

September 16, 2020

In the recent Hong Kong High Court case *Akbank T.A.S. v. Mainford Ltd & Ors*¹, we assisted the claimant bank in pursuing and recovering significant sums of funds fraudulently transferred to various overseas bank accounts held by several layers of third party recipients, on the basis of constructive trust, knowing receipt and unjust enrichment.

Of particular interest is that, in the judgment granted in favour of our client, the court considered and discussed at length the legal principles applicable to a "conduit pipe" defence raised by one of the defendants against the bank's claim of unjust enrichment. We analyse below the constituent elements of the defence.

What is a "conduit pipe" defence?

The "conduit pipe" defence is a defence to an unjust enrichment claim where a defendant claims that he is merely a mechanism, or an innocent conduit pipe, through which payment to the ultimate recipient is effected. In other words, he is not a recipient who received benefits of the funds transferred.

Arguments advanced by the parties

In this case, the defendant asserted that its bank account maintained with one of the banks in Hong Kong was hacked by unknown fraudsters for the purposes of receiving and transferring away funds and that this account was no more than an innocent conduit used by the wrongdoers, without authorisation, by and without knowledge of the defendant itself. Therefore, the defendant alleged that it was an innocent victim in the fraud and that it had never been unjustly enriched.

In making the argument, the defendant relied on the appeal decision by the High Court of *Australia in National Commercial Banking Corporation of Australia v. Batty*², which concerned the liability of an innocent partner being sued as a result of his partners' misappropriation of cheques payable to a third party by depositing the cheques in their firm's account and withdrawing the proceeds for their own use.

In *Batty*, the High Court of Australia held that, where money had been paid into the account of a person, who has technically received it, although he is quite unaware of that fact, and the money is then misappropriated, still without his knowledge or intervention, he will not be answerable for the money unless, before the misappropriation, he ought to have known that he had possession or control of it.

The defendant also relied on *Transvaal & Delagoa Bay Investment Co. Ltd. v. Atkinson*³, in which it was held that an intermediary who had received money for the purpose of handing it on to a third party, and had handed it on, was no longer accountable to the sender. In such case, the intermediary was a mere conduit pipe, as he had not had the benefit of the windfall.

During the trial, we submitted on behalf of the plaintiff that the "conduit pipe" line of defence was available only in limited circumstances in which the intermediary received money specifically for the purposes of onward transmission to the true recipient i.e. normally applicable to banks and/or money changers. It was further submitted that this was wholly different from the relevant defendant's situation, where it was not alleging that it acted in any capacity as agent of any sort. Submissions were made that reliance on Batty was therefore misplaced in the context, and in any event the case had not been followed in Hong Kong and did not represent Hong Kong law.

The court's approach

The court considered the parties' arguments and adopted the bank's argument that the "conduit pipe" defence was not available to the defendant.

The court held that the starting point in this sort of situation was that a recipient of stolen funds, even if **innocent** of any involvement in the misappropriation, was **ordinarily under an obligation to repay** the true owner if he had not given full consideration for the monies received⁴, subject to any defence of change of position. Liability accrues when the **enrichment takes place** and it is **not necessary** to show that the benefit continued or was continuing as at the date of trial.

The onus was therefore on the relevant defendant to show and prove on a balance of probability that a defence to the claim of unjust enrichment existed.

It is established law in *Shanghai Tongji Science & Technology Industrial Co. Ltd. v. Casil Clearing Ltd*⁵ that no restitutionary claim will be available against a defendant which has become involved in the wrongful transfer of funds merely in the capacity of an unwitting conduit for the transfer.

In deciding whether a "conduit pipe" defence was made out, the court made a distinction between:

1. a case which is a mechanical receipt and transmission of funds, especially if under some duty or obligation such as is owed by a bank to act on the instructions of others, without the operation of a decision-making element in the transmission of funds; and
2. a case which involves a more voluntary or less obligatory receipt and transmission of funds.

In the former category, the recipient may rely on the "conduit pipe" defence to negate its obligation owed to the owner of funds. In contrast, the latter category encompasses cases where the funds transmitted ought not be in the defendant's hands.

In this case, the relevant defendant sought to argue that it fell within the first category, notwithstanding that it was not under banking duties to handle transmission of funds. The court held that, in such circumstances, the defendant bore the evidential burden to prove that the funds were transferred to and removed from its account in an unauthorised manner.

Importantly, considering the fact that the defendant failed to sign and return any transaction cancellation request to its bank, nor lodged any complaint to the bank or police despite the serious consequences of its bank account being hacked and used for illegal activities, the court held that the evidence adduced by the defendant was wholly unsatisfactory and insufficient to establish that the transfer out of the defendant's bank account was unauthorised by the defendant.

On balance, the court accepted that the bank's claim of unjust enrichment was made out.

Key takeaways

- As a general principle, a recipient of stolen funds is generally under an obligation to repay an equivalent sum to the true owner, even if it is innocent in the misappropriation, provided that the recipient did not provide any consideration for the sum.
- Ignorance of receipt of funds does not, by itself, provide an absolute defence to a claim of unjust enrichment. The obligation to repay funds to the true owner is also not discharged merely because the funds have already been transferred away and are no longer in the hands of the recipient.
- Ultimately, the recipient bears the burden of showing a defence and the court will require the recipient to provide a cogent and coherent explanation as to his innocent involvement and there is no "get out of jail free" card.
- In order to rely on a "conduit pipe" defence to a claim of unjust enrichment, a recipient would normally need to show that funds are transmitted to and from him mechanically and his case would be particularly strong if he is under a duty to receive and transmit the funds. In a case where the recipient is not under any duty to transmit funds as an agent, the court will scrutinise the evidence, in particular the business of the recipient and his action taken during and after the transmission, in deciding whether the transmission was genuinely involuntary and/or unauthorised.

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1. [2020] HKCFI 396↔
 2. (1986) 160 CLR 251↔
 3. [1994] 1 All ER 579, at 585↔
 4. *Lipkin Gorman v. Karpnale Ltd.* [1991] 2 AC 548↔
 5. (2004) HKCAAR 79↔

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