

Knowing Receipt in Chinese Trust Law

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Abstract

Article 22 of the Trust Law of the People's Republic of China (Chinese Trust Law) implements the knowing receipt rule, aiming to balance the interests between beneficiaries and third parties transacting with trustees. However, the knowledge requirement necessary to give rise to liability for the knowing receipt has never been thoroughly examined by scholars and practitioners since the introduction of the Chinese Trust Law in 2001. The ambiguities inherent in Article 22 have resulted in inconsistent interpretations of the knowing receipt rule, thereby raising questions about how this rule can align with the bona fide acquisition rule under Chinese property law. In light of this, this article analyses the 'knowledge' component in the knowing receipt rule with two aims. First, it identifies the uncertainties surrounding the interpretation of the 'knowledge' component. These uncertainties emphasise the challenges of implementing Article 22 and highlight potential conflicts that may arise between the application of the Chinese trust and property laws. Second, through an examination of the unconscionable receipt rule and equity's darling rule under English law, it underscores the reasons for Chinese law to draw insights from its English counterpart and proposes the lessons that could be incorporated into the future reform of Article 22.

I Introduction

In English law, where a trustee transfers trust property to a third-party recipient in breach of trustee duties, the beneficiary may be entitled to bring two claims: (a) an equitable proprietary claim to recover the traceable proceeds of the transfer in the hands of the recipient and (b) a personal claim for unconscionable receipt.¹ In China, the Trust Law of the People's Republic of China (the Chinese Trust Law) provides a Chinese version of the knowing receipt rule, granting rights to both settlors and beneficiaries to claim back trust property from a third-party recipient if the third-party recipient was aware that the trustee's disposition of property contravened the purposes of the trust.² According to

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¹ *Barnes v Addy* (1874) LR 9 Ch App 244. The form of receipt-based liability in Equity is traditionally called 'knowing receipt'. However, recent developments in case law suggest that it is more proper to call this form of receipt-based liability as 'unconscionable receipt'. See *Bank of Credit and Commerce International (Overseas) Ltd (in liq) v Akindele* [2001] Ch 437, 448; *Byers v Saudi National Bank* [2022] EWCA Civ 43, [69]-[75]; *Byers v Samba Financial Group* [2021] EWHC 60 (Ch), [103]-[106].

² 《中华人民共和国信托法》 [Trusts Law of the People's Republic of China] (People's Republic of China) National People's Congress, 28 April 2001 (Chinese Trust Law), arts 22 and 49.

the Chinese knowing receipt rule, the third-party recipient's liability arises from their knowledge of the trustee's breach of trust purposes. Article 22 (1) of the Chinese Trust Law stipulates the following:

[a] Where a trustee disposes of trust property against the purposes of the trust or results in losses to the trust property due to violation of the management duties or improper handling of the trust affairs, the settlor has the right to apply to the people's court for rescinding the disposition and is entitled to require the trustee to restore the trust property to its original status or to make compensation; [b] if the recipient of the trust property accepts the trust property whilst being fully aware (*mingzhi* 明知) that the disposition contravenes the purposes of the trust, he/she shall return the trust property or make compensation.³

Article 49 of the Chinese Trust Law also grants beneficiaries 'the rights that the settlor enjoys' as prescribed in Article 22.⁴ Accordingly, where a trustee disposes of the trust property in breach of trust purposes or causes losses to trust property as a result of their breach of management duties or improper handling of trust affairs, both the settlor and the beneficiary are entitled to rescind the disposition and require the trustee to restore the trust property or make compensation. However, the settlor or beneficiary can only raise a claim against the third-party recipient for the recovery of the trust property or compensation for the loss to the trust property if the recipient was fully aware of the breach of trust purposes. While this rule may initially appear straightforward, a closer examination reveals two main ambiguities regarding the degree and content of the knowledge requirement. First, in terms of the content of knowledge, only the third-party recipient's knowledge of the breach of trust purposes can trigger their liability. Why does the law exempt a third-party recipient from bearing any liabilities when the trustee's disposition causes losses to the trust property due to the trustee's breach of management duties or mishandling of trust affairs, regardless of the third-party recipient's knowledge? Second, in terms of the degree of knowledge, the third-party recipient is liable only if they were 'fully aware' (*mingzhi* 明知) that the disposition was against the trust purposes at the time of receipt. However, what is meant by being 'fully aware'? Can only actual knowledge suffice? These questions remain unanswered in the Chinese Trust Law and other statutory rules in Chinese law.

³ Under Chinese civil law, when a person obtains possession of another's property, the main remedy available to the owner is the return of the property. Compensatory liability will only be imposed if it is either impossible or unnecessary to return the property. See 《中华人民共和国民法典》 [Civil Code of the People's Republic of China] (People's Republic of China) National People's Congress, 28 May 2020 (Chinese Civil Code), art 157. The Chinese Trust Law does not provide any guidance on how to determine whether the trustee or third-party recipient should be held responsible for returning the trust property or making compensation, as stipulated in Article 22. Given that the law was drafted by legal scholars who specialised in civil law in 2001 and viewed trust law as a new member of civil law, we can reasonably interpret Article 22 as meaning that the trustee or third-party recipient should return the trust property. If it is impossible or unnecessary to return the trust property, then the trustee or third-party recipient should be liable for compensation instead. See 江平 [Jiang Ping] and 陈夏红 [Chen Xiahong], 《沉浮与枯荣:八十自述》 [Trials and Triumphs: An Eighty-Year Autobiography] (法律出版社 [Law Press], 2010) 404, 410.

⁴ Article 49 of the Chinese Trust Law states: 'The beneficiary has the right to exercise the same rights as the settlor, as stipulated in Articles 20 to 23 of this Law. If, while exercising these rights, the beneficiary holds differing views from the settlor, he or she may seek a ruling from the people's court'.

In English law, the concept of knowledge in knowing receipt has received substantial academic and judicial attention over the past several decades.⁵ Five categories of knowledge were developed in the English High Court case of *Baden Delvaux and Lecuit v Société Générale pour Favoriser le Développement du Commerce et de l'Industrie en France SA*⁶ (*Baden Delvaux*). The knowledge-based liability test for the claim of knowing receipt was later replaced by the test of unconscionability in the English Court of Appeal decision of *Bank of Credit and Commerce International (Overseas) Ltd v Akindele*⁷ (*Akindele*). The adoption of the unconscionability test does not mean that the knowledge of the third-party recipient becomes irrelevant in the assessment of the unconscionable recipient's liabilities. Rather, the flexibility of the unconscionability test grants the court leeway in promoting a sensible balance between the interests of the beneficiary and the third-party recipient.⁸ In contrast, there has been little, if any, attempt made by Chinese scholars or practitioners over the past two decades to develop an in-depth understanding of the knowledge requirement under Article 22 of the Chinese Trust Law. The lack of specific guidelines resulted in confusion and uncertainties in judicial practice.⁹

According to the principles of Chinese property law, when an unauthorised individual transfers property, the recipient will be considered bona fide (*shanyi* 善意) if they were unaware of the

⁵ For cases that discuss the knowing receipt rule, see, eg, *Byers v Saudi National Bank* [2023] UKSC 51; *Criterion Properties plc v Stratford UK Properties LLC* (2003) 1 WLR 2108; *Bank of Credit and Commerce International (Overseas) Ltd (in Liq) v Akindele* (n 1); *Armstrong DLW GmbH v Winnington Networks Ltd* [2013] Ch 156. For scholarly writings that analyse the knowing receipt rule, see, eg, Lynton Tucker et al (eds), *Lewin on Trusts (Volume II)* (Sweet & Maxwell, 20th ed, 2020) [42-022]-[42-100]; Ben McFarlane, Charles Mitchell and Jessica Hudson, *Hayton, McFarlane and Mitchell on Equity and Trusts* (Sweet & Maxwell, 15th ed, 2022) 571–92; Rohan Havelock, 'The Transformation of Knowing Receipt' (2014) 22 *Restitution Law Review* 1; Robert Chambers, 'The End of Knowing Receipt' (2016) 2(1) *Canadian Journal of Comparative and Contemporary Law* 1.

⁶ *Baden v Société Générale Pour Favoriser le Développement du Commerce et de l'Industrie en France SA* (1993) 1 WLR 509.

⁷ *Bank of Credit and Commerce International (Overseas) Ltd (in Liq) v Akindele* (n 1).

⁸ *Byers v Saudi National Bank* (n 5) [40].

⁹ For example, in the civil judgment 'Wenjiang District People's Court of Chengdu City, Sichuan Province, Initial Ruling, 2013, Case No 801', the plaintiff, Mr Wang, entrusted his shares in a certain company to the defendant, Mr Li. Without any written authorisation from the plaintiff, Mr Li transferred the shares to China Water Resources and Hydropower Seventh Engineering Bureau Limited. The company, upon acquiring the shares, did not make inquiries about Mr Li's right to dispose of the shares. The court only held Mr Li liable for improper disposal of trust property and ordered him to compensate the plaintiff. In this case, the transferee, without actual knowledge of Mr Li's improper disposal, should have known but did not know Mr Li's lack of right for disposal. The court concluded that, according to the existing provisions of the Chinese Trust Law, the transferee is not required to assume liability. According to this judgment, the assessment of the application of Article 22 is based solely on the actual knowledge of a third-party recipient. However, this judicial view has not been widely accepted within Chinese academia. See Lusina Ho, Rebecca Lee and Jinping Jin, 'Trust Law in China: A Critical Evaluation of Its Conceptual Foundation' in Lusina Ho and Rebecca Lee (eds), *Trust Law in Asian Civil Law Jurisdiction: A Comparative Analysis* (Cambridge University Press, 2013) 96–97; 文杰 [Wen Jie], 《信托财产不当处分的撤销权质疑》 [Questioning the Right to Rescind Inappropriate Disposition of Trust Property] (2018) 71 (2) 武汉大学学报 (哲学社科版) *Wuhan University Journal (Philosophy & Social Science)* 73, 80.

transferor's lack of right to dispose of the property and acted without material negligence¹⁰ at the time of transfer.¹¹ The term 'bona fide' is thus understood through the lens of the recipient's knowledge. This knowledge contains two elements. The first element concerns the degree of knowledge, which encompasses both actual and putative knowledge. Here 'putative knowledge' refers to situations where the recipient of the property would have known about the transferor's lack of right to dispose of the property if the recipient had not acted with material negligence. In such cases, the knowledge of the transferor's lack of right to dispose of the property will be imputed to the recipient. The second element pertains to the content of the recipient's knowledge, specifically about the transferor's lack of right to dispose of the property. According to Chinese property law, ownership cannot be transferred by a transferor lacking the authority to dispose of the property.¹² However, the bona fide acquisition rule provides a defence to a bona fide recipient, who is entitled to obtain the property ownership transferred by an unauthorised transferor if the recipient has paid a reasonable consideration for purchasing the property and the transfer of immovable property has been registered, if required by law, or the transferred movable property has been delivered.¹³ As a result, the original property owner loses their ownership and is unable to raise a claim for recovery against the recipient. The only recourse available to the original property owner is to seek compensation from the unauthorised transferor.¹⁴

Professor Wen Jie proposes that any inappropriate disposition of trust property by a trustee should be considered an unauthorised disposition under property law.¹⁵ Therefore, when assessing a third-party recipient's knowledge under Article 22 of the Chinese Trust Law, the same standard should be applied as when determining the recipient's knowledge under the bona fide acquisition rule.¹⁶ According to this perspective, the third-party recipient would be held liable to return the trust property or provide compensation if they had actual knowledge or exhibited material negligence in not knowing that the trustee's disposition of the trust property contravened trust purposes. While this viewpoint merits consideration, it necessitates robust justifications. To justify the application of the same standard for determining the knowledge requirement under Article 22 of the Chinese Trust Law and

¹⁰ Chinese law does not provide an explicit definition of material negligence. However, both courts and scholars generally agree that this term refers to a higher level of negligence where the recipient of transferred property fails to exercise reasonable care and diligence in verifying the transferor's right to dispose of the property. The main difference between material negligence and general negligence lies in the degree of negligence. Material negligence involves a greater degree of carelessness on the part of the recipient, while general negligence denotes a lower level of carelessness. See Mengyun Tang, 'Does China Need Good Samaritan Laws to Save Yue Yue?' (2014) 47(1) *Cornell International Law Journal* 205, 228; Guangdong Foshan Intermediate People's Court, Guangdong Province, Civil Judgment, Appealing Ruling, 2021, Civil Case No 11629.

¹¹ 《最高人民法院关于适用《中华人民共和国民法典》物权编的解释（一）》 [Interpretation of the Supreme People's Court on the Application of the Property Rights Provisions of the Civil Code of the People's Republic of China (I)] (People's Republic of China) Supreme People's Court, 29 December 2020 (Interpretation I of Property Rights Provisions), art 14. For a detailed discussion of the bona fide acquisition rule in Chinese property law, see Part II-B.

¹² Chinese Civil Code, art 240.

¹³ Chinese Civil Code, art 311.

¹⁴ Ibid.

¹⁵ Wen (n 9) 80.

¹⁶ Ibid.

the bona fide acquisition rule, it is essential to identify the similarities in their underlying rationales and policy considerations. Additionally, it is important to comprehend the legal implications that would emerge if the standard for determining the transferee's knowledge under the bona fide acquisition rule were employed to ascertain the knowledge that triggers a third-party recipient's liability under Article 22. In a jurisdiction that values legal coherence and consistency, addressing these questions is of utmost importance. However, up to this point, there has been a lack of in-depth analysis of these issues.

This article considers the knowledge component under Article 22 of the Chinese Trust Law. The structure of the article is as follows. After the Introduction, Part II construes the meaning and operation of the knowledge component within Chinese property and trust laws. It highlights inconsistencies and uncertainties in the existing legislation and proposes questions for further investigation. Part III embarks on a comparative law analysis, scrutinising the knowledge component within English trust law. The reasoning behind this analysis is rooted in the legislative history of the Chinese Trust Law. Notably, Chinese legislators extensively referred to English trust law cases and commentaries during discussions concerning the feasibility and necessity of integrating trust law into China's domestic legal framework. Accordingly, this comparative law analysis serves to identify the insights Chinese law has gleaned from its English counterpart during the implementation of Article 22, and to illuminate the uncertainties associated with Article 22 as highlighted in Part II. Furthermore, the analysis of English law identifies useful guidelines, developed through its extensive case law, for the interpretation and application of rules concerning unconscionable receipt and equity's darling. These guidelines then form the groundwork for ensuing discussions on the reform of the Chinese knowing receipt rule. Part IV outlines proposals that Chinese law could consider in the future to address the identified uncertainties and inconsistencies within the existing legal framework. This entails clarifying the degree of knowledge required and expanding the scope of knowledge content that triggers the third-party recipient liability. Specifically, Part IV consists of two sections. Section A discusses the proposals, which are formulated based on a comprehensive interpretation of Chinese trust and property law, as well as insights drawn from English law. Section B examines the application of both the original and reformed versions of Article 22 in hypothetical scenarios, with the objective of assessing the feasibility and effectiveness of these proposals. Finally, Part V concludes the article by summarising the key findings and reflecting on the implications of the proposed reforms.

II The Knowing Receipt Rule under Chinese Law

Articles 22 and 49 of the Chinese Trust Law grant the settlor and the beneficiary three rights: the right of rescission, the right to claim for restoration of the trust property to its original status, and the right to claim for compensation. Where the trustee's disposition violates trust purposes or the trustee's breach of management duties or mishandling of trust affairs leads to a loss of trust property, the settlor or beneficiary has the right to apply for rescission of the trustee's disposition and seek restoration or compensation from the trustee. However, for the settlor or beneficiary to trace back the disposed property or raise a compensatory claim against a third-party recipient, the third-party recipient must be 'fully aware' (*mingzhi* 明知) of the breach of the trust purposes at the time of receiving the trust

property.¹⁷ In other words, the lack of knowledge can be used as a defence by a third-party recipient against a settlor's or beneficiary's claim for recovery of trust property or compensation.

In examining the knowledge requirement imposed on the third-party recipient, this section will begin by outlining the right of rescission under Article 22 and discussing the policy considerations that underpin it. In determining the extent of knowledge needed to activate the liability of the third-party recipient, we argue that these policy considerations should be taken into account. Furthermore, as mentioned in the Introduction, there has been a proposal to apply similar standards for determining the knowledge of the third-party recipient under Article 22 and that of the bona fide transferee under the bona fide acquisition rule. This section explores the relationship between the third-party recipient's defence of lack of knowledge under Article 22 and the bona fide acquisition defence in property law. The aim is to ascertain the normative justifiability of the aforementioned proposal to apply similar standards for the knowledge requirement under Article 22 and the bona fide acquisition rule, as well as to ensure the compatibility between Chinese trust law and property laws. This is a crucial aspect in maintaining coherence within the Chinese legal system. We now proceed to section A, focusing on the right of rescission.

A The Right of Rescission

Articles 22 and 49 of the Chinese Trust Law provide the settlor and beneficiary with the right to apply for rescission of the trustee's disposition. In practice, for the trustee to dispose of trust property, they must first enter into a contract with the third-party recipient, agreeing on the transfer of the trust property. The third-party recipient only obtains ownership of the trust property once the trustee delivers the property or registers the third-party recipient as the owner, as applicable.¹⁸ It is important to note that the conclusion of the contract to transfer ownership and the actual transfer of ownership are two distinct acts.¹⁹

Article 22 of the Chinese Trust Law grants the right of rescission in two circumstances: (1) when the trustee's disposition breaches trust purposes, or (2) when the trustee violates their management duties or improperly handles trust affairs, resulting in a loss of trust property. However, the obligation for the third-party recipient to return the trust property or provide compensation arises only if they were fully aware of the breach of trust purposes at the time of receipt. Therefore, the third-party recipient is allowed to retain the trust property under two circumstances: (1) when they did not have 'full knowledge' of the breach at the time of receipt, and (2) when a loss of trust property is incurred due to the trustee's violation of their management duties or improper handling of trust affairs, irrespective of the third-party recipient's knowledge. The following question arises: What are the actual

¹⁷ Chinese Trust Law, art 22. Chinese law provides no clarification on the specific meaning or requirements of 'full knowledge' for third-party recipients under Article 22. This issue is further explored in a later section of this article. See Part IV-A.

¹⁸ Under Chinese property law, the transfer of ownership of movables and immovable property comes into effect upon delivery and registration respectively. See Chinese Civil Code, arts 209 and 224.

¹⁹ Hui Jing, 'Third-Party and Bankruptcy Effects under Chinese Trust Law: Comparisons with English Trust Law' (2024) *Asian Journal of Comparative Law* 1, 7.

legal consequences of exercising the right of rescission? It is doctrinally inconsistent to assert that the settlor or beneficiary can apply for rescission of the trustee's disposition while the third-party recipient is still entitled to retain the trust property in the aforementioned two scenarios. The Chinese Trust Law does not provide an explicit answer to this question.

Article 22 is not the only legal provision that grants the right of rescission. Chinese private law also grants an individual the right to apply for rescission in other circumstances. For example, if a person conducts a legal act²⁰ due to material misunderstanding,²¹ fraud,²² or under duress,²³ they are entitled to apply for rescission of their own act. Another example is when a debtor disposes of their proprietary interests, thereby infringing on the realisation of their creditor's rights; in this situation, the creditor is granted the right to apply for rescission of the debtor's act.²⁴ The Chinese Civil Code explicitly states that a rescinded act is not legally binding *ab initio*.²⁵ As mentioned previously,²⁶ the Chinese Trust Law was drafted by civil law experts. It can thus be inferred that the right of rescission granted by Article 22 embodies the same meaning as that in Chinese civil law. Therefore, if the trustee's disposition is rescinded under Article 22, the disposal act loses its legally binding effect *ab initio* and does not create, modify, or terminate any legal relationships. Meanwhile, scholars and practitioners generally agree that Chinese property law does not accept the principle of abstraction.²⁷ A valid transfer of ownership is dependent on the existence of a valid legal basis, such as a valid contract.²⁸

If Article 22 allows the third-party recipient to preserve the trust property, both the contract between the trustee and the third-party recipient and the trustee's transfer of ownership of the trust property should remain valid. Therefore, neither the trustee's act to conclude a contract with the third-party recipient nor their act to transfer ownership of trust property is truly rescinded.²⁹ From a doctrinal interpretation of Articles 22 and 49 of the Chinese Trust Law, it can be understood that the

²⁰ Here the 'legal act' refers to an act of a natural person, a legal person or an unincorporated organisation to create, alter, or terminate civil legal relations through manifestation of intention under Chinese law. See Chinese Civil Code, art 133.

²¹ Chinese Civil Code, art 147.

²² Ibid arts 148 and 149.

²³ Ibid art 150.

²⁴ Ibid arts 538 and 539.

²⁵ Ibid arts 155 and 542.

²⁶ See the text under n 3.

²⁷ Siyi Lin, *The Law of Unjust Enrichment in China: Necessary or Not?* (Springer International Publishing, 2022) 37-9. The principle of abstraction originated from German law, according to which a transfer of ownership is legally separate, and the validity of the transfer does not rely on the underlying contract or other legal basis. While the rejection of the principle of abstraction is not explicitly stated in the Chinese Civil Code or other legal doctrines, the denial of this principle can be inferred from judgments found in mainstream databases within China. See Jens Thomas Füller, 'The German Property Law and Its Principles' in Wolfgang Faber and Brigitta Lurger (eds), *Rules for the Transfer of Movables: A Candidate for European Harmonisation or National Reforms?* (Sellier, 2008) 200; Zhicheng Wu and Lei Chen, 'Revisiting Property Transfer Theory: English Law and Chinese Law Compared' (2023) 43(2) *Legal Studies* 259, 265.

²⁸ Lin (n 27) 38.

²⁹ The inconsistencies between the legal consequences of the rights of rescission under Article 22 of Chinese Trust Law and Chinese civil law have also been noticed by other Chinese scholars. See Wen (n 9) 75.

settlor and the beneficiary have the right of rescission if the trustee either (1) disposes of trust property in violation of trust purposes, or (2) breaches their management duties or mishandles trust affairs, leading to a loss of trust property. However, the trustee's disposition is only rescinded in substance when two conditions are met: the trustee's disposal act breaches the trust purposes, and the third-party recipient is fully aware of this breach upon receiving the trust property. Thus, a conflict arises between the first and second parts of Article 22 of the Chinese Trust Law because it confines the knowledge sufficient to trigger the third-party recipient's liability to the knowledge of a breach of trust purposes. To resolve this conflict, it would be crucial to broaden the scope of the required knowledge of the third-party recipient to encompass the awareness of the trustee's violation of management duties and improper handling of trust affairs.

The Chinese Trust Law grants the settlor and the beneficiary the right to rescind the trustee's disposition. They can seek restoration or compensation to protect the trust property from losses due to the trustee's misconduct. This ultimately safeguards the beneficiary's interests by ensuring the realisation of trust purposes and the security of trust property.³⁰ However, this arrangement inevitably impacts the interests of the third-party recipient, who may be required to return the trust property or provide compensation due to the trustee's breach of trust purposes. Since the third-party recipient is external to the trust arrangement, additional reasoning is required to justify prioritising the beneficiary's interests over theirs. Therefore, Article 22 stipulates that the third-party recipient's awareness of the breach of trust purposes is a necessary condition to trigger their liability to return the trust property or provide compensation. This requirement for the third-party recipient's knowledge serves to balance the interests of the beneficiary and the third-party recipient.

B The Bona Fide Acquisition Defence

It is generally acknowledged that, under Chinese law, only a person with the authority to dispose of property can successfully transfer property ownership.³¹ In line with this principle, a property owner is entitled to raise a proprietary claim against the transferee for the recovery of the transferred property if the transferor disposed of the property in an unauthorised manner.³² However, Article 311 of the Chinese Civil Code establishes an exception to this principle: the bona fide acquisition defence. This defence allows a bona fide transferee to acquire property ownership from an unauthorised disposer if the following three conditions are met. First, the transferee acts in good faith at the time of transfer (the Latin term 'bona fide' means 'in good faith'). Second, the transfer is made at a reasonable price. The reasonableness of the price is determined objectively, with reference to market standards and transaction practices.³³ Third, the transferred movable or immovable property has been registered as

³⁰ The Explanation of the Trust Law of the People's Republic of China, 14 November 2003, available at http://www.npc.gov.cn/zgrdw/npc/flsyywd/jingji/2003-11/14/content_324177.htm (accessed on 6 February 2024).

³¹ Lin (n 27) 131. English law has a similar rule, known as the rule of *nemo dat quod non habet*, which states that 'one cannot give what one hasn't got'. For an account of this English law rule, see James E Penner, *The Law of Trusts* (Oxford University Press, 2014) 41.

³² Chinese Civil Code, arts 235 and 238.

³³ Interpretation I of Property Rights Provisions, art 18.

required by law or has been delivered to the transferee where registration is not required. If the transferee acquires property ownership by fulfilling these conditions, the original property owner's recourse is limited to claiming compensation against the unauthorised transferor.³⁴

The key aspect of the bona fide acquisition rule that we are concerned with is the understanding of the transferee's good faith. According to the judicial interpretation issued by the China's Supreme People's Court (SPC), a transferee acts in good faith if 'they do not know about the transferor's lack of power of disposition, and such unawareness is not due to their *material negligence* when receiving the movable or immovable property'.³⁵ The SPC goes on to explain that the transferee should be deemed as 'materially negligent' if the true owner could prove the transferee should have known the transferor's lack of power to dispose a real estate or if the circumstances, location or timing of the transaction do not conform to the customary practices at the time of the transfer of chattels.³⁶ As noted in Part I, for the purposes of this article, a transferee who should have been aware of the transferor's lack of disposition power and is deemed materially negligent for failing to do so is considered to have 'putative knowledge'. To summarise, the degree of knowledge that disqualifies a transferee from claiming a bona fide acquisition defence encompasses both actual and putative knowledge. Furthermore, the content of this knowledge is restricted to the transferor's lack of disposition power.

Chinese property law adheres to the principle of publicity of real rights (*wuquan gongsbi* 物权公示). This principle necessitates that real rights, which are enforceable against the world, must be visible to outsiders through reasonable inspections.³⁷ For movable property, possession typically satisfies the publicity requirement, while for immovable property, registration serves as the basis for establishing the publicity of associated real rights.³⁸ It is worth noting that possession and ownership of property in transactions do not often align. The bona fide acquisition rule allows transferees to rely on the public display of real rights in transactions, reasonably asserting that the individual in possession of a movable or registered as the owner of real estate is indeed the rightful owner of the property and consequently possesses the right of disposition. Transferees may acquire ownership of property if they were unaware of, and not materially negligent in not knowing, the transferor's lack of power of disposition. The bona fide acquisition rule safeguards the interests of the transferees, even though such protection evidently infringes upon the rights of the original property owner. The underlying policy consideration is to facilitate the circulation of property and promote transaction certainty by reducing the burden on the transferee to investigate the transferor's power of disposition.³⁹

³⁴ Chinese Civil Code, art 311 (2).

³⁵ Interpretation I of Property Rights Provisions, art 14 (emphasis added).

³⁶ Ibid, arts 15 and 16.

³⁷ Simon Werthwein, 'Acquisition of Ownership' in Bu Yuanshi (ed), *Chinese Civil Law: A Handbook* (Hart Publishing 2013) 209.

³⁸ Chinese Civil Code, arts 224 and 209.

³⁹ Werthwein (n 37) 209.

C Relationship between Article 22 of the Chinese Trust Law and the Bona Fide Acquisition Defence

As mentioned in Part I, Chinese scholars have proposed that the knowledge requirement, which preclude a bona fide acquisition defence, should be applied to determine whether a third-party recipient's knowledge is sufficient to activate their liability under Article 22 of the Chinese Trust Law.⁴⁰ However, upon closer inspection, this proposition requires a further justification.

When a transferor disposes of property without authorisation, the owner's claim to recover the property from the transferee is a proprietary claim based on their ownership. However, while the Chinese Trust Law does not specify the nature of the settlor's or beneficiary's claim to recover the trust property from the third-party recipient under Articles 22 and 49 of the Chinese Trust Law, our analysis suggests that such a claim is of a personal nature for two reasons. First, the settlor and the beneficiary hold the same rights against the third party for the recovery of the trust property under Articles 22 and 49. The nature and content of these rights should be the same.⁴¹ As a civilian jurisdiction, China embraces an absolute notion of ownership in its property law, which represents the most extensive right over property, allowing for only one owner of an object at any given time.⁴² Although the question of who retains ownership of trust property in China continues to be contentious due to the Chinese Trust Law's 'entrustment'⁴³ approach, it is theoretically untenable for both the settlor and the beneficiary to concurrently assert proprietary claims against the third-party recipient based on their ownership of the trust property. Second, Chinese private law adheres to the *numerus clausus* principle, which means that only the legislature is authorised to create proprietary rights that are effective against the entire world and that the types and contents of these rights must be prescribed by law.⁴⁴ Since the legislature has never declared that the rights of settlors and beneficiaries under Articles 22 and 49 are proprietary rights, these rights should be characterised as personal rather than proprietary.⁴⁵ Therefore, it is reasonable to state that when a settlor or beneficiary requires a third-party recipient to return trust property under Articles 22 and 49, the third-party recipient can cite their unawareness of the trustee's breach of trust purposes as a defence against the

⁴⁰ Wen (n 9) 80.

⁴¹ Article 49 of the Chinese Trust Law endowers beneficiaries with the same rights as the settlors, including those granted by Article 22, through duplication. For details, see n 4.

⁴² Chinese Civil Code, arts 114 and 240.

⁴³ Article 2 of the Chinese Trust Law defines the trust as the settlor's act to 'entrust (*weitu*) the rights in his property to the trustee and the trustee manages or disposes of such property in his own name in accordance with the wishes of the settlor for the benefit of the beneficiary or for a specified objective'. In Chinese law, 'entrustment' is typically used for establishing an agency relationship that does not require any transfer of ownership to the agent. The entrustment approach seems to indicate that the settlor may create a trust without transferring ownership of trust property to the trustee, which lead to ambiguities in the location of ownership of trust property under Chinese law. For an account of this statutory uncertainty, see Lusina Ho, 'Trust Laws in China: History, Ambiguity and Beneficiary's Rights' in Lionel Smith (ed), *Re-Imaging the Trust: Trusts in Civil Law* (Cambridge University Press, 2012) 192–96; Hui Jing and Siyi Lin, 'Registration of Chinese Trusts: Lessons from English Trust Law' (2023) 3 *Conveyancer and Property Lawyer* 267, 271–72.

⁴⁴ Chinese Civil Code, art 116.

⁴⁵ Ho (n 43) 185; Lusina Ho, *Trust Law in China* (Sweet & Maxell Asia, 2003) 174–75.

settlor's or beneficiary's personal claims. However, under the bona fide acquisition rule, the transferee's lack of knowledge is a key element of a defence against a proprietary claim by the owner of the disposed property.

Despite these differences, the two defences are not entirely distinct but rather interconnected in certain contexts. To ensure coherence between Chinese trust and property laws, it is crucial to ascertain that trust law does not grant the settlor or beneficiary a personal claim against a third-party recipient for recovery of the trust property if the third-party recipient already obtains the ownership of the trust property through bona fide acquisition and is entitled to retain the property. This implies that the third-party recipient's knowledge under Article 22 must be sufficient in terms of degree and content to preclude the application of the bona fide acquisition defence. On the other hand, a scenario may arise where the third-party recipient does not possess sufficient knowledge to trigger liability for return under Article 22. However, their knowledge of the trustee's improper disposition is nonetheless enough to prevent them from raising a bona fide acquisition defence. In this scenario, the owner of the trust property, whether it be the settlor, trustee, or beneficiary, can still bring a proprietary claim against the third-party recipient to recover the trust property under property law. Based on the above interpretations, to ensure consistency between trust law and property law, the knowledge requirement under Article 22 should be at least as stringent as, or more stringent than, that required to preclude the bona fide acquisition defence under property law.

The bona fide acquisition rule grants ownership to the bona fide transferee, allowing them to rely on the publicity of property rights in transactions without the burden of investigating the transferor's right to dispose of the property.⁴⁶ This rule facilitates property transactions. Article 22 of the Chinese Trust Law exempts a third-party recipient from the liability to return trust property or make compensation if they are unaware of the breach of trust purposes. This means that in transactions, the transferee does not need to consider whether the property being disposed of is held in trusts or if the disposition aligns with trust purposes or the trustee's duties. Therefore, both the knowledge requirement under Article 22 and the bona fide acquisition rule aim to protect the interests of transferees and facilitate transactions. A trust is a private arrangement between the settlor and trustee, and public disclosure is generally not mandatory.⁴⁷ This makes it even more challenging for a third-party recipient to know about a breach of trust purposes compared to knowing about a lack of the right of disposal. Consequently, the knowledge requirement set in Article 22 makes it difficult to trigger the third-party recipient's liability to return the trust property.

D Preliminary Observations

The foregoing analysis leads to two preliminary observations. The first pertains to the issue associated with Article 22 of the Chinese Trust Law. According to part (a) of Article 22 and Article 49, both the settlor and the beneficiary have the right to rescind any transactions conducted between the trustee

⁴⁶ See Part II-B-2.

⁴⁷ Article 10 of the Chinese Trust Law mandates the registration of trust property in certain cases. However, it remains unclear which kinds of trust property requires registration and how the registration requirement should be implemented. See Jing and Lin (n 43) 268.

and a third-party recipient provided that the trustee disposes of trust property in violation of trust purposes or breaches their management duties and results in a loss of trust property. However, part (b) of Article 22 states that the third-party recipient is not obligated to return the trust property if they were not fully aware of the trustee's breach of trust purposes at the time of receiving the trust property. As a result, the trustee's disposition can only be effectively rescinded if the trustee's act of disposal violates trust purposes and the third-party recipient is fully aware of the trustee's breach of trust purposes when receiving the trust property. Therefore, a conflict exists between parts (a) and (b) of Article 22 of the Chinese Trust Law.

Second, although the lack of knowledge of a third-party recipient under Article 22 and the bona fide acquisition rule are defences against different claims in substance, these two defences are interconnected and serve similar policy considerations. To ensure coherence between trust and property law, it is crucial to avoid any conflicts arising from the operation of these two defences. Specifically, if a third-party recipient's knowledge is sufficient to trigger their liability to return the trust property under Article 22, they should not be able to invoke a bona fide acquisition defence to retain ownership of the trust property. Therefore, the knowledge required of a third-party recipient under Article 22 must be stringent enough to preclude the availability of the bona fide acquisition defence. Conversely, no conflict will arise if a third-party recipient lacks sufficient knowledge to trigger their liability under Article 22, while their knowledge still prevents them from being considered as a bona fide transferee under Chinese property law. In such a situation, the owner of the trust property can still bring a proprietary claim against the third-party recipient for the return of the trust property under property law, although they do not have a claim enforceable against the third-party recipient under Article 22.

III In English Trust Law

Part II has demonstrated that the knowing receipt rule under Chinese trust law and the bona fide acquisition defence under Chinese property law share similar concerns regarding the balancing of interests between beneficiaries/property owners and third-party recipients. After clarifying their operations and associated problems, this part explores two rules designed to achieve a similar balance under English law:⁴⁸ unconscionable receipt and equity's darling. According to English law, a beneficiary is entitled to recover the trust property that has passed into the hands of someone other than the trustee, provided that the beneficiary's equitable proprietary interest has not been overreached or overridden.⁴⁹ The beneficiary can bring a 'purely proprietary claim',⁵⁰ requiring the transferee to return the property to the trust. The personal claim in unconscionable receipt applies when the transferee, who is not a bona fide purchaser for value without notice, no longer has the property. This could be a result of the transferee transferring, depleting, or destroying the property, consequently preventing a proprietary claim from the beneficiary.⁵¹ The beneficiary's access to proprietary and

⁴⁸ English law in this article refers to the law of England and Wales.

⁴⁹ *Byers v Saudi National Bank* (n 5) [42].

⁵⁰ *Ibid* [65].

⁵¹ *Ibid* [5], [42].

personal claims allows for potential conflicts arising between the beneficiary and the third-party recipient. English trust law has recognised the rules of unconscionable receipt and equity's darling to ensure interpersonal respect⁵² between the third-party recipient and the beneficiary. Although the two rules operate in parallel, the scenarios under which they are invoked often overlap. The rule of unconscionable receipt favours the beneficiary by establishing liabilities against the third-party recipient. In contrast, the rule of equity's darling favours the third-party recipient by allowing them to claim legitimate entitlement to the property they receive and thus defeat the beneficiary's claim. The operation of these two rules promotes a balance between the interests of the beneficiary and the third-party recipient.

The rationale for analysing English law rules here originates from the legislative history of the Chinese Trust Law. Chinese legislators extensively consulted cases and commentaries related to English trust law when debating the feasibility and necessity of adopting trust law into China's domestic legal system.⁵³ The enactment of the Chinese Trust Law has demonstrated that the absence of 'the distinction between the legal and equitable estate'⁵⁴ in Chinese law does not pose an insurmountable barrier to incorporating trust law into the Chinese legal system. Instead, Chinese legislators have utilised a range of mechanisms specific to Chinese law to essentially replicate the functions performed by an English express trust. The function of balancing interests between beneficiaries and third-party recipients is integral within English express trust structures. Chinese legislators have recognised the importance of this function and strived to implement it via Article 22 of the Chinese Trust Law.

Thus, the examination of these two English law rules carries significant implications for comparative law in two main aspects. First, this examination underscores the differences between Chinese and English laws in terms of third-party recipient liabilities within the framework of trust law. These differences encapsulate the distinct traits of Chinese trust law, whilst simultaneously shedding light on the factors contributing to the ambiguities associated with Article 22 as outlined in Part II. Second, the analysis of English law aids in identifying the guidelines related to the interpretation of unconscionable receipt and equity's darling. These guidelines, developed through the rich case law of English courts, showcase the balancing act these courts perform when addressing conflicts of interest

⁵² An autonomy-based private law is committed to ensuring interpersonal respect between self-determining individuals, as Hanoch Dagan remarked, 'A satisfying conception of private law should ... affirm and vindicate our claims from one another to relational justice, which derives from a robust notion of interpersonal respect [for] each other's right of self-determination. In other words, it should conceptualise these frameworks as interactions between free and equal individuals who respect each other given the persons they actually are'. See Hanoch Dagan, 'The Challenges of Private Law: A Research Agenda for an Autonomy-Based Private Law' in Kit Barker, Karen Fairweather and Ross Grantham (eds), *Private Law in the 21st Century* (Hart, 2017) 73.

⁵³ Hui Jing, 'The Duty of Loyalty in Chinese Trust Laws' (2020) 13 *Journal of Equity* 347, 347; 江平 [Jiang Ping] and 周小明 [Zhou Xiaoming], 《论中国的信托立法》 [Research on the Legislation of Chinese Trust Law] (1994) 6 *中国法学 China Legal Science* 53, 56–57; 胡大展 [Hu Dazhan], 《论信托法的源流》 [On the Origin and Development of Trust Law] (2001) 4 *法学家 The Jurist* 74, 75–80.

⁵⁴ *Stack v Dowden* (2007) 2 AC 432, 468.

between beneficiaries and third parties transacting with trustees. Such balancing concerns are also prevalent in Chinese law, providing a foundation for Chinese law to gain insights from the experiences of English law. These insights illuminate the proposed reforms regarding Article 22 in Part IV. We now move forward with section A, focusing on the analysis of unconscionable receipt.

A Unconscionable Receipt

The rule of unconscionable receipt reflects the idea of interpersonal respect by requiring proof of fault before imposing any liability on a third-party recipient due to their receipt of trust assets. To successfully establish a claim for unconscionable receipt, four conditions are generally required to be met: (a) the third-party recipient must have received the asset beneficially, (b) the trust asset must have been disposed of in breach of trust or fiduciary duty, (c) there must be evidence of fault on the part of the third-party recipient,⁵⁵ and (d) the beneficiary must have a continuing equitable proprietary interest in the trust asset when it reaches the hands of the third-party recipient.⁵⁶

Condition (a), the requirement that the third-party recipient must have received the property beneficially, can be subdivided into two requirements. First, the third-party recipient must have received the asset, directly or indirectly, in which the beneficiary has an equitable proprietary interest.⁵⁷ Second, the third-party recipient must receive the trust asset beneficially for themselves rather than

⁵⁵ *El Ajou v Dollar Land Holdings plc* (1994) 2 All ER 685, 700; *Byers v Saudi National Bank* (n 5) [46]. There have been increasing calls by commentators and senior members of the judiciary for third-party liabilities to be strict rather than fault-based. See Lord Nicholls, 'Knowing Receipt: The Need for a New Landmark' in WR Cornish et al (eds), *Restitution Past, Present and Future* (Hart, 1998) 311–12; *Dubai Aluminium Co Ltd v Salaam* (2003) 2 AC 366, 391; *Twinsectra Ltd v Yardley* (2002) 2 AC 164, 194; *Criterion Properties Ltd v Stratford UK Properties Ltd* (2004) 1 WLR 1864, [4]. Nevertheless, the prevailing view in English law continues to emphasise the element of fault in the imposition of personal liabilities on third-party recipients. David Salmons observed that the purpose of the equitable regime is to aid in the retrieval of misused assets when a trustee has violated their duty to preserve them. If the courts intend to impose strict liability personal claims on innocent recipients based on the principle of unjust enrichment, there must be substantial justifications for such action, but no such justifications could be found under existing law. See David Salmons, 'Claims Against Third-Party Recipients of Trust Property' (2017) 76(2) *Cambridge Law Journal* 399, 429.

⁵⁶ *Byers v Saudi National Bank* (n 5) [8], [97], [155]. Before the case of *Byers v Saudi National Bank*, a knowing receipt claim could be invoked in instances of unauthorised dispositions by charitable trustees, where no beneficiaries possessed vested equitable proprietary interest in the trust asset. It could also be applicable in cases involving discretionary trusts, where the beneficiaries' interest could only be characterised as a mere hope or expectation to acquire entitlement to the benefit of the trust asset, rather than a vested proprietary interest. For applications of knowing receipt claims within the context of charitable and discretionary trusts, see, eg, *Lewis v Tamplin* [2018] EWHC 777 (Ch); *Right Reverend Hollis (Bishop of Portsmouth) v Rolfe* [2008] EWHC 1747 (Ch); *Eden Refuge Trust v Hobepea* [2012] NZCA 124. The *Saudi* case, as the first English Supreme Court authority, established the requirement that a knowing receipt claim depends on the claimant sustaining a continuous equitable proprietary interest in the trust asset acquired by the third-party recipient. This stance may potentially influence the implementation of knowing receipt claims in relation to charitable and discretionary trusts. Until the English courts offer further clarification on this issue, the degree to which the *Saudi* case's reasoning restricts the application of knowing receipt claims remains ambiguous. It merits exploration as to whether knowing receipt claims remain viable in situations where no beneficiaries possess an equitable proprietary interest in the trust asset.

⁵⁷ *Arthur v Attorney General of the Turks & Caicos Islands* [2012] UKPC 30, [38].

ministerially.⁵⁸ Condition (b) requires that the receipt of asset must have arisen from a breach of trust⁵⁹ or fiduciary duty.⁶⁰ Here, the fiduciary duty is not understood in a restrictive sense as encompassing only the avoidance of conflicts of interest and the avoidance of making unauthorised benefit. Rather, it is construed as a trustee-like stewardship⁶¹ duty to adhere to the limits of one's authority when disposing of the asset for the benefit of another person.⁶² Condition (c) requires that the third-party recipient must have been at fault at the time they received the asset transferred in breach of trust or fiduciary duty; alternatively, if the third-party recipient had been innocent at the time of receipt, they must have been at fault subsequently. The fault requirement suggests that the unconscionable-receipt liability stems from the third-party recipient's moral culpability for their decision to accept the trust property. This culpability takes precedence over the 'importance of protecting [the third-party recipient's ability] to rely upon property received',⁶³ thereby vindicating the beneficiary's equitable property rights. Condition (d) construes a knowing receipt claim as premised on the notion that the beneficiary sustains an equitable proprietary interest in the trust asset when the third-party recipient becomes aware of the breach of trust. This 'continuing proprietary interest' stipulation elucidates the reason a knowing recipient bears a personal obligation to restore the trust asset to its rightful equitable owner, while also serving as its custodian in the interim.⁶⁴ Should the beneficiary's proprietary equitable interest in the trust asset be extinguished or overridden upon the third-party recipient's receipt of the trust asset, the third-party recipient cannot be held liable for knowing receipt.⁶⁵ Among the four conditions, the fault element holds particular significance for the comparative law analysis undertaken in this article and hence will be scrutinised in more depth below.

1 Baden Categorisation of Knowledge and Unconscionability

Until 2000, the categorisation of knowledge⁶⁶ proposed by Peter Gibson J in *Baden Delvaux* had been widely applied by courts when investigating a third-party recipient's level of fault in actions for

⁵⁸ *Twinsectra Ltd v Yardley* (n 55); *Barnes v Addy* (1874) 9 Ch App 244, 254–55; *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 291–92.

⁵⁹ *Novoship (UK) Ltd v Mikhaylyuk* [2015] QB 499, [89].

⁶⁰ *Arthur v Attorney General of the Turks & Caicos Islands* (n 57) [31].

⁶¹ Stewardship is used to dictate the administration of property for the benefit of another person. See *AIB Group (UK) Plc v Mark Redler & Co Solicitors* [2015] AC 1503, [50]–[51]; *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch), [513]; *Bairstow v Queens Moat Houses Plc* (2001) 2 BCLC 513, [53]; *Burnden Holdings (UK) v Fielding* [2018] AC 857, 864.

⁶² *El Ajou v Dollar Land Holdings Plc* (n 55) 700, 705. See also McFarlane, Mitchell and Hudson (n 5) 571.

⁶³ Paul S Davies, *Accessory Liability* (Hart, 2015) 92.

⁶⁴ *Byers v Saudi National Bank* (n 5) [10].

⁶⁵ *Ibid* [114]–[115], [155]. In the recent English Supreme Court decision of *Byers v Saudi National Bank* [2023] UKSC 51, Lord Briggs analyses (at [42]) a knowing receipt claim as ancillary to a proprietary claim, while Lord Burrows construes (at [157]) a knowing receipt claim as an equitable proprietary wrong. The 'continuing proprietary interest' prerequisite underpins both assertions, notwithstanding the distinct reasoning. Irrespective of the disparity in their rationale, both Lord Briggs and Lord Burrows concur (at [97] and [201]) that a knowing receipt claim is precluded if the claimant's proprietary equitable interest has been extinguished or overridden by the time the recipient acquires the property.

⁶⁶ The knowledge can be classified into five types: (i) actual knowledge; (ii) wilfully shutting one's eyes to the obvious; (iii) wilfully and recklessly failing to make such inquiries as an honest and reasonable man would

unconscionable receipt.⁶⁷ According to *Baden* categorisation, the fault element is construed according to the knowledge possessed by the third-party recipient. Since the introduction of *Baden* categorisation, the debate over its utility has never been settled. For example, in the English Court of Appeal decision of *Akindele*,⁶⁸ Nourse LJ, with whom Ward LJ and Sedley LJ agreed, held that ‘grave doubts [exist] about [*Baden* categorisation’s] utility in cases of knowing receipt’.⁶⁹ Acknowledging the institutional distinction between unconscionable receipt and dishonest assistance,⁷⁰ Nourse LJ limited the application of the *Baden* categorisation to the context of dishonest assistance, stating that a new test based on conscience should be formulated in cases of unconscionable receipt:

The recipient’s state of knowledge must be such as to make it *unconscionable* for him to retain the benefit of the receipt. A test in that form, though it cannot, any more than any other, avoid difficulties of application, ought to avoid those of definition and allocation to which the previous categorisations have led.⁷¹

Nourse LJ did not clarify the meaning of ‘unconscionability’, allowing it to be interpreted on a case-by-case basis. The flexibility inherent in the unconscionability test endows the courts with more leeway in determining how to balance the interests of the beneficiary and the third-party recipient.⁷² The replacement of ‘*Baden* categorisation’ with ‘unconscionability’ does not imply that knowledge has become completely irrelevant in evaluating a third-party recipient’s liability. Nourse LJ associated his analysis of unconscionability with the defendant’s state of knowledge.⁷³ By finding that the defendant

make; (iv) knowledge of circumstances which would indicate the facts to an honest and reasonable man; and (v) knowledge of circumstances which would put an honest and reasonable man on inquiry. See *Baden v Société Générale Pour Favoriser Le Développement Du Commerce et de L’industrie En France SA* (n 6) 575.

⁶⁷ The form of liability rooted in Equity, traditionally referred to as ‘knowing receipt’, has been increasingly replaced in some court decisions with the term ‘unconscionable receipt’. See, eg, *Bank of Credit and Commerce International (Overseas) Ltd (in Liq) v Akindele* (n 1) 448; *Byers v Saudi National Bank* (n 1) [69]–[75]; *Byers v Samba Financial Group* (n 1) [103]–[106]. However, in the most recent ruling by the English Supreme Court in *Byers v Saudi National Bank* [2023] UKSC 51, Lord Briggs underscored (at [82]) the misuse of ‘unconscionability’ when assessing the degree and nature of knowledge required from third-party recipients. He further asserted (at [11]) that the crux of equity’s imposition of knowing receipt liability is to uphold the beneficiary’s ongoing beneficial ownership of the subject property. This is as opposed to addressing the perceived unconscionability of the recipient’s assumption of ownership of the property after becoming aware that the property was transferred to them in violation of trust.

⁶⁸ *Bank of Credit and Commerce International (Overseas) Ltd (in Liq) v Akindele* (n 1).

⁶⁹ Ibid 455. The *Baden* categorisation’s utility in cases of dishonest assistance has also been challenged. For example, in the Privy Council case of *Royal Brunei Airlines Sdn Bhd v Philip Tan Kok Ming* (1995) 2 AC 378, Lord Nicholls of Birkenhead remarked (at 392) that ‘knowingly is better avoided as a defining ingredient of [dishonest assistance], and in the context of [dishonest assistance] the *Baden* sale of knowledge was best forgotten’.

⁷⁰ Dishonesty in the context of knowing assistance has never been a prerequisite for receipt-based liabilities. See Ibid 448.

⁷¹ Ibid 455 (emphasis added).

⁷² There are also criticisms against the loose use of ‘unconscionability’ in judgments. For example, Graham Virgo commented that ‘although the language of conscience and unconscionability remain[s] the touchstone for [equity], judges and commentators have lost sight of what conscience and unconscionability actually mean’. See Graham Virgo, ‘Conscience in Equity: A New Utopia’ (2017) 15(1) *Otago Law Review* 1, 1.

⁷³ *Bank of Credit and Commerce International (Overseas) Ltd (in Liq) v Akindele* (n 1) 457–58.

‘did not have *actual or constructive knowledge* that his receipt of the [money] was traceable to a breach or breaches of fiduciary duty by [the trustee]’,⁷⁴ his Lordship asserted that there was no unconscionability on the defendant’s part.⁷⁵ The way in which Nourse LJ arrived at his conclusion suggests that a defendant’s actual and constructive knowledge is relevant to the assessment of unconscionability.

Nourse LJ’s reasoning in *Akindele* was endorsed by Carnwath LJ in the English Court of Appeal case of *Criterion Properties PLC v Stratford UK Properties LLC (Criterion)*.⁷⁶ On the one hand, Carnwath LJ emphasised the limitations of solely relying on a defendant’s actual knowledge in the assessment of unconscionability:

I disagree respectfully with the judge in thinking that the question in the present case could be answered simply by reference to whether Oaktree had actual knowledge of the circumstances which gave rise to the breach of duty.⁷⁷

On the other hand, similar to Nourse LJ in *Akindele*, Carnwath LJ did not define the term ‘unconscionability’ in order to ensure the greatest possible flexibility in its interpretation. His Lordship identified a variety of factors relating to the analysis of unconscionability, including ‘the legal advice received by both parties’⁷⁸ and the ‘actions and knowledge in the context of the commercial relationship of the parties as a whole’.⁷⁹ These factors confirmed the relevance of a defendant’s constructive knowledge to the assessment of unconscionable receipt liabilities. As Carnwath LJ observed, ‘If all the facts which make the transaction unlawful were *known to all* the parties ... [subjective] ignorance of the law will not excuse them’.⁸⁰

In the English High Court case of *Armstrong DLW GmbH v Winnington Networks Ltd*,⁸¹ Stephen Morris QC endorsed Nourse LJ’s analysis in *Akindele* that unconscionability ought to be the test for assessing receipt-based liabilities. When determining the role of *Baden* categorisation in the assessment of unconscionability, Stephen Morris QC subscribed to *Lewin*’s observation that ‘the *Baden* classification of knowledge is still *useful* in distinguishing different types of knowledge for the purpose

⁷⁴ Ibid 458.

⁷⁵ Ibid.

⁷⁶ *Criterion Properties Plc v Stratford UK Properties LLC* (n 5). In this case, there was a ‘poison pill’ agreement between the managing director and another director of Criterion. They signed the agreement with Oaktree, which allowed Oaktree to be bought out of a partnership with Criterion on favourable terms if another party gained control of Criterion or if its chairman or managing director were no longer involved in the company’s management. However, when the managing director of Criterion was dismissed, Oaktree tried to exercise its option to be bought out. Criterion claimed that the agreement was unauthorized and sought to have it set aside. This case was appealed to the House of Lords ([2004] UKHL 28) where the court was given the chance to clarify the meaning of unconscionability within the context of the case. However, the court ultimately determined that the issue of unconscionability was not applicable since the defendant had not received any property as a result of the agreement. Instead, the primary concern was to determine the validity of the poison pill agreement.

⁷⁷ Ibid [38].

⁷⁸ Ibid [39].

⁷⁹ Ibid [40].

⁸⁰ Ibid [39] (emphasis added).

⁸¹ *Armstrong DLW GmbH v Winnington Networks Ltd* (n 5).

of determining what kind of knowledge makes it *unconscionable* for the defendant to retain the trust property'.⁸² Building on *Baden* categorisation, Stephen Morris QC identified the relevance of a defendant's actual and constructive knowledge in the analysis of unconscionability:

Baden types (1) to (3) knowledge on the part of a defendant render receipt of trust property 'unconscionable'. ... Further Baden types (4) and (5) knowledge also render receipt 'unconscionable' but only if, on the facts actually known to this defendant, *a reasonable person would either have appreciated that the transfer was probably in breach of trust or would have made inquiries or sought advice* which would have revealed the probability of the breach of trust.⁸³

In the recent English Supreme Court decision, *Byers v Saudi National Bank*⁸⁴ (*Saudi*), the issue of knowing receipt came to the forefront. The *Saudi* case centred on a situation in which the trustee, Mr Al-Sanea, transferred the trust asset, comprising securities, to the respondent-recipient, Samba Financial Group (Samba). Samba was aware that the trustee held the securities in trust for the appellant, Saad Investments Company (Saad). Nevertheless, Samba accepted the receipt of the trust asset without conducting inquiries into the nature of the transfer, as a diligent and reasonable bank would have done.⁸⁵ Pursuant to Saudi Arabian law, which governed the transfer, Saad's proprietary equitable interest in the securities was extinguished upon the transfer. As a result, Samba became the exclusive owner of the securities once they were registered in Samba's name.⁸⁶ The central question arising in this case was whether Saad could initiate a knowing receipt claim against Samba. The facts indicate that the nature and extent of the knowledge required from a third-party recipient are not contested issues in this particular instance. As Lord Briggs elucidated,

The uncertainty [around knowing recipient liabilities] lies on *the boundaries of what may amount to knowledge, and in particular whether there is a category of knowledge called "constructive knowledge"*. That uncertainty does not arise in this case, because the process whereby the appellant [Saad] came to establish its factual case, involving as it did the barring of the respondent [Samba] from contesting most of the pleaded facts due to its failure to give disclosure, *produced the result that whatever was the knowledge precisely required, Samba had it*. That part of the requirements for establishing liability in knowing receipt is therefore established beyond the respondent's ability to challenge it.⁸⁷

While the *Saudi* case did not engage in extensive discussions about the nature and extent of knowledge required from a third-party recipient, Lord Briggs did address the relevance of

⁸² Ibid [131] (emphasis added).

⁸³ Ibid [132] (emphasis added).

⁸⁴ *Byers v Saudi National Bank* (n 5).

⁸⁵ Ibid [14].

⁸⁶ Ibid [15].

⁸⁷ Ibid [33] (emphasis added). Lord Burrow also addressed the irrelevance of the question concerning the nature and extent of knowledge required from a third-party recipient in the current case. He stated (at [101]) that '[the] terminology of "unconscionability" has unhelpfully obfuscated the answer to the important question of whether the required knowledge for knowing receipt extends beyond actual knowledge to include constructive knowledge. That question is one of law to be decided once and for all and the answer to it does not vary depending on the facts. But resolution of that question is not now before us and we have heard no submissions on it'.

unconscionability when assessing knowledge in the context of a knowing receipt claim. The appellant, to substantiate their argument, drew upon Nourse LJ's reasoning in *Akindele*, positing that the essence of knowing receipt liability lies in a flexible approach to the knowledge requirement. This suggests that the recipient's state of knowledge, given the specifics of the case, must render it unconscionable for the recipient to retain the property for their own use and benefit.⁸⁸ However, Lord Briggs critiqued this approach as 'wrongly elevat[ing] unconscionability from an equitable objective into an unruly and unpredictable test for liability'.⁸⁹ Given the potential ambiguity that an unconscionability analysis could introduce to issues concerning property title priority, Lord Briggs advocated for the separation of the unconscionability analysis from the determination of a third-party recipient's knowledge. His judgment, as cited below, explicitly supports this assertion:

While the regulation of unconscionable conduct may be the underlying purpose of many equitable principles, *the extent to which unconscionability acts as a determining factor in the operation of those principles in particular cases varies widely*. Where in the broken-down personal relations within a family a non-contractual promise to transfer property in the future has led to detrimental reliance, unconscionability may play a large part in moulding the remedy to be given to the reliant party ... But where the competition is between legal and equitable interests in marketable property the underlying objective of regulating unconscionable conduct needs to take second place to the established principles regulating priorities. *The dictates of predictable title would be nullified if in every case of competing priorities the outcome depended on the endlessly variable views of different chancery judges about what the dictates of conscience required on the unique facts of that particular case*. The same principled approach answers the appellants' related submission that the knowledge requirement is only a flexible aspect of the need to demonstrate unconscionability. Issues as to priority in title to property need to be resolved on a more predictable basis than that.⁹⁰

2 Observations by the Privy Council

Presently, no English Supreme Court's authority has explicitly clarified the nature and extent of the knowledge required for establishing receipt-based liabilities.⁹¹ The Privy Council, in contrast, has

⁸⁸ Ibid [34].

⁸⁹ Ibid [82].

⁹⁰ Ibid [40] (emphasis added). It is important to underscore that Lord Briggs's discourse on the relevance of unconscionability in assessing the nature and extent of knowledge is merely obiter, not ratio decidendi. The remaining judicial members, including Lord Hodge, Lord Leggatt, Lord Burrows, and Lord Stephens, did not participate in Lord Briggs's exploration of this particular aspect.

⁹¹ The latest English Supreme Court case of *Byers v Saudi National Bank* [2023] UKSC 51 centres around the issue of knowing receipt. Nevertheless, the ruling did not delve into the specifics of the knowledge necessary for establishing receipt-based liabilities since the matter was not pertinent to the current case. See Ibid [33], [101]. In *Dubai Aluminium Co Ltd v Salaam (Livingstone, third parties)*, Lord Millett affirmed that liability for a receipt claim is grounded on fault. However, he specifically highlighted that it is based on allegations of dishonesty, referring to it as involving dishonest receipt. See *Dubai Aluminium Co Ltd v Salaam (Livingstone, third parties)* (2003) 2 AC 366, 391, 395. It remains unclear whether this emphasis on dishonesty stems from the arguments presented in the case or if it holds broader implications for our understanding of the fault requirement in such cases. A more recent case, *Williams v Central Bank of Nigeria*, featured Lord Neuberger emphasizing within a single paragraph that the liability of the recipient is rooted in dishonesty. See *Williams v Central Bank of Nigeria* [2014] AC 1189, 1215. This perspective diverges from the stance taken by Nourse LJ in

recognised the relevance of a defendant's constructive knowledge to the assessment of unconscionability in several cases. In *Arthur v Attorney General of the Turks & Caicos Islands*,⁹² Sir Terence Etherton, delivering the judgment of the Privy Council, remarked that 'Knowing receipt in the *Akindele* sense is ... not merely absence of notice but unconscionable conduct amounting to equitable fraud. It is a classic example of lack of bona fide'.⁹³ Equitable fraud and lack of bona fide entail the 'objective notion of fault';⁹⁴ the analogy with these two concepts confirms the objective aspect of the knowledge of the third-party recipient. The objective construction of unconscionability in the context of unconscionable receipt was also acknowledged in *Credit Agricole Corporation and Investment Bank v Papadimitriou (Papadimitriou)*.⁹⁵ The central issue in *Papadimitriou* lay in the meaning of bad faith, which would prevent the defendant from relying on the defence of equity's darling.⁹⁶ When analysing bad faith, Lord Clarke of Stone-cum-Ebony asserted that both actual and constructive knowledge are crucial in the assessment of the defendant's state of mind and that constructive knowledge will arise where 'the facts known to the [defendant] would give a *reasonable [defendant] in the position of the particular [defendant]* serious cause to question the propriety of the transaction'.⁹⁷ Lord Sumption agreed with Lord Clarke of Stone-cum-Ebony's reasoning on bad faith and further clarified that this was also the test for unconscionable receipt. His Lordship stated the following:

Whether a person claims to be a bona fide purchaser of assets without notice of a prior interest in them, or disputes a claim to make him accountable as a constructive trustee on the footing of [unconscionable] receipt, *the question what constitutes notice or knowledge is the same*.⁹⁸

B Equity's Darling

The rule of equity's darling applies when trustees engage in transactions not authorised by trust documents. If the recipient of legal interests in the trust assets is a purchaser who has paid value for it and has no notice of the beneficiary's equitable interests, they will prevail over the beneficiary and become both legally and beneficially entitled to the purchased assets.⁹⁹ There are two conditions that need to be met to successfully invoke this mechanism. First, the recipient must have given something of value (i.e. consideration) in exchange for the property received. Second, the recipient must have

Akindele, where it was explicitly stated that dishonesty is not a prerequisite for receipt-based liabilities. See *Bank of Credit and Commerce International (Overseas) Ltd (in Liq) v Akindele* (n 1) 448.

⁹² *Arthur v Attorney General of the Turks & Caicos Islands* (n 57).

⁹³ *Ibid* [40].

⁹⁴ Graham Virgo, *The Principles of Equity & Trusts* (Oxford University Press, 4th ed, 2020) 637.

⁹⁵ *Credit Agricole Corporation and Investment Bank v Papadimitriou* [2015] UKPC 13.

⁹⁶ *Ibid* [2]. The defence of Equity's darling is illustrated below in Part III-B.

⁹⁷ *Ibid* [20].

⁹⁸ *Ibid* [33] (emphasis). In contrast, Rohan Havelock argued that that personal liability should only be imposed when there is actual knowledge on the part of the defendant. This requirement is necessary to ensure that the defendant's conscience is adequately affected. Additionally, it helps prevent potential misuse of judicial discretion in imposing liability and serves to safeguard the security of receipt and the integrity of commercial transactions. See Havelock (n 5) 15–18. See also *Re Montagu's Settlement Trusts* [1987] Ch 264, 285.

⁹⁹ *Akers v Samba Financial Group* [2017] AC 424, [62]–[63]; *Independent Trustee Services Ltd v GP Noble Trustees Ltd* [2013] Ch 91, [106].

acted in good faith, meaning they had no awareness of the beneficiary's hidden equitable interest.¹⁰⁰ The requirement of consideration implies that there is 'exchange of economic value'¹⁰¹ between the trustee and the third-party recipient. This exchange is grounded on the recipient's anticipation of deriving benefits from the transaction, and their voluntary actions align harmoniously with this expectation. The second condition, good faith, indicates that the recipient must act honestly and 'without notice, *actual or constructive*, of [the beneficiary's] equitable right'.¹⁰² The recipient is expected to make reasonable enquiries that any cautious, reasonable, and prudent individual would make in their position. Failing to make such enquiries renders the recipient wilfully ignorant, discouraging equity from 'exploit[ing] the shelter it offers to the vulnerable'¹⁰³ third party. Similarly, the beneficiary is expected to inform the recipient of any secret personal arrangements they have with the trustee. If they fail to provide reasonable notice, their interests may be subordinated to those of the recipient in case of a conflict, as equity prefers not to impose the costs of a private trust arrangement on innocent third parties.¹⁰⁴

Linguistically, the terms 'notice' and 'knowledge' may have different meanings. In *In re Montagu's Settlement Trusts*, Sir Robert Megarry V-C's criticism of the loose replacement of 'knowledge' with 'notice' in books and authorities supports this point:

In the books and the authorities, the word 'notice' is often used in place of the word 'knowledge', usually without any real explanation of its meaning. This seems to me to be a fertile source of confusion; for whatever meaning the layman may attach to those words, *centuries of equity jurisprudence have attached a detailed and technical meaning to the term 'notice', without doing the same for 'knowledge'*. The classification of 'notice' into actual notice, constructive notice and imputed notice has been developed in relation to the doctrine that a bona fide purchaser for value of a legal estate takes free from any equitable interests of which he has no notice.

Now until recently *I do not think there had been any classification of 'knowledge' which corresponded with the classification of 'notice'*. However, in the Baden case ... the judgment sets out five categories of knowledge, or of the circumstances in which the court may treat a person as having knowledge. ...

¹⁰⁰ *Independent Trustee Services Ltd v GP Noble Trustees Ltd* (n 99) 92.

¹⁰¹ Lon L Fuller, 'Consideration and Form' (1941) 41(5) *Columbia Law Review* 799, 815.

¹⁰² *Macmillan Inc v Bishopsgate Investment Trust plc (No 3)* (1995) 1 WLR 978, 1000 (emphasis added). See also Aruna Nair and Irit Samet, 'What Can "Equity's Darling" Tell Us about Equity?' in Dennis Klimchuk, Irit Samet and Henry E Smith (eds), *Philosophical Foundations of the Law of Equity* (Oxford University Press, 2020) 276; FW Maitland, *Equity: A Course of Lectures by F W Maitland*, ed J Brunyate (Cambridge University Press, 1936) 130.

¹⁰³ Nair and Samet (n 102) 285.

¹⁰⁴ Irit Samet and Hanoch Dagan, 'Express Trust: The Dark Horse of the Liberal Property Regime' in Simone Degeling, Jessica Hudson and Irit Samet (eds), *Philosophical Foundations of the Law of Trusts* (Oxford University Press, 2023) forthcoming.

Type (i) corresponds to actual notice, and types (ii), (iii), (iv) and (v) correspond to constructive notice. *Nothing, however, is said (at least in terms) about imputed knowledge.*¹⁰⁵

However, regarding equity's darling and unconscionable receipt, the boundaries of the two terms have not been clearly defined. As observed by Lord Sumption in the Privy Council case of *Papadimitriou*, 'the question what constitutes notice or knowledge is the same'¹⁰⁶ when discussing unconscionable receipt and equity's darling. Stephen Morris QC made a similar observation in the English High Court case of *Armstrong DLW GmbH v Winnington Networks Ltd*:

[T]here is often an overlap between, and sometimes a mixing of, the concept of 'notice' for this defence and the concept of 'knowledge' in the context of knowing or unconscionable receipt of trust property. However, in present circumstances, I do not consider that there is any relevant distinction to be drawn between 'notice' and 'knowledge'.¹⁰⁷

In the English Supreme Court case of *Byers v Saudi National Bank*,¹⁰⁸ Lord Briggs used 'knowledge' and 'notice' interchangeably when delineating receipt-based liabilities:

Notice (or even knowledge) that the property was previously subject to C's equitable interest would not on its own be enough, unless the purchaser *knew, or had notice*, that the sale by the trustee was in breach of trust, and therefore incapable of overreaching that equitable interest. ... Thus *knowledge or notice* that the transfer involved a breach of trust is generally the equivalent of *knowledge or notice* of a continuing equitable interest.¹⁰⁹

While the interplay between the concepts of 'knowledge' and 'notice' continues to be a subject of debate among legal scholars, a consensus generally exists that these terms are interconnected in specific contexts. Particularly in cases concerning the defence of equity's darling and allegations of unconscionable receipt, 'there [is] a correlation between notice and knowledge'.¹¹⁰ The notice that a third-party recipient receives can influence their degree of knowledge. Consequently, this can impact the evaluation of liabilities associated with unconscionable receipt.¹¹¹ Understanding the nuanced relationship between these two elements is therefore vital in accurately assessing such cases.

Once these two conditions are fulfilled, the defence of equity's darling can be successfully established. Consequently, the law prioritises the third-party recipient by overriding the beneficiary's equitable proprietary interest. This 'overriding' approach strives to strike a reasonable balance between

¹⁰⁵ *In re Montagu's Settlement Trusts* [1987] Ch 264, 277 (emphasis added). See also *Carl-Zeiss-Stiftung v Herbert Smith & Co (a firm) (No 2)* (1969) 2 Ch 276, 296; *MCP Pension Trustees Ltd v AON Pension Trustees Ltd* [2012] Ch 1, 20–21; JE Penner, *The Law of Trusts* (Oxford University Press, 10th ed, 2016) [11.167].

¹⁰⁶ *Credit Agricole Corporation and Investment Bank v Papadimitriou* (n 95) [33]. See also *Akers v Samba Financial Group* (n 99) [43].

¹⁰⁷ *Armstrong DLW GmbH v Winnington Networks Ltd* (n 5) [112]. See also SH Goo and Alice Lee, *Land Law in Hong Kong* (LexisNexis, 5th ed, 2022) 542–43.

¹⁰⁸ *Byers v Saudi National Bank* (n 5).

¹⁰⁹ *Ibid* [20] (emphasis added).

¹¹⁰ *MCP Pension Trustees Ltd v AON Pension Trustees Ltd* (n 105) 23.

¹¹¹ *Byers v Saudi National Bank* (n 5) [33].

the beneficiary's need to protect their property rights and the preservation of the third-party recipient's legitimate interests. At the core of this equilibrium is the notion that trust law is committed to fostering mutual respect between the beneficiary and the bona fide purchaser, ensuring that both parties' rights and interests are fairly considered and protected.

IV The Way Forward

Having identified the ambiguities concerning the Chinese knowing receipt rule and explained the functioning of the rules of unconscionable receipt and equity's darling, this part outlines potential directions for Chinese law to develop rational principles governing third-party recipient liabilities under Article 22 of the Chinese Trust Law. This analysis consists of two sections. Section A examines the lessons that Chinese law can glean from the two English rules and identifies areas in which Article 22 can be reformed. Section B first applies the existing rules and then the reformed doctrine to two hypothetical scenarios, providing a clear understanding of how the newly reformed doctrines address current issues.

It is essential to emphasise that drawing insights from the two English rules in Section A does not suggest that English law is inherently superior in this regard, nor should Chinese law merely adopt it. Instead, as analysed in Part II, Chinese law has incorporated the knowing receipt rule under Article 22 of the Chinese Trust Law. However, there is a scarcity of legislative clarifications or case guidance on implementing this rule. In comparison, English law has established an array of useful guidelines through case law, exploring the interpretation and application of rules related to unconscionable receipt and equity's darling. Taking into account the shared concerns that underpin both English and Chinese trust laws — such as balancing the interests of beneficiaries and third-party recipients, promoting property circulation, and safeguarding transaction certainty — it is valuable to explore the reasoning behind the two English rules and uncover potential insights that may prove beneficial to Chinese law.

A The Proposed Reforms of Article 22

Trustees are generally obligated to administer and dispose of trust assets in accordance with the instructions outlined in the trust instruments. Allowing a third-party recipient to retain trust property when a trustee disposes of it in breach of their trustee duty is detrimental to safeguarding the interests of the beneficiaries and achieving the settlor's purpose in establishing the trust. To strike a fair balance between the interests of the beneficiary and the third-party recipient, mechanisms are needed. As analysed earlier,¹¹² the knowledge requirement under Article 22 of the Chinese Trust Law is one such mechanism.

The knowledge requirement under Article 22 encompasses two aspects: degree and content of knowledge. However, the Chinese Trust Law does not provide clear definitions or explanations for these aspects, leading to ambiguity in their interpretation and application. Regarding the degree of knowledge, Article 22 uses the term 'fully knowing' (*mingzhi* 明知). However, its exact meaning and requirements are not specified in Article 22 or any other provisions of the Chinese Trust Law. This

¹¹² See Part II-C.

lack of clarity contributes to uncertainties in determining the legal consequences of the right of rescission granted by Article 22. Regarding the content of knowledge, both situations where the trustee's disposition breaches trust purposes or results in losses to trust property due to violations of their management duties or improper handling of trust affairs give the settlor or beneficiary the right to rescind the trustee's disposition. However, under Article 22, only the third-party recipient's knowledge of the breach of trust purposes can trigger their liability to return the trust property or provide compensation.¹¹³ These ambiguities and inconsistencies have led to debates and differing interpretations of Article 22.¹¹⁴ Therefore, to address these issues, this section proposes reforms to Article 22 from both the degree and content perspectives.

1 Clarification of the Degree of Knowledge

The analysis of Part II-C indicates that, doctrinally, the knowledge requirement under Article 22 of the Chinese Trust Law should be equal to or stricter than the requirement for precluding the bona fide acquisition defence under property law. This ensures that when a third-party recipient is obligated to return trust property under trust law, they cannot use the bona fide acquisition defence to claim ownership of the property. As mentioned earlier,¹¹⁵ the knowledge that prevents the application of the bona fide acquisition defence comprises two types: (a) actual knowledge of the transferor's lack of authority to dispose of the property and (b) putative knowledge, which refers to situations where the transferee would have known about the transferor's lack of authority of disposal had they not acted with material negligence. In such cases, the knowledge of the transferor's lack of authority is attributed to the third-party recipient.¹¹⁶ Therefore, if the same standard is applied, the knowledge required to activate the third-party recipient's liability under Article 22 should encompass (a) actual knowledge of the breach of trust purposes and (b) putative knowledge, meaning that, although the third-party recipient did not have actual knowledge of the breach of trust purposes, their lack of knowledge was due to their material negligence in failing to make enquiries when receiving the trust property. If a more stringent standard is implemented, only actual knowledge of the breach of trust purposes can instigate the third-party recipient's liabilities under Article 22. As previously concluded,¹¹⁷ both suggestions are viable in preserving doctrinal consistency between Chinese trust and property laws.

As previously explained,¹¹⁸ trust arrangements in China are typically confidential, which presents challenges for outsiders in identifying the existence or purpose of a trust. This practical aspect complicates the process for third-party recipients to ascertain whether a transaction involves a breach of trust, thereby posing difficulties in triggering a third-party recipient's liability under Article 22. In order to facilitate property circulation and ensure transaction certainty, it is both rational and feasible

¹¹³ See Part II-A

¹¹⁴ Wen (n 9) 79; 焦若昀 [Jiao Ruoyun], 《信托受益人撤销权中的利益平衡》 [Balancing of Interests in the Trust Beneficiary's Right of Revocation] (2022) 5 贵州民族大学学报 (哲学社科版) *Guizhou Minzu University Journal (Philosophy & Social Science)* 143, 148.

¹¹⁵ See Part II-B

¹¹⁶ See Part II-B.

¹¹⁷ See Part II-C.

¹¹⁸ Ibid.

to require transaction parties to investigate the propriety of a transaction. In view of this, a sound balance of interests between beneficiaries and third-party recipients necessitates a significant policy concern: third-party recipients should not be permitted to retain trust property if their failure to scrutinise the transaction's propriety is a result of material negligence, which could be circumvented with a reasonable and diligent inquiry. Taking into account this policy concern as well as the aforementioned practical considerations, it is suggested that a more efficacious approach would be to permit both actual and putative knowledge to activate the third-party recipient's liabilities for the return of trust property or provision of compensation under Article 22. This implies that a uniform standard should be applied to the knowledge requirements under both Article 22 and the bona fide acquisition rule.

The experience in English law supports the aforementioned proposition. As noted earlier,¹¹⁹ while debates persist regarding the interpretation of 'knowledge' and 'notice' in the contexts of unconscionable receipt and equity's darling, there is an indisputable connection between these two elements. The notice obtained by a third-party recipient can impact their degree of knowledge and, subsequently, affect the evaluation of liabilities pertaining to unconscionable receipt. Comprehending the intricate relationship between these elements is crucial for accurately evaluating cases concerning equity's darling and unconscionable receipt. Within the context of equity's darling, 'notice' encompasses both actual and constructive notices.¹²⁰ In the context of unconscionable receipt, 'knowledge' consists of both actual and constructive knowledge.¹²¹ Regarding the required degree of knowledge, the notice necessary for the equity's darling defence is as rigorous as the knowledge needed for assessing unconscionable receipt. As articulated by Stephen Morris QC in the English High Court case of *Armstrong DLW GmbH v Winnington Networks Ltd*, 'I do not consider that there is any relevant distinction to be drawn between "notice" and "knowledge"'¹²² when speaking of unconscionable receipt and equity's darling. Similarly, Lord Sumption remarked in the Privy Council case of *Papadimitriou* that 'the question of what constitutes notice or knowledge is the same'¹²³ in relation to unconscionable receipt and equity's darling.

In light of the aforementioned discussions, it is recommended that Article 22 adopts a consistent standard for the degree of knowledge that would preclude the application of a bona fide acquisition defence. Consequently, either actual or putative knowledge should be sufficient to trigger the liability of the third-party recipient under Chinese trust law. This approach harmonises the knowledge requirements and ensures a fair balance between the interests of beneficiaries and third-party recipients.

¹¹⁹ See Part III.

¹²⁰ See Part III-B.

¹²¹ See Part III-A.

¹²² *Armstrong DLW GmbH v Winnington Networks Ltd* (n 5) [112].

¹²³ *Credit Agricole Corporation and Investment Bank v Papadimitriou* (n 95) [33].

2 Expanding the Scope of the Content of Knowledge

Attention should also be given to the content of knowledge required under part (b) of Article 22. As previously argued,¹²⁴ parts (a) and (b) of Article 22 conflict. According to part (a), if a trustee disposes of trust property against trust purposes or causes any losses to trust property due to violations of their management duties or improper handling of trust affairs, the settlor or beneficiary can apply to rescind the disposition. However, under part (b), the third-party recipient is only obligated to return the trust property or provide compensation if they were fully aware of the trustee's breach of trust purposes when receiving the property. As a result, in situations where the trustee's disposition of the trust property is still within the scope of trust purposes but constitutes a breach of management duties or improper handling of trust affairs and causes losses to the trust property, the trustee's disposition can be rescinded. However, the liability of the third-party recipient to return the trust property would not be invoked under the current provisions of part (b).

The dilemma can be addressed by broadening the scope of knowledge required under part (b) to encompass both scenarios detailed in part (a): breach of trust purposes and breach of trustee's management duties or improper handling of trust affairs, resulting in losses to the trust property. Implementing this proposal would foster doctrinal consistency within Article 22 and facilitate the legitimate exercise of the settlor's or beneficiary's right of rescission. This proposal can also find support in English law. To trigger unconscionable recipient liabilities, English law necessitates that third-party recipients possess knowledge that the trustees' disposition of the trust property constitutes a breach of trust duties.¹²⁵ The trust duties here refer to the obligations imposed on trustees, and the 'knowledge' requirement can be satisfied as long as the recipients possess either actual or constructive knowledge.¹²⁶ The breach of trust duties embodies the essence of the knowledge required from third-party recipients, and English law does not differentiate between breach of trust purposes and breach of management duties. A literal interpretation of the phrase 'breach of trust duties' could construe both breaches of trust purposes and management duties as falling within its scope. Considering that the phrase 'breach of trust duties' is not commonly used by Chinese trust scholars and practitioners, merely substituting the language of parts (a) and (b) with this phrase may pose challenges in the practical implementation of Article 22. Instead, a more prudent recommendation is to expand the scope of knowledge required under part (b) to encompass both scenarios outlined in part (a), using the same language to describe the two scenarios for part (a) under part (b). This approach is not only doctrinally feasible but also constitutes a judicious reform for this provision.

B Application of the Reformed Doctrine

Section A above presented two proposals for the reform of Article 22 of the Chinese Trust Law. In this section, both the current doctrines and the hypothetical reformed doctrines are applied to two

¹²⁴ See Part II-A.

¹²⁵ See Part III.

¹²⁶ See Part III-A.

factual scenarios to provide a clear demonstration of how the proposed reforms can effectively resolve uncertainties and ambiguities surrounding the current Article 22.

1 Scenario A

Consider a straightforward scenario: A trustee holds property in trust for the settlor, who is also the beneficiary of the trust. The trustee transfers the property to a third-party recipient in breach of trust purposes. The settlor wishes to bring claims against both the trustee and the third-party recipient to recover the trust property or seek compensation.

Under Article 22 of the Chinese Trust Law, the settlor is entitled to (a) exercise the right to rescind the trustee's disposition, (b) bring a claim against the trustee for the restoration of the trust property or for compensation, or (c) make a claim against the third-party recipient if they were fully aware of the breach of trust purposes at the time of receiving the property. The pivotal question here is whether the settlor can successfully bring a claim against the third-party recipient. Under Chinese property law, the settlor has the right to demand the return of the trust property from the third-party recipient unless the recipient claims to have acquired the property ownership through bona fide acquisition.¹²⁷ One requirement for bona fide acquisition is that the third-party recipient was not aware of the trustee's lack of power of disposition. This implies that they were not aware that the trustee's disposition was in breach of trust purposes and that this lack of knowledge was not due to their material negligence.¹²⁸ Because Article 22 does not clarify the degree of knowledge required, it remains unclear what level of knowledge is necessary for the third-party recipient to be held liable for the return of the trust property. Given this ambiguity, the knowledge under Article 22 could theoretically be interpreted as comprising three types: (a) actual knowledge of the breach of trust purposes, (b) putative knowledge resulting from the third-party recipient's *material* negligence in failing to inquire about the compliance of the disposition with trust purposes, and (c) constructive knowledge due to the third-party recipient's *general* negligence in failing to inquire about the compliance of the disposition with trust purposes.¹²⁹ If constructive knowledge alone is deemed sufficient, a conflict could arise between Chinese trust and property laws. This is because, although constructive knowledge would be sufficient to trigger a third-party recipient's liability to return the trust property, it would not preclude them from raising the bona fide acquisition defence. As a result, the third-party recipient is still entitled to retain the trust property by invoking the bona fide acquisition defence.

In contrast, the proposed reform clarifies the degree of knowledge required under Article 22. Only a third-party recipient's actual knowledge or putative knowledge of the breach of trust purposes due to their material negligence in failing to make proper enquiries would give rise to the liability to return the trust property or make compensation. With regard to actual or putative knowledge, the third-party recipient would not be considered as having acted in good faith, and the bona fide

¹²⁷ Chinese Civil Code, art 311.

¹²⁸ Interpretation I of Property Rights Provisions, art 14.

¹²⁹ In the context of Chinese law, the terms 'putative knowledge' and 'constructive knowledge' are not considered language of art. The authors used these terms intentionally to differentiate between the degree of negligence associated with each type of knowledge.

acquisition defence would not be available. However, if the third-party recipient only has constructive knowledge resulting from general negligence in failing to make proper enquiries when receiving the trust property, their liability under Article 22 would not be triggered. This type of constructive knowledge would also not prevent them from relying on the bona fide acquisition defence to retain the trust property under Chinese property law. As a result, there would be no conflict between Chinese trust and property laws.

2 Scenario B

In this scenario, all the facts remain the same as in Scenario A, except that the trustee transfers the property to a third-party recipient in violation of their management duties. According to part (a) of Article 22 of the Chinese Trust Law, the settlor has the right to apply for the rescission of the trustee's disposition. However, the settlor can only claim against the trustee to restore the trust property or seek compensation. Under part (b) of Article 22, the settlor has no claim against the third-party recipient because the trustee's violation pertains to management duties rather than breach of trust purposes. This results in a doctrinal inconsistency within Article 22: part (a) allows the settlor to rescind the trustee's disposition while part (b) does not require the third-party recipient to return the trust property. Nevertheless, the doctrinal inconsistency does not leave the settlor with no remedies. Although no claim against the third-party recipient is available under Chinese trust law, the settlor can seek assistance from Chinese property law. They could file a claim against the third-party recipient to recover the trust property if the recipient had (a) actual knowledge of the trustee's violation of management duties or (b) putative knowledge of the trustee's violation of management duties due to their material negligence in failing to investigate the transaction details when receiving the trust property. The presence of either knowledge (a) or (b) on the part of the third-party recipient prevents them from being considered bona fide, and they are therefore not allowed to rely on the bona fide acquisition defence to retain the trust property.

If Article 22 is reformed as proposed, the scope of knowledge under part (b) would be expanded to include both scenarios prescribed under part (a). In this case, the settlor would have the right to rescind the trustee's disposition under the current hypothetical scenario and could make a claim against the trustee to recover the trust property or seek compensation. Meanwhile, the settlor would also be entitled to claim against the third-party recipient to recover the trust property if the recipient had actual knowledge of the trustee's violation of management duties or putative knowledge of such violation due to their material negligence in failing to investigate the transaction details upon receiving the property. This actual or putative knowledge on the part of the third-party recipient would preclude them from invoking the bona fide acquisition defence to retain the trust property. This would resolve the doctrinal incoherence of Article 22 of the Chinese Trust Law, and no conflict between Chinese trust law and property law would arise.

V Conclusion

This article examined the knowledge element of Article 22 of the Chinese Trust Law and made two significant findings. First, the Chinese knowing receipt rule was introduced to balance the interests of

third-party recipients and trust beneficiaries. However, due to a lack of clarity regarding the degree and content of knowledge required for third-party recipients under Article 22, there have been inconsistencies and uncertainties in interpreting and implementing the rule. Second, the third-party recipients' defence under Article 22 is related to, rather than separate from, the bona fide acquisition defence in various respects. To ensure doctrinal coherence and consistency between Chinese trust and property laws, the knowledge requirement under Article 22 should be at least as stringent as that for the bona fide acquisition defence under property law.

This article further explored potential reforms that could be implemented for Article 22. It proposes that the degree of knowledge required for third-party recipients under part (b) of Article 22 be clarified to encompass both actual and putative knowledge. Additionally, it suggests that the content of the knowledge under part (b) of Article 22 be expanded to include both scenarios outlined in part (a) of Article 22. These reforms would enhance the coherence of Article 22 and foster harmony between Chinese trust and property laws. They would also find support in English law, which introduced the rules of unconscionable receipt and equity's darling to balance the interests of beneficiaries and third-party recipients. Although one might argue that English law, especially equity, has a unique historical tradition and that drawing analogies and insights from it should be prohibited, this argument overstates jurisdictional differences and overlooks the fact that Chinese trust law was introduced following extensive consultation and discussion of English trust law literature. Functional analysis is crucial in the process of legal rule transplantation and transformation. The knowing receipt rule introduced in China functions as a mechanism to strike a fair balance between beneficiaries and third-party recipients. The concerns of transaction facilitation and interest balancing underpin both English and Chinese trust law, creating a foundation for cross-jurisdictional conversations and establishing a basis for Chinese law to glean insights from its English law forerunner.