people think that the claim has something to do with bog standard claims in restitution where C sues D, arguing that D has been unjustly enriched at his expense – that has nothing to do with the sort of common law claim that the judge in this case was considering.) You can only bring a proprietary claim against someone if they have *currently got your property*. If they don't have your property, then you don't have a proprietary claim against them – the best you can do is bring a personal claim against them: (i) for a wrong, arguing that they did something wrong in receiving or disposing of your property; or (ii) under the law on unjust enrichment, arguing that they have been, and continue to be, unjustly enriched at your expense as a result of receiving your property. There could have been a proprietary claim here in respect of the money the defendant made as a result of selling the claimants' EUAs – the authorities that the judge in this case relied on (*Lipkin Gorman*, *FC Jones*, and *Foskett* v *McKeown*) are all very clear that if the EUAs belonged to the claimants, then the claimants could claim that the money obtained in return for the EUAs belonged to them. But the proprietary claim being considered here was in respect of the EUAs received by the defendant. And as the defendant no longer had those EUAs, the idea that you could still have a proprietary claim against the defendant in respect of those EUAs is absolute nonsense.

(2) The idea that because the conmen acquired *de facto* ministerial control over the claimants' EUAs, they then acquired legal title to those EUAs, is again nonsense. If a thief steals my car, he acquires *de facto* ministerial control over my car, but it's still my car. Here, the judge may have been misled by Lord Browne-Wilkinson's judgment in *Westdeutsche Landesbank*, which affirms that if A steals a bag of coins belonging to B, A will hold those coins on a constructive trust for B. The judge may have thought in a very commonsensical way – how could A hold those coins on a constructive trust for B, unless A owned the coins at common law? Well, Lord Browne-Wilkinson says that A *does* hold the coins on a constructive trust for A, so it must be that A *does* own the coins at common law. Conclusion – someone who acquires *de facto* ministerial control over an item of property, also acquires legal title to it. (See para [128] for support for this reading of the way the judge reasoned.) This is a nutty conclusion, but the conclusion seems to have a logical basis. So what's gone wrong? What's gone wrong is that the judge doesn't realise that Lord Browne-Wilkinson's constructive trust is not a real trust, but a fake trust – invented to allow the legal owner of stolen property to

take advantage of the equitable tracing rules to find out where it's gone. But the judge in this case thinks that the trust is real – which means: (i) that the thief who has stolen the property has to have legal title to it, and (ii) that the person whose property has been stolen can bring claims for unconscionable/knowing receipt against people who receive that property. (i) is definitely untrue, but there isn't much objection to allowing (ii) – once the legal owner has found out where his/her property went (using the equitable tracing rules) there doesn't seem to be much objection to allowing him/her to sue anyone who acted unconscionably in receiving or disposing of the property along the way.

(3) So far as the claim for unconscionable/knowing receipt went, the judge pitched the level of knowledge required for a defendant to be held liable for unconscionable/knowing receipt *very* low. On the *Baden Delvaux* scale of knowledge (where (1) is knowing; (2) is wilfully shutting your eyes to the obvious; (3) is wilfully and recklessly failing to make such inquiries as an honest and reasonable person would make; (4) is knowledge of circumstances that would indicate the facts to an honest and reasonable person; and (5) is knowledge of circumstances that would put an honest and reasonable person on inquiry), the judge went down all the way to point (5) on the scale. This will please those academics who want liability for knowing receipt to be strict (but subject to defences) – but the judge quoted absolutely no authority in favour of his reading of what sort of state of knowledge would make someone's receipt of trust property 'unconscionable'.

Talking of academics who would like liability for knowing receipt to be strict, but subject to defences – the primary defence that would be available under such a regime would, of course, be a defence of change of position. The big question would then be: What sort of state of knowledge would result in a defendant who has received trust assets being unable to rely on a defence of change of position when he or she subsequently disposes of those assets? (Remember that if the defendant still has the assets then there is no need for a claim in knowing/unconscionable receipt – the beneficiary can simply sue for the assets.) *Armstrong* v *Winnington* contains some useful reflections on when someone who is sued in unjust enrichment will be prevented from relying on a defence of change of position if he or she subsequently does something to dispose of that enrichment.

The judge endorsed the decision of the Court of Appeal in *Niru Battery* v *Milestone Trading* (2002), that a defendant will not be able to rely on the defence of change of position if he or she acted in *bad faith* in disposing of his or her enrichment. This will include, but not be limited to, cases where the defendant acted *dishonestly* in disposing of the enrichment. It will also include cases where the defendant *failed to act in a commercially acceptable way* or was guilty of *some kind of sharp practice* (both of the last two italicised phrases are from Clarke LJ's judgment in *Niru Battery*). In a case where a defendant knows money had been paid to him or her by mistake, he will never be allowed to rely on a defence of change of position if he/she subsequently disposes of that money, no matter how good his or her intentions might have been in paying that money away (this was the case in *Niru Battery*). But in a case where a defendant thinks money might have been paid to him by mistake, but can't be sure, he/she may be found to have acted in bad faith in paying the money away without first making inquiries as to whether the money had been paid to him/her by mistake – particularly in the case where he/she appreciated he had good reason to believe the money had been paid by mistake. The judge in *Armstrong* v *Winnington* held that a defendant would *not* be held to have acted in bad faith merely because a reasonable person in his/her situation would have suspected that money had been paid to him/her by mistake – the defendant would actually have had to have suspected this before he/she could have been held to have acted in bad faith by paying the money away.

It seems, then, that in the mind of the judge in *Armstrong* v *Winnington*, a defendant who had disposed of trust assets that had been transferred to him in breach of trust could be sued for knowing/unconscionable receipt if *a reasonable person who knew what the defendant knew* would have suspected something was wrong or would have asked some questions; but a defendant who was sued in unjust enrichment after disposing of an enrichment that he had unjustly received at another's expense would only be barred from relying on a defence of change of position if *he* suspected that something was wrong.

If liability for knowing/unconscionable receipt is part of the law on unjust enrichment, it's undesirable for the standard of knowledge required for liability in knowing/unconscionable receipt to different from the standard of knowledge required before a defendant in an unjust enrichment case will lose the defence of change of position – and the standard of knowledge required before a defendant could be held liable for knowing/unconscionable receipt should have been beefed up to bring it into line with the standard of knowledge required for a change of position defence to be lost.

If, on the other hand, liability for knowing/unconscionable receipt is (as I contend) simply a form of liability for breach of a duty to conserve the trust property, which duty is acquired when someone who receives trust property decides to retain it in circumstances where he knows he ought to hand it over to the beneficiary, then there is no need for the two standards of knowledge – in knowing/unconscionable receipt and in unjust enrichment – to align; but it definitely shouldn't be the case that someone will be held liable for knowing/unconscionable receipt based simply on the fact that a reasonable person who knew what the defendant knew would have been put on suspicion that something was wrong.

But whichever way you look at it, the standard of liability for knowing receipt was set far too low in *Armstrong* v *Winnington*.