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# RESTITUTIONARY WEAPONS IN THE FIGHT AGAINST FRAUD

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### INTRODUCTION

1 Most discussions about the civil remedies available to a victim of fraud against third party recipients centre on the claimant's ability to prove that the third party received the claimant's property or its traceable proceeds or substitutes (in law or in equity). The ability to trace or follow fraudulently misappropriated property, its proceeds or substitutes - although essentially an evidential process<sup>1</sup> - is key to establishing the claimant's right to relief. Little mention is made of what remedies may be available to a victim of fraud when the tracing process breaks down, so that he cannot establish that his property or its proceeds or substitutes have made its way into the recipient's hands.

2 The purpose of this article is to analyse recent developments in Jersey law, dealing with personal remedies against third party recipients, both where the victim can prove receipt of his property or its proceeds or substitutes by the third party and in cases where the tracing trail runs cold but the victim can show that the fraudster transferred his own assets to the recipient in order to defeat his claim.<sup>2</sup> It is proposed to compare the personal remedies offered under English and Jersey law against third party recipients of: first, the traceable substitutes or proceeds of the victim's property; and, second, the fraudster's own assets. Volunteers and purchasers are dealt with separately. It will be seen that Jersey law may offer a victim an easier path to establishing the personal liability of the recipient in both cases. This may make it more attractive for claimants in multi-jurisdictional fraud cases involving Jersey assets, trusts and/or trustees to argue, if at all possible, that Jersey law should be the applicable law. As a matter of principle, the Jersey approach also suggests a move towards a more coherent response to fraud, which is grounded in the law of restitution. A detailed consideration of dishonest assistance is beyond the scope of this article, which focuses on receipt by third parties of either the subject-matter of the fraud or the fraudster's own property.<sup>3</sup>

### THE ESTEEM JUDGMENT

3 Sheikh Fahad was the director of Grupo Torras SA ("GT"), a company owned by the Kuwait Investment office. Between 1988 and 1990, Sheikh Fahad conspired with others to defraud GT of some US \$430 million of which his own personal share was approximately \$120 million. During this period, he paid some of his own money and the

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<sup>1</sup> See, e.g. Mitchell, *Tracing, following and claiming the proceeds of stolen assets*, (2003) 7 Jersey Law Review 7 and Hayton, *Shams, piercing veils, remedial constructive trusts and tracing*, (2004) 8 Jersey Law Review 6.

<sup>2</sup> *Golder v Société des Magasins Concorde Ltd* 1967 JJ 72; and *In the matter of the Esteem Settlement and the No. 52 Trust (Abacus (C.I.) Limited as Trustee)* 2002 JLR 53.

<sup>3</sup> See, however, paragraph 45 *infra* where the test for dishonesty is discussed.

stolen money to the trustees of trusts he had set up around the world between 1981 and 1994, most notably to Abacus (CI) Ltd ("Abacus"), the trustee of two Jersey settlements, the Esteem Settlement and the No. 52 Trust and the administrator of Ceyla, a Liechtenstein Anstalt. Within a few months of March 1990, Sheikh Fahad had become hopelessly insolvent.<sup>4</sup> On 14 April 1993, GT issued a writ in England alleging conspiracy to defraud against Sheikh Fahad and others. GT obtained judgment against Sheikh Fahad for approximately \$800 million in the English High Court on 24 June 1999. GT then brought an action in Jersey, which included an equitable proprietary claim in respect of £1.276 million, an alternative claim in restitution for the same sum and a claim to set aside all transfers made into the Esteem Settlement, the No. 52 Trust and Ceyla at any time after the fraud began in May 1988, on the basis that these transfers were made in fraud of GT as a creditor of Sheikh Fahad ("the Pauline Action").

4 Birt, Deputy Bailiff, allowed the equitable proprietary claim to the extent that GT's money was still traceable into two properties in London. Because it had allowed the equitable proprietary claim, the Court did not need to express a view on the restitutionary claim, but the Deputy Bailiff took the opportunity to state that where an innocent third party receives the subject-matter of a breach of trust or fraud or its traceable substitute, he must make restitution to the victim of the breach or fraud, subject to the defence of change of position.<sup>5</sup> He also allowed the Pauline Action in respect of some of the transfers by Sheikh Fahad of his own money and the proceeds of the fraud to Abacus of the Esteem Settlement, subject to the defence of change of position. The judgment shows how Jersey law has developed to deal with third party recipients where they have received the traceable proceeds of fraud or assets transferred by the fraudster in order to defeat the victim's claims. In order to see clearly the difference between the English and Jersey approaches, it is useful to look first at the position of recipients of the victim's property or its traceable proceeds and then at the position of recipients of money transferred by the fraudster into which the victim's property is not traceable.

## **PERSONAL LIABILITY OF RECIPIENTS OF THE VICTIM'S PROPERTY OR ITS TRACEABLE PROCEEDS OR SUBSTITUTES**

### **(a) English law – knowing receipt**

5 Under English law, a knowing receipt claim will lie against a third party recipient of the victim's property or its traceable proceeds or substitutes, but only if the victim can prove that the third party received it with knowledge that it was transferred in breach of trust/fraudulently. The test is whether the recipient's state of knowledge is such as to make it unconscionable for him to retain the benefit of the receipt.<sup>6</sup> Once knowledge has been proved, the recipient becomes personally liable as a constructive trustee of the assets received. The element of knowledge must be proved in the case of volunteers and

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<sup>4</sup>2002 JLR 53, 146.

<sup>5</sup>2002 JLR 53, 111-113

<sup>6</sup>*BCCI v Akindele* [2001] Ch 437 at paragraph 70 of the judgment of Nourse LJ.

purchasers alike, as English law does not distinguish between them for the purposes of a knowing receipt claim.

6 If the victim can prove receipt but not knowledge, then no claim at all will lie against the recipient. This means that in a case where the victim can trace the proceeds of fraud into the hands of the recipient but not beyond, and even though he can prove receipt, in the absence of proof of knowledge on the part of the recipient the victim will be left with no remedy (because the tracing trail has run cold). The requirement of knowledge as a constituent part of the cause of action in every case has been criticised:<sup>7</sup> it is difficult to see why recipients of the traceable proceeds of fraud to which they are not entitled - irrespective of their state of knowledge at the time of receipt - should not come under a personal liability to make restitution to the victim. Whether they should also be treated as constructive trustees is a separate question and the two issues should not be elided.

## **(b) Jersey law – personal restitutionary liability**

### **(i) Volunteers**

7 In *Esteem* the Deputy Bailiff rejected knowledge or fault as a necessary prerequisite for the imposition of a personal receipt-based liability on a recipient who did not give value in exchange for receipt of the victim's property or its traceable proceeds or substitutes. This development will make it easier for victims of fraud to recover against remote volunteer recipients whose state of mind it may be difficult to prove. The Deputy Bailiff explicitly recognised that the basis of recovery is restitutionary; the aim is to prevent the volunteer recipient from being enriched through receipt of the proceeds of the fraud at the expense of the victim. According to the Deputy Bailiff, "the state of mind required for a 'knowing receipt' claim is not required in Jersey. It is a strict restitutionary liability."<sup>8</sup> The liability is a personal one only: in order to impose liability as a constructive trustee on the recipient it will remain necessary to prove fault or knowledge. This approach keeps separate the question whether the volunteer recipient should make restitution from the question whether he should be treated as a constructive trustee with all the consequences that follow from that status.

8 It is also clear from the Deputy Bailiff's judgment that innocent volunteers, who have acted in good faith and changed their position in reliance on the receipt will be able to rely on the change of position as a defence (in whole or in part) to the receipt-based liability.<sup>9</sup> For example, if a fraudster transferred stolen gold to his niece by way of gift and she used part of it to finance a holiday which she would not otherwise have been able to take, she would only be liable to return the gold still in her hands and could rely on the change of position defence in respect of the gold which she had sold to pay for her holiday, as long as she could demonstrate that she had acted in good faith so that her conscience was

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<sup>7</sup>Lord Nicholls, *Knowing Receipt: The Need for a New Landmark*, in WR Cornish *et al* (eds), *Restitution: Past, Present and Future* (1998) 231.

<sup>8</sup>2002 JLR 53, 113, para. 157

<sup>9</sup>Applying the test set out by Lord Goff in *Lipkin Gorman v Karpnale Ltd* [1991] 2 AC 548, 580.

untouched by the fraud. Although the Deputy Bailiff confirmed the principle that the concept of relative fault is not to be introduced into the Jersey law on change of position,<sup>10</sup> his judgment provides little guidance as to when a recipient will be deemed not to have acted in good faith so as to be denied the defence.

9 In *Lipkin Gorman* Lord Goff thought that a recipient who pays away the money received with knowledge of the facts entitling the plaintiff to restitution would be acting in bad faith. The quality of knowledge required in order to constitute bad faith was discussed further by the Court of Appeal in *Niru Battery Mfg Co v Milestone Trading Ltd*,<sup>11</sup> which held that the touchstone of bad faith is not merely dishonesty (although the defence of change of position would be lost in those circumstances): the focus is on whether it would be unjust to allow restitution. The key to the principle of change of position is that it involves a balance between the interests of the payer and those of the payee. The Court of Appeal drew parallels with the degree of knowledge required to support a knowing receipt claim - the recipient's state of knowledge must be such as to make it unconscionable for him to retain the benefit of the receipt.<sup>12</sup> This does not require him to act dishonestly; it can include a failure to act in a commercially acceptable way and sharp practice. For example, where the payee has grounds for believing that a payment may have been made by mistake, but cannot be sure, good faith may well dictate that he should make enquiry; a person who has, or thinks he has, good reason to believe that he has been paid by mistake is unlikely to have been found to have acted in good faith if he pays the money away without first making enquiries of the person from whom he received it.<sup>13</sup> Thus, actual and definite knowledge of the plaintiff's right to restitution is not always necessary: if the recipient is put on enquiry as to the circumstances surrounding the transfer of assets to him, the principle of good faith requires him not to dispose of them without making further enquiry.

10 If the *Niru Battery* test were to be adopted in Jersey, its effect combined with that of the recognition of strict personal restitutionary liability on the part of a volunteer recipient would be to relocate knowledge as an element of the cause of action to an element of any defence. This would cause the burden of proof to shift from the claimant - who would need to prove that the recipient had knowledge in order to fix him with personal liability for knowing receipt under English law - to the recipient who, under Jersey law, would need to prove that he did not have sufficient knowledge to render unconscionable his retention of the benefit. If the recipient could show that he did not have such knowledge as to make it unconscionable for him to retain the benefit of the receipt in circumstances where he had changed his position in reliance on it, he would not be personally liable to the extent of his legitimate change of position.

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<sup>10</sup>Applying the decision of the Privy Council in *Dextra Bank & Trust Company Ltd v Bank of Jamaica* [2002] 1 All ER (Comm) 193.

<sup>11</sup>[2003] EWCA Civ 1446.

<sup>12</sup>*BCCI v Akindole* [2001] Ch 437, 456 per Nourse LJ.

<sup>13</sup> [2002] EWHC 1425, para 135 of the judgment of Moore-Bick J. at first instance.

11 This strikes a sensible balance between the interests of the victim of a fraud and the third party recipient who acts in good faith because it will usually be more difficult for a victim to prove knowledge on the part of a remote third party recipient than it will be for that recipient to prove his own lack of knowledge and change of position. If the victim can prove knowledge, the recipient will hold the proceeds of fraud as constructive trustee under both English and Jersey law. If, however, the victim cannot prove knowledge, no personal remedy will be available against the recipient under English law, whereas under Jersey law the restitutionary remedy will be available. It follows that where a victim is likely to experience such difficulties of proof against a volunteer recipient, if it is possible to argue for the application of Jersey law rather than English law, it would be advantageous to do so.

## (ii) Purchasers

12 In his judgment in *Esteem*, the Deputy Bailiff made no mention of the position of recipients who have given value. On the facts, GT was an innocent volunteer and it follows that any comments made by the Deputy Bailiff on this point would have been *obiter*. Nevertheless, his judgment begs the question whether strict restitutionary liability should also be imposed on recipients who give value for what they receive. If not and they are to be treated differently, the distinction has the following consequences. In the case of purchasers, the requirement of knowledge would remain an element of the cause of action, so that the burden of proof of knowledge would rest on the victim of the fraud. In the case of volunteers, the availability of the receipt-based restitutionary claim would require the location of the issue of knowledge in the context of the defence of change of position, so that the burden of proof of lack of knowledge would rest on the recipient. In the absence of any sound reason for the distinction it is difficult to see why the incidence of the burden of proof should be different in each case.

13 Purchasers and volunteers are treated differently under English law to the extent that the defence of *bona fide* purchase is available only to recipients who have given value for what they have received in good faith and without notice of the plaintiff's equitable title to it. Continuing the example set out at paragraph 8 above, if the fraudster's niece paid him for some of the gold and did so in good faith and without notice of the fraud, the *bona fide* purchaser defence would operate in respect of the part of the gold for which she had given value, so that she would only have to return the remainder still in her hands. The availability of the *bona fide* purchase defence in the context of transfers of personal property appears to be predicated upon the need not only to protect individual recipients who have, as a consequence of receipt, sustained losses which it would be inequitable to force them to bear, but also to facilitate trade by protecting transactional security in exchange dealings with the primary economic objective of facilitating the free transfer of wealth.<sup>14</sup> It is this second objective – to protect the market – which is unique to the *bona fide* purchase defence and does not form part of the rationale for the defence of change of

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<sup>14</sup>Barker, "After Change of Position: Good Faith Exchange in the Modern Law of Restitution" in Birks, P., ed., *Laundering & Tracing* (1995), p. 191, pp. 192-3.

position. The change of position defence is more individualistic in nature: it is concerned to protect individual recipients who have, as a consequence of receipt, sustained losses which it would be inequitable to force them to bear, and so it is available to purchasers and volunteers alike. It may be that the wider rationale for the *bona fide* purchase defence justifies its wider ambit; in contradistinction to the change of position defence, it operates as a complete bar to the claim, is not limited to post-receipt losses and protects not only the initial purchaser but also those who derive property from him.<sup>15</sup>

14 In circumstances where the need to facilitate trade and the interests of the individual are both protected by the existence of the *bona fide* purchase and change of position defences, there is no obvious justification for the burden of proof of knowledge resting on the victim of the fraud simply because the recipient is a purchaser rather than a volunteer. In the absence of any principled reason to the contrary it makes sense for the cause of action to be the same whether the recipient is a volunteer or a purchaser and for knowledge or lack of it to be a relevant element of any available defences rather than of the cause of action itself.<sup>16</sup> In those circumstances, there is no logical impediment to the recognition of the personal restitutionary liability on the part of a third party recipient who has given value for what he has received.

15 This prompts the question whether Jersey law recognises the operation of the *bona fide* purchase defence. If it does, then the requirements of security of receipt and freedom of trade could be regarded as being adequately protected, so that there would be no apparent difficulty with the extension of the strict personal restitutionary liability to both categories of recipient. If on the other hand Jersey law recognises only change of position as a defence to a receipt-based restitutionary claim, then consideration must be given as to whether the requirements of exchange transactions and security of receipt require purchasers to be treated differently from volunteers, so that the personal restitutionary remedy should only be available against the latter and victims of fraud would still have to prove knowing receipt on the part of the former.

16 Unfortunately, the position in Jersey is unclear. In *Esteem* the Deputy Bailiff appears to have assumed (without deciding) that the *bona fide* purchaser principle is recognised in Jersey, at least in the context of equitable proprietary claims, in so far as he held that where an innocent volunteer has a wholly owned company into which the proceeds of fraud are injected, *e.g.* through a loan account, it is artificial to treat the company as a *bona fide* purchaser for value so that the tracing stops at the relationship between the volunteer and his company – the tracing exercise must be continued into what the company did with the proceeds. The principle was also recognised in the *Golder* case in the context of a Pauline Action (as to which more below) and, more recently, as a factor which could possibly circumscribe the operation of the *Hastings Bass* principle.<sup>17</sup> The *Golder* case was, however, subsequently distinguished by the Royal Court in

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<sup>15</sup>*Op. cit.* p. 191, pp. 195-198.

<sup>16</sup>See *e.g.* Barker, *op cit.*, p. 209.

<sup>17</sup>*Seaton Trustees Limited v Benedict John Morgan* [2007] JRC 206, para 19, per Clyde-Smith Commr (*obiter*).

*Mendonca v Le Boutillier*.<sup>18</sup> In that case, it was held that although a transferee acting in good faith receiving chattels from a transferor who did not have good title did acquire: (a) the right to receive any income and benefits from these movables without having to account for them to the owner; and (b) civil possession followed by eventual ownership if the owner did not reclaim the chattels within a period of ten years, *bona fide* purchase without notice would not of itself suffice to prevent the original owner from being entitled to reclaim the chattels. The Court stated that the Jersey law of contract was based on Roman law and distinguished *Golder* on the basis that it related to a Pauline Action rather than a straightforward contractual claim.

17 It may be that *Mendonca* itself can be distinguished as relating to a contractual claim, while the operation of the *bona fide purchase defence* could be recognised extra-contractually in the context of equitable proprietary claims, Pauline Actions and personal restitutionary claims based upon the receipt of misappropriated funds. Further examination of this point by the Royal Court would be welcome. In the absence of a clear statement as to whether the *bona fide* purchaser principle operates in Jersey at least in relation to equitable proprietary and/or restitutionary claims so sufficiently as to protect transactional security, it is difficult to say with any certainty whether Jersey law can or should allow victims of fraud to invoke the receipt-based restitutionary claim against recipients who have given value for what they have received or whether victims of fraud would still have to prove knowing receipt against purchasers.

### **(iii) Liability for profits**

18 In *Esteem* the Deputy Bailiff held that third party recipients of the proceeds of fraud could be deemed constructive trustees of those proceeds if they were at fault, *i.e.* had knowledge of the provenance of the funds/the plaintiff's title to them. In other words, in order to hold a third party recipient liable as constructive trustee (rather than simply liable to make restitution), it is legitimate to require the victim of the fraud to prove knowledge (rather than allowing strict liability subject to defences). The location of the requirement of knowledge in the context of the cause of action - rather than in the context of any defences - in such a case is justifiable in light of the burdens imposed and advantages gained by the treatment of the recipient as a constructive trustee. For example, constructive trustees will be liable to pay compound interest;<sup>19</sup> and the victim will be able to claim any increase in value in the trust property from a constructive trustee.<sup>20</sup> Thus, the arguments justifying the shifting of the burden of proof in relation to knowledge to the defendant where it is merely sought to impose a personal restitutionary remedy upon him are not sufficient to do the same where it is sought to impose upon him the more onerous obligations of constructive trusteeship.

### **(c) Conclusion**

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<sup>18</sup>1997 JLR 142, 148.

<sup>19</sup>*Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669.

<sup>20</sup>Goff & Jones, *The Law of Restitution* (6<sup>th</sup> ed), p. 740.

19 In cases where the defendant has received the property of the victim of a fraud or its traceable proceeds or substitutes, the introduction of a receipt-based restitutionary remedy into Jersey law is to be welcomed. In cases where the recipient is a volunteer, it makes sense to locate the element of knowledge in the context of any defence of which he may avail, rather than requiring the victim of a fraud to prove knowledge. In cases where there is a question as to whether or not Jersey law or English law should govern the dispute, this new development should encourage plaintiffs to argue that Jersey law is the applicable law. The position of purchasers is less clear. In the absence of clarification as to the existence and ambit of the *bona fide* purchase defence in Jersey law, it is difficult to predict whether the Royal Court will impose a personal restitutionary liability on purchasers in the same way. Where it is sought to compel a recipient – be he volunteer or purchaser - to disgorge any profits made out of the proceeds of the fraud, the victim will still have to prove knowledge as an element of the cause of action in order to impose the more onerous obligations of constructive trusteeship. This is consistent with principle and in line with English law. In the next part of this article consideration will be given to the different approaches of English and Jersey law to recovery by the victim of a fraud when the tracing trail runs cold.

#### **PERSONAL LIABILITY OF RECIPIENTS OF THE FRAUDSTER'S PROPERTY BY WAY OF A TRANSFER OF WHICH A SUBSTANTIAL OBJECTIVE IS TO DEFEAT THE VICTIM'S CLAIM**

##### **(a) The principle**

20 Where the victim of a fraud cannot establish a proprietary connection between the subject-matter of the fraud and any assets received by the third party recipient, he will not be able to advance a knowing receipt claim (England) or a receipt-based personal restitutionary claim (Jersey). Nevertheless, if the victim can show that the fraudster transferred his own assets to the third party recipient with the intention to defeat the claims of creditors, he may be entitled to revoke the transfer, irrespective of his inability to trace into its subject-matter. The principle is not new: it derives from the Roman law *actio Pauliana* and can be traced through the Statute of Elizabeth 1571 into section 172 of the English Law of Property Act 1925 and, most recently, into sections 423-5 of the Insolvency Act 1986,<sup>21</sup> article 17 of the Bankruptcy (*Désastre*) Law 1998, and the Pauline Action, which forms part of Jersey customary law.

21 The rationale of the *actio Pauliana* is that -

"... if a person has alienated his property in fraud of creditors who have been put in possession by order of the governor, they are allowed to bring an action cancelling the

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<sup>21</sup>*The Commissioners of the Inland Revenue v Hashmi* [2002] EWCA Civ 981, para 21 of the judgment of Arden LJ; *Muir Hunter on Insolvency*, para 3-2936.



alienation, that is alleging that the property has not been alienated and therefore remains an item in the debtor's estate."<sup>22</sup>

In form the action resembles rescission, save that the party entitled to trigger the rescission or revocation of the transaction is the creditor whose interests have been prejudiced, rather than the person who has made the transfer (the fraudster).

**(b) English law – Section 423 of the Insolvency Act and transactions at an undervalue**

22 This principle is expressed in English law through the operation of Section 423 of the Insolvency Act 1986, which entitles creditors to set aside transactions at an undervalue which are made by a debtor, where a substantial purpose of the transaction is to put assets beyond the reach of a person who is making or may make a claim against him or otherwise prejudicing the interests of such a person.<sup>23</sup> It is axiomatic to say that transactions at an undervalue may include transfers of assets in respect of which no value is given. An application to set aside such a transaction will be treated as having been made on behalf of every victim of it, and the court has a wide discretion as to the sort of order it may make (*e.g.* vesting orders, discharge or release of securities, *etc.*)<sup>24</sup> There is no requirement to prove insolvency at the time of or as a result of the transaction and it extends to persons who may be future creditors. Section 423 is the first provision in Part XVI of the Insolvency Act, which is entitled “Provisions Against Debt Avoidance”. A declaration of bankruptcy/insolvency is not a prerequisite for Section 423 to operate. Sections 238 and 339 deal with the position where transactions at an undervalue have been entered into by an insolvent company or a bankrupt individual and how they may be set aside.

**(c) Jersey statute - Article 17 of the Bankruptcy (Désastre) Law 1990, as amended**

23 Article 17 of the Bankruptcy (*Désastre*) Law 1990 (as amended by the Bankruptcy (*Désastre*) (Amendment) Law 2006). permits a transaction at an undervalue to be set aside, where the transaction has been entered into by a person in respect of whose property a declaration of *désastre* has been made, unless the debtor entered into it in good faith for the purpose of carrying on a business and there were reasonable grounds for believing that the transaction would be of benefit to the debtor. A parallel provision which operates in the context of a creditors' winding up is to be found in Article 176 of the Companies (Jersey) Law 1991. These Jersey provisions were based on sections 238 and 339 of the English Insolvency Act. It follows that although it is also premised on the notion of a transaction at an undervalue, Article 17 does not operate as a direct statutory equivalent of Section 423, not least because it is only applicable where a declaration of

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<sup>22</sup>*The Institutes of Justinian*, Book IV, Title VI, para 679, no. 6, as set out in Lee, *The Elements of Roman Law* (3<sup>rd</sup> ed., 1952), p.448.

<sup>23</sup>*The Commissioners of the Inland Revenue v Hashmi* [2002] EWCA Civ 981, para 25 of the judgment of Arden LJ.

<sup>24</sup>See *Muir Hunter on Insolvency*, paras 3-2936 *et seq.*

*désastre* has already been made. The nearest thing to Section 423 under Jersey law appears to be the Pauline Action.

**(d) Jersey customary law – the Pauline Action**

24 The Pauline Action also provides a victim of fraud with the right to revoke a transfer by the fraudster of his assets to a third party recipient if the transfer causes the victim to become a creditor of the fraudster and it renders the fraudster insolvent or is made at a time when he is already insolvent. The action derives from Jersey customary law and the elements of the cause of action differ depending on whether the recipient is a volunteer or has made payment at an undervalue (when the transfer is known as an *aliénation lucrative*) or is a purchaser who has given full value (when the transfer is known as an *aliénation onéreuse*). If the cause of action is established, the transfer of assets is revoked so that the assets then become available to satisfy the victim's claim.

**(i) Personal liability of volunteers – aliénations lucratives**

25 A volunteer recipient's liability to return the benefit depends on the victim being able to demonstrate the following:

- (a) a transfer of assets from the fraudster to the recipient which was made at a time when the fraudster was insolvent or which rendered him insolvent in the sense that his liabilities exceeded his assets.<sup>25</sup> If the victim can prove insolvency in this sense at the time of the Pauline Action, the burden of proof will shift to the fraudster to prove that he was not insolvent at the time of the transfer.<sup>26</sup> Where a fraudster has misappropriated and dissipated funds which exceed the value of his own assets (as will often be the case with large frauds), insolvency will not be difficult to prove;
- (b) that the victim was a creditor at the time of the transfer. A victim of fraud will become a creditor at the time the facts giving rise to his cause of action occur, even if the validity of the cause of action is not established until later. In practice the debtor/creditor relationship will be easy to establish;<sup>27</sup>
- (c) that a substantial intention of the fraudster in making the transfer was to defraud his creditors. This need not be his only or dominant purpose but it must be a substantial purpose;<sup>28</sup> and
- (d) that the victim of the fraud was actually prejudiced by the transfer.<sup>29</sup> Again, this should be relatively easy to prove: the transfer of assets coupled with insolvency will have the effect of rendering the fraudster unable to meet the victim's claim.

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<sup>25</sup>2002 JLR 53, 126-7.

<sup>26</sup>2002 JLR 53, 128-9.

<sup>27</sup>2002 JLR 53, 124.

<sup>28</sup>2002 JLR 53, 134.

<sup>29</sup>2002 JLR 53, 132.

It would only be if the victim were able to trace the proceeds of the frauds to other defendants, who retained them or were good for the money, and make successful personal or proprietary claims against them that it might be said that he had not been prejudiced by the transfer of assets.

26 The Deputy Bailiff described the Pauline Action against Abacus, an innocent volunteer, as revocatory in nature and "essentially a restitutionary action seeking to place the parties back into the position in which they would have been before the transaction."<sup>30</sup> He stated that when the recipient is an innocent volunteer, the creditor is not entitled to compensation – he is merely entitled to claim the property itself, subject to the operation of the defence of change of position.<sup>31</sup>

27 The Deputy Bailiff did not analyse in detail why the Pauline Action – at least in the case of an *aliénation lucrative* – should be treated as restitutionary in nature. Indeed, a Pauline Action against a volunteer is not easily described as an action requiring the recipient to make restitution to the creditor for a benefit gained at his expense (in the subtractive sense) because the volunteer need not have received the creditor's money or its traceable proceeds to be liable; nor is the action properly categorised as one which grants restitution for a wrong because the innocent volunteer recipient has committed no wrong. Even so, Birks describes this type of action as a restitutionary action, which is recognised directly in response to the need to protect creditors and investors from this sort of malpractice.<sup>32</sup> Although it does not fit into the usual categories of restitution to reverse subtractive unjust enrichment (*e.g.* mistake, duress, ignorance) or restitution for wrongs, the policy of creditor protection appears to drive the need for a restitutionary remedy to be recognised.

28 According to the Deputy Bailiff, the Pauline Action is best regarded as a personal action in order to prevent the unjust enrichment of the recipient. He confirmed that the creditor has no title in the thing alienated from the fraudster to the volunteer recipient, and went on to say that the creditor is not asserting any claim to the thing itself: he is simply actioning the recipient to return it (if he still has it) to the fraudster's patrimony or to return such value originating from the thing as may remain in the recipient's hands. When read in conjunction with the Deputy Bailiff's earlier statement that the creditor claims the property itself subject to the defence of change of position, this statement could lead to confusion, as it tends to suggest that the claim is in fact proprietary (for the value retained by the recipient) rather than personal (for the full amount transferred).

29 The distinguishing feature of the Pauline Action is that it does not assert any pre-existing proprietary right or title on the part of the creditor in the assets or money transferred to the recipient. The creditor is not seeking to *re-vest* property in himself, which has made its way through the fraudster into the hands of the volunteer recipient and

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<sup>30</sup>2002 JLR 53, 138.

<sup>31</sup>2002 JLR 53, 135.

<sup>32</sup>Birks, *An Introduction to the Law of Restitution* (1986), pp 308-9.

may be identified as having been received by him. He is simply asserting an entitlement to revoke the transfer from the fraudster to the recipient on the basis that it was made by the fraudster at a time when he was insolvent in order to defeat his (the creditor's) claim. It is therefore not a proprietary claim (in the legal or equitable sense). If, as the Deputy Bailiff seems to have intended, the claim is to be treated as a personal one, it would perhaps be clearer to say that the recipient comes under a personal liability to make restitution of what he has received, save and in so far as he may rely on any change of position made in good faith and in reliance on the receipt.

30 If it is right to say that the Pauline Action – at least in the case of an *aliénation lucrative* – is restitutionary in nature, it follows that in a case of fraud, where the victim becomes a creditor of the fraudster because the fraudster has misappropriated the creditor's money, dissipated it (at least in part) to a volunteer and has insufficient assets to repay it, the Pauline Action mirrors the receipt-based restitutionary claim which now forms part of Jersey law. In both cases the volunteer recipient will be held personally liable to make restitution of the funds received, subject to the availability of the change of position defence. Logic dictates that the test for establishing good faith change of position should be the same, whatever the cause of action. On this basis, if the *Niru Battery* test is to be applied in Jersey (and there is no reason why it should not be applied here), the test for establishing the defence in all cases will be whether the recipient's knowledge is such that it would be unconscionable for him to retain the benefit of the receipt. It follows that knowledge should not be a pre-requisite to establishing the cause of action in either case: rather, it becomes relevant in establishing whether the recipient changed his position in good faith and in reliance on the receipt. The difference between the two causes of action is then only that in order to establish the receipt-based restitutionary claim, the creditor needs to use the tracing process to identify the stolen property or its traceable substitutes or proceeds in the hands of the volunteer recipient.

31 If this analysis is correct and were to be adopted in Jersey, it might be said that Jersey law provides a seamless response to fraud where the proceeds of the fraud and/or the fraudster's own assets are transferred to a volunteer recipient. Where the victim can trace his property into the hands of the recipient, the recipient will be strictly liable to make restitution of the benefit, subject only to the operation of the change of position defence. Where the victim cannot trace, but can show that the fraudster transferred assets to the recipient with the substantial intention of defeating the rights of his creditors, and that transfer rendered the fraudster insolvent or was made at a time when he was already insolvent, he can bring a Pauline Action to reverse the transaction and again, the recipient will be strictly liable to make restitution subject to being able to establish a good faith change of position in reliance on the receipt of the assets.

32 By way of contrast, although it may be easier for a victim to establish a case under Section 423 of the Insolvency Act (*e.g.* because there is no need to prove insolvency and/or because Section 423 is also available to creditors with future claims), the

unavailability of the purely receipt-based restitutionary remedy in the UK and the fact that it will often be relatively easy to prove insolvency in large-scale fraud cases makes the application of Jersey law and the Pauline Action more attractive to victims of fraud.

**(ii) Purchasers**

33 As discussed in paragraphs 22-3 above, Section 423 of the Insolvency Act is limited in the sense that it applies only to transactions at an undervalue. It does not catch transfers of assets by the fraudster to a third party recipient who gives full value for them, even if the recipient had knowledge of or shared the fraudster's intention to defeat creditors. This is in contradistinction to the terms of the predecessors of Section 423, *i.e.* s. 172 of the Law of Property Act 1925 and the Fraudulent Conveyances Act 1571, both of which allowed a disposition made with intent to defraud creditors to a transferee who had notice of that intent to be set aside even where the transferee had given value.<sup>33</sup> Section 423 provides no remedy for victims of fraud in cases where the tracing trail stops and the fraudster transfers his own assets to a third party for full value in order to defeat the victim's claim.

34 Section 423 does not deal with the situation where a fraudster (who has become insolvent as a result of the fraud) transfers his own assets to a third party for value in order to defeat the claim of the victim of the fraud. The Pauline Action can, however, provide the victim with a remedy in those circumstances.

35 In circumstances where the debtor/fraudster has transferred his assets to a third party for value (known as an *aliénation onéreuse*) and that third party is privy to the real nature of the transaction, *i.e.* that it was being made in order to defeat creditors' interests, the Pauline Action operates to set aside the transfer of assets to the third party. It follows that even when the tracing trail runs cold, a victim of fraud may still be able to reverse a transfer by the debtor of his own assets to a third party for value. This makes the Pauline Action a powerful weapon against fraud in circumstances where the fraud renders the fraudster insolvent.

36 The judgment of the Royal Court in the case of *Golder v Société des Magasins Concorde Ltd*<sup>34</sup> sets out the elements of the cause of action where there has been an *aliénation onéreuse*. As in the case of an *aliénation lucrative*, the victim of the fraud/the creditor does not have to prove that the recipient received the creditor's property or its identifiable proceeds or substitutes. The conditions for the victim's success in the case of a transaction for value (an *alienation onéreuse*) are the same as those outlined in relation to *aliénations lucratives* save that the victim must also show a degree of complicity on the part of the recipient. Importantly, an *aliénation* does not become *onéreuse* simply because some *cause* or value is given; if the transaction is at an undervalue, it will still be

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<sup>33</sup>Muir Hunter, *op cit*; *Lloyd's Bank Ltd v Marcan* [1973] 1 WLR 1387; *The Commissioners of Inland Revenue v Hashmi* [2002] EWCA Civ 981, at para 21 of the judgment of Arden LJ.

<sup>34</sup>1967 JJ 721.

deemed to be an *aliénation lucrative*.<sup>35</sup> The victim of a fraud will only need to go on to prove the complicity of the third party recipient if the recipient has given full value for what he has received.

37 According to the Royal Court in *Golder*, the liability of the recipient in the case of a Pauline Action based on an *aliénation onéreuse* is to make restitution. In *Golder* a Guernsey company bought the business of a Jersey company after judgment had been entered against the Jersey company in an unfair dismissal claim. The personnel in both companies were related and the Royal Court found that the sale had been engineered in order to defeat the claim of the former employee of the Jersey company, who had brought the wrongful dismissal claim. It turned out that the business of the Jersey company had then been sold on by the Guernsey company to a third party. The Royal Court found that the third party was a *bona fide* purchaser for value without notice of the fraudulent nature of the sale and whose title could not therefore be impugned. The net proceeds of sale remained in the hands of the Guernsey company. The Bailiff referred to the writings of Domat and held that the true nature of the obligation on the Guernsey company was to make restitution to the plaintiff. The Court declared that the purported sale as between the Guernsey company and the Jersey company was void and obliged the Guernsey company to make restitution to the plaintiff in the amount of the award of compensation and costs.

38 In *Esteem* the Deputy Bailiff characterised the liability arising in the case of an *aliénation onéreuse* as having its basis in fraud. He did not go on to discuss whether in such a case the Pauline Action would be characterised as restitutionary in nature. It may be possible to characterise the cause of action in the case of an *aliénation onéreuse* as one giving rise to a liability to make restitution for a wrong. In a Pauline Action against a recipient who has given value, the defendant's wrong is his acceptance of the fraudster's assets in circumstances where he was privy to the real nature of the transaction, *i.e.* that a substantial purpose of it was to defeat the victim's claim. The recipient can be said to have acted unconscionably and neither the defence of change of position nor the *bona fide* purchase defence will be available, as the recipient will be unable to prove good faith. Further analysis from the Royal Court of the juridical nature of the cause of action in the case of an *aliénation onéreuse* would be welcome.

39 It is also possible to identify parallels between the Pauline Action in the case of an *aliénation onéreuse* and knowing receipt under English law. In a knowing receipt claim the recipient's wrong is his acceptance of the assets of the victim or their traceable proceeds with sufficient knowledge of their provenance such as to make it unconscionable for him to retain them. In a Pauline claim against a recipient who has given value, the wrong is similar in nature and in both cases, the recipient can be said to have acted unconscionably. However the cause of action is characterised (as restitutionary or otherwise), in neither case is the defence of change of position or the *bona fide* purchase

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<sup>35</sup>2002 JLR 53, 130 per Birt DB.

defence available because the recipient cannot prove good faith. In both cases the state of mind and knowledge of the recipient is crucial.

40 Neither of the judgments in *Golder* or *Esteem* stipulate precisely the degree of knowledge required on the part of the recipient so that the victim can use the Pauline Action to set aside a transaction for full value. In *Esteem*, the Deputy Bailiff simply repeated the phrase used in *Golder*, *i.e.* that in order to be liable, the recipient must have been privy to the real nature of the transaction. This phrase gives little guidance as to the state of mind required.

41 Some explication of the degree of knowledge required can, however, be found in the French commentaries referred to by the Royal Court in *Golder*. Pothier stated that in cases where the debtor is insolvent and makes a transfer in defeasance of his creditor's interest -

*"[J]e [the creditor] pourrais agir contre le tiers acquéreur pour faire rescinder l'aliénation qui lui en a été faite en fraude de ma créance, pourvu qu'il ait été participant de la fraude, conscius fraudis, s'il était acquéreur à titre gratuit."*<sup>36</sup>

[I could take action against the recipient in order to rescind the transfer which was made to him fraudulently in order to defeat my claim, provided that he was a participant in the fraud, conscius fraudis, if he acquired the title onerously, *i.e.* by giving value for it.]

Pothier's emphasis is on participation by the recipient, *conscius fraudis*, *i.e.* with consciousness of the fraud. This suggests that knowledge of the fraudulent intent is required, but neither the degree of knowledge nor the level of participation is stipulated.

42 Domat also focused on the fact of participation by the recipient in a fraud on creditors, stating that:

*"Celui qui aura participé à une fraude faite à des créanciers, sera tenu de rendre tout ce qu'il se trouvera avoir reçu par une telle voie, après les fruits ou autre revenus, & les intérêts, si ce sont des deniers, à compter depuis le jour qu'il les aura reçus. Et toutes choses seront remises au même état où elles étaient avant cette fraude."*<sup>37</sup>

[Anyone who has participated in a fraud on creditors, will be obliged to return all that he is found to have received in this way, after the fruits or other profits, and the interests, if they take the form of money, are to be counted from the date on which he received them. And all things shall be given back in the same state in which they were before this fraud.]

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<sup>36</sup> Pothier, *Traité des Obligations*, Part I, Ch II, Article II, p. 177

<sup>37</sup> Domat, *Les Lois Civiles dans leur Ordre Naturel*, Livre II, Section II (*Nouvelle Edition*, p. 194)

43 In the absence of any express description of the degree of participation and/or knowledge/consciousness of the fraud on the part of the recipient, it is difficult to assess what is required. Shortly after judgment was given on liability in the wrongful dismissal claim in *Golder*, the Guernsey company offered to buy the business of the Jersey company for market value, which offer was accepted. Formal agreements of sale were entered into in July 1966, after the judgment on quantum was delivered. The court referred to the relationship between the board members of both companies (they were closely related by marriage), the admission that the board members of the Jersey company hated the plaintiff and the fact that the sale was shrouded in secrecy. This was all sufficient to demonstrate that the Guernsey company was "privy to the real nature of the transaction" and "had knowledge of" the intention to defraud the plaintiff. Although there was no real discussion of the type or extent of knowledge required, it was clear on the facts that the board members of the Guernsey company had knowledge of the Jersey company's intention to defraud the plaintiff. The family connection suggests that the knowledge was probably actual, as opposed to constructive.

44 In light of *Golder* and the French authorities, it seems that the victim of a fraud will need to prove, as a minimum, that the recipient was conscious of the fraud when he received and gave value for the assets transferred to him by the fraudster. It is less clear whether the recipient will be held liable simply because he was put on enquiry (*i.e.* whether unconscionability will suffice); nor is it clear whether the victim will also need to show that the recipient participated in the fraud, *i.e.* shared the fraudster's intention to defeat the creditor's claim and took steps to effect that intention (*i.e.* whether dishonesty must be proved).

45 In order to assess what degree of knowledge should be required in order to prove liability in the context of an *aliénation onéreuse* it may be helpful to draw on the parallels between the Pauline Action and knowing receipt. In the context of a knowing receipt claim the touchstone is unconscionability – does the recipient know enough to make it unconscionable for him to retain the benefit of the receipt? In knowing receipt cases, the policy is to protect the victims of a breach of trust: the defendant who is held to be liable knew or ought to have known that the property received by him was transferred in breach of trust. As between himself and the victim, he is morally culpable and there can be no reason for him to retain the benefit of what he received. In the case of dishonest assistance, in order to be personally liable to restore the value of the trust property to the plaintiff (which may no longer be in his hands), the defendant's participation in a transaction (which assisted a breach of trust) must be contrary to normally acceptable standards of honest conduct.<sup>38</sup> The difference in standard between receipt and assistance may be simply due to the fact that in cases of receipt the defendant had the trust property in his hands at one point (at which time his state of mind should have prompted him to return it), whereas in a case of assistance, he need not have received it at all and could

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<sup>38</sup>*Barlow Clowes v Eurotrust* [2006] 1 All ER 333. The *Barlow Clowes* judgment changed the test for liability for dishonest assistance from that of subjective dishonesty, as previously articulated in *Royal Brunei Airlines v Tan* [1995] 2 AC 378, to that of objective dishonesty, an easier test for a plaintiff to satisfy.



never have returned it. His role is slightly more tangential and so, in order to make him liable as constructive trustee, his conduct must have been worse than that necessary to make him liable simply for receipt.

46 In the absence of any additional policy reason which requires the victim to prove actual knowledge or dishonesty in the context of a Pauline Action, it is difficult to see why the recipient should not be liable on the basis of the unconscionability test, as expounded in the *Niru Battery* test: he will be liable to give up the assets he has received if he has or has good reason to think that the transaction in which he is involved is being carried out in order to defraud creditors or the victim's claim. In Pauline Actions, the policy is to protect creditors from actions taken by their debtors to defeat or prejudice their claims. If a recipient of the debtor's assets knows or should know that the transfer to him is intended to defeat the claims of a creditor, as between himself and the creditor he is morally culpable and should therefore be liable. The only additional factor in the context of a Pauline Action is that the creditor may never have had title to the assets transferred by the debtor to the recipient for value. It may be possible to justify a higher standard of knowledge or dishonesty in such a case on the basis that: (i) the third party recipient never received the property of the victim of the fraud/the creditor or its traceable proceeds, only the property of the fraudster; and (ii) it may be more difficult for a recipient to ascertain the debtor's state of mind at the time of the transfer and that the intention to defraud creditors was a substantial purpose out of, quite possibly, several purposes, than it would be for him to ascertain that assets received were transferred in breach of trust. On the other hand, in cases of fraud at least, it may be preferable to standardise the degree of knowledge required of the recipient so that the same standard applies whether he received the traceable proceeds of the victim's property or assets of the fraudster in order to defeat the victim's claim. This is a question which will need further consideration and exposition by the Royal Court.

47 This leads on to the question whether there is any reason for purchasers to be treated differently from volunteers in the context of Pauline Actions. The availability of the *bona fide* purchase defence in English law makes it easier to argue for a strict restitutionary response in the case of receipt by third parties of the proceeds of fraud, subject to the change of position defence (in the case of volunteers) and both defences (in the case of purchasers); proof of knowledge by the victim only becoming necessary when it is sought to hold the recipient liable as a constructive trustee. The fact that purchasers are treated differently in the context of a Pauline Action, so that the burden of proof of the recipient's knowledge rests on the victim, may be largely due to the fact that under Roman law/Jersey customary law, there appears to be no complete *bona fide* purchase defence, at least in the case of contractual disputes. If the *bona fide* purchase defence were available to recipients in the context of Pauline Actions, there might be an argument for extending the strict restitutionary liability to them too, subject to the change of position defence. This would only work if the standard for liability were held to be knowledge/unconscionability rather than dishonesty and, if accepted, it would create

complete symmetry between the receipt-based restitutionary remedy where the defendant receives the traceable proceeds of the victim's property and the Pauline Action. At the moment, however, it is difficult to say whether such an alignment is desirable because: (i) it is unclear whether the test for knowledge in relation to *aliénations onéreuses* is knowledge or dishonesty; and (ii) if the former, consideration would still have to be given to whether transactional security can be said to be sufficiently well protected under Jersey law to allow purchasers to be subjected to strict restitutionary liability and for the question of their knowledge to be located in the context of any defences upon which they might seek to rely, rather than as an element of the cause of action itself.

### **(iii) Liability for profits**

48 In *Esteem* the Deputy Bailiff held that there was an unbroken line of French commentary to the effect that the innocent volunteer does not have to account for the profits earned whilst he is the owner of the thing which has been alienated, "at any rate prior to the commencement of proceedings."<sup>39</sup> He rejected the argument that as the Pauline Action is one grounded in the law of restitution, it would be fairer to make the recipient account for the fruits of the transferred assets subject to a change of position defence, stating that the court could not change a long-established rule simply because some other rule might be fairer. Instead he held that the innocent recipient is free to do what he pleases with the assets and use their profits until such times as litigation is commenced seeking to set aside his title. Once he knows that his title is under attack, he should act cautiously before deciding to deal with the profits earned during that period.<sup>40</sup> The decision therefore permits of a limited liability to give up profits earned on the subject-matter of the transfer, even though the claim is not a proprietary one, nor is it a claim to re-vest title to property in the creditor upon rescission (in respect of which an order for disgorgement of profits could possibly be recognised).<sup>41</sup>

49 Simply relying on the date of commencement of litigation without more as the relevant date for determining whether the volunteer recipient should be liable for profits appears to be a little arbitrary. For example, the creditor might have been in correspondence with the recipients for months before commencing litigation and in the course of that correspondence may have put the recipient on notice that the transfer of assets by the fraudster was made with the intention of defrauding the creditor's claim and that the recipient's title to the assets was under challenge. In that case, is it difficult to see why the creditor should still receive all the interest/profits up to the date on which litigation was commenced. Similarly, would the settlement of a Pauline Action before the commencement of proceedings preclude a claim for profits? A better way of rationalising the French commentaries on the obligation to give up the fruits of the assets transferred to the volunteer recipient may be to say that from the date on which the action was commenced in the *Esteem* case, Abacus' knowledge was such to make it unconscionable

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<sup>39</sup>2002 JLR 243, 250.

<sup>40</sup>2002 JLR 243, 253.

<sup>41</sup>*Shalson v Russo* [2003] EWHC 1637, para 126 of the judgment of Rimer J; cf. *Re Goldcorp Exchange Ltd (in Liquidation)* [1995] 1 AC 74, 102-104 per Lord Mustill.

for it to generate and keep any profits made after that date. On that basis, the touchstone of unconscionability as set out in *Akindale* could be applied to Pauline Actions for profits against volunteers. An account of profits would be ordered only from the date on which the recipient had sufficient knowledge of the victim's challenge to his title to the assets so as to make it unconscionable for him to retain the benefit of any profits generated on those assets. Applying the touchstone of unconscionability in this way would mirror the use of the concept to distinguish between the personal liability of an innocent volunteer for receipt of the traceable proceeds of the victim's property and the liability as constructive trustee of a volunteer who has knowledge of the fraud. This would provide an attractive symmetry between the claims predicated on receipt of the traceable proceeds of the victim's property and the Pauline Action in the case of an *aliénation lucrative*. The proper distinction would be not between volunteers and purchasers but between recipients who had the requisite knowledge and those who did not.

50 Whatever the test for establishing the state of mind of a guilty recipient in the case of an *aliénation onéreuse*, it seems likely that such a recipient will be liable for profits. If, as discussed, it is thought right to compel a volunteer recipient to disgorge any profits (either from the date on which litigation has been commenced or from the date on which his conscience is touched with the awareness that his title to the assets is subject to challenge), it is arguable that in circumstances where the recipient has accepted the transfer of the assets from the fraudster at a time when he was privy to the real nature of the transaction, from that point on he should be obliged to disgorge any profits made from the tainted assets.

51 The French commentators do not expressly state that profits are to be disgorged, but the view that they should be appears to gain some support from the writings of Domat, as cited in the *Golder* case -

*"Celui qui aura participé à une fraude faite à des créanciers, sera tenu de rendre tout ce qu'il se trouvera avoir reçu par une telle voie, après les fruits ou autre revenus, & les intérêts, si ce sont des deniers, à compter depuis le jour qu'il les aura reçus. Et toutes choses seront remises au même état où elles étaient avant cette fraude."*<sup>42</sup>

[Anyone who has participated in a fraud on creditors, will be obliged to return all that he is found to have received in this way, after the fruits or other profits, and the interests, if they take the form of money, are to be counted from the date on which he received them. And all things shall be given back in the same state in which they were before this fraud.]

The use of the word, "after" in relation to the fruits or profits suggests that those fruits are profits are also to be returned.

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<sup>42</sup> Domat, *op cit*.

52 If recipients of *aliénations onéreuses* are always liable to disgorge profits, care must be taken to delineate clearly the state of mind required in order to establish liability on their part. For this reason, further clarification on the meaning of the phrase “privity to the real nature of the transaction” would be welcome. If the test is knowledge/unconscionability, then there is a clear parallel with the obligation to give up profits earned by a defendant guilty of knowing receipt.

**(c) Conclusion**

53 As a result of the Deputy Bailiff’s judgment in *Esteem* a victim of fraud seeking to recover assets under Jersey law now has powerful weapons at his disposal. As against third party volunteer recipients, he may assert the strict liability receipt-based restitutionary remedy in order to recover the traceable proceeds or substitutes of his property and, where this leaves a shortfall, the Pauline Action in order to recover any of the fraudster’s own property which has been transferred away for less than full value in order to defeat his claim. In neither case will the victim need to prove knowledge on the part of the volunteer recipient as an element of the cause of action: the recipient’s state of mind will be relevant only in so far as he seeks to rely on the good faith change of position defence. It is argued that the touchstone for knowledge/good faith against which the recipient’s state of mind should be measured is that of unconscionability as explained in the *Niru Battery* case. As regards profits, an innocent volunteer does not have to account for profits prior to the commencement of proceedings seeking to set aside his title. Arguably, the law can and should be modernised so that the touchstone is unconscionability rather than the date on which proceedings are commenced.

54 The position of third party purchasers is less clear. A victim of fraud may certainly recover the traceable proceeds or substitutes of his property if he can prove knowing receipt on the part of the third party purchaser, but as yet it is unclear whether Jersey law will recognise a strict liability restitutionary remedy subject only to the change of position and/or *bona fide* purchase defences. This depends on whether it is thought that the element of knowledge should continue to be treated as part of the relevant cause of action or whether it should be relocated as a requirement of any defence to a strict liability receipt-based claim. Careful consideration also needs to be given to whether and if so, how and to what extent the *bona fide* purchase defence should operate under Jersey law and if not, how the need to protect transactional security can be met.

55 Where a fraudster has mixed the proceeds of fraud with his own assets and transferred both away to third parties, when the tracing trail runs cold the Pauline Action may provide an effective remedy against purchasers for full value. It offers a victim more protection than either the English or Jersey statutory remedies but, as in the case of a knowing receipt claim, the victim must prove knowledge on the part of a purchaser as an element of the cause of action. Again, the standard of knowledge is unclear and there are arguments which can be made in favour of both the unconscionability standard and a higher standard of dishonesty. In the absence of clear analysis as to the operation of the

*bona fide* purchase defence under Jersey law, it is difficult to see how arguments can be made for strict restitutionary liability on the part of purchasers. In view of the fact that a purchaser for full value must have a guilty mind before he will be liable to a claim by way of Pauline Action, there is no reason why he should not also be accountable for profits.

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