Proprietary remedy confirmed for bribes and secret commissions

Article

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Proprietary Remedy Confirmed for Bribes and Secret Commissions

FHR European Ventures LLP v Cedar Capital Partners LLC
[2014] UKSC 45; [2014] 3 W.L.R. 535

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Introduction

When will the courts award a proprietary remedy? At common law, this is unusual: the action against a converter of goods is personal. Conversely, in equity, it is the norm against a fiduciary. The question is important because of the advantages brought by a proprietary remedy, a right of ownership: priority in insolvency over the fiduciary's general creditors and the ability to follow and trace the property in question as well as reach its fruits and profits. Hence it is important to know just when such a remedy is or is not available and why.

For the particular breach of fiduciary duty of taking a bribe or secret commission, the remedy awarded has vacillated for the last 200-odd years. The Supreme Court has now delivered the final instalment in this saga: *FHR European Ventures LLP v Cedar Capital Partners LLC*.[1] The Court held that the remedy against a fiduciary who takes a bribe or secret commission ("bribe", for short) is proprietary.

Furthermore, *Lister & Co v Stubbs*[2] and *Metropolitan Bank v Heiron*[3] holding the remedy is personal are overruled in totality. The multitude of cases inconsistent with the conclusion of *FHR* – including *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd*[4] – are overruled "at least in so far as they relied on or followed *Heiron* and *Lister*".[5]

However, *FHR* decided as little as it possibly could. In particular it did little to tie its decision to any underlying principles which fully explained when and why such a remedy would be awarded. This note explores the matters *FHR* did not.

[1] *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45; [2014] 3 W.L.R. 535.
[2] *Lister & Co v Stubbs* (1890) 45 Ch. D. 1 CA.
[3] *Metropolitan Bank v Heiron* (1880) L.R. 5 Ex. D. 319 CA.
[4] *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* [2011] EWCA Civ 347; [2012] Ch. 453.
[5] *FHR* [2014] UKSC 45; [2014] 3 W.L.R. 535 at [50].

Facts

The material facts are extremely simple. FHR engaged Cedar as purchasing agent to secure the purchase of a hotel at the best possible price. Mr Mankarious, who controlled Cedar, duly brokered a sale of the Monte Carlo Grand Hotel for the sum of €211.5m. What Mankarious had failed to disclose to FHR is that Cedar would be accepting a commission of €10m under an "exclusive brokerage agreement" with the sellers. After a hard-fought trial on liability, judgment was entered for €10m in FHR's favour for Cedar's breach of fiduciary duty. Cedar's coffers were empty, so FHR sought proprietary relief in order to follow the €10m into the hands of Mankarious.

Lower Court Decisions

However, Simon J., seeking to follow *Sinclair v Versailles*, refused to grant a proprietary remedy. The test in *Sinclair* provided for proprietary relief only where:

> "[T]he asset or money is or has been beneficially the property of the beneficiary or the trustee acquired the asset or money by taking advantage of an opportunity or right which was properly that of the beneficiary."[6]

It had not (and has not) been decided whether the €10m fell within the first category, i.e. if it had come from the purchase monies. Regarding the second, Simon J. held that:

> "[I]t is artificial to describe the Exclusive Brokerage Agreement as Cedar taking advantage of an opportunity which was properly that of their principals and that the relevant opportunity was the opportunity to purchase the Hotel for €201.5 million rather than for €211.5 million."[7]

On this point, the Court of Appeal allowed the appeal. Lewison L.J., with the support of the rest of the court, reviewed the earlier authorities and concluded a broader interpretation of the second category was warranted. Indeed, taking a bribe is presumed to increase the purchase price by the amount of the bribe (irrebuttably according to *Hovenden and Sons v Millhoff*[8] and this point cemented by *FHR*). The taking of the secret commission amounted to the interception of FHR's opportunity to purchase at the best price and a proprietary remedy was granted.[9]

[6] *Sinclair* [2011] EWCA Civ 347; [2012] Ch. 453 at [88].
[7] *FHR European Ventures LLP v Mankarious (Interim Hearing)* [2011] EWHC 2999 (Ch) at [17].
[8] *Hovenden and Sons v Millhoff* (1900) 83 L.T. 41 CA at 42–43.
[9] *FHR European Ventures LLP v Cedar Capital Partners LLC (sub nom FHR European Ventures LLP v Mankarious)* [2013] EWCA Civ 17; [2014] Ch. 1 at [59].

Supreme Court Decision

In a single judgment of an expanded, seven-judge court, the Supreme Court upheld FHR's claim for a proprietary remedy for different reasons than those of the Court of Appeal. The Supreme Court wished to decide on the bases of past authority, principle, policy and practicalities.[10]

The previous conflicting authorities were reviewed and in the face of the inconsistency of a minority of cases, the Court preferred the majority where a proprietary remedy had been granted.[11] Although the remedy had rarely been in issue, it was important that generations of eminent judges and barristers had assumed that the remedy was proprietary.[12]

Two competing principles were weighed up. FHR advanced the simplest principle that all benefits an agent accrues in breach of fiduciary duty are beneficially owned by the principal. Cedar argued that there is an exception so that it only applies for benefits acquired within the terms of the engagement, thus including secret profits but excluding bribes and secret commissions. The Court held that "in the absence of any other good reason, it would seem right to opt for the simple answer" where subtle distinctions are concerned.[13]

The Court found "force" in the argument that a proprietary remedy will prejudice unsecured creditors by giving the property to the principal in its entirety, taking it out of the distribution in the case of the fiduciary's insolvency. However, it preferred the counter-arguments, namely that the proceeds of a bribe ought not to be in the estate and in practice the bribe represents the increase in the purchase price and "can fairly be said" to be the principal's property.[14]

The Court favoured the pragmatic arguments that: it is paradoxical that a weaker remedy would be awarded in the case of the worse wrongdoing of bribery, where a proprietary remedy would be awarded in the case of a secret profit (which I refer to as "the equivalence problem");[15] it is paradoxical that on past authority, if *Heiron* and *Lister* were right, one would get a personal remedy in the case of a cash bribe but a proprietary one in the case of shares;[16] and it is artificial to distinguish between the situations where the bribe comes traceably from the company's money or not.[17] As for policy, the Court repeated Lord Templeman's concerns from *Attorney-General for Hong Kong v Reid* that "[b]ribery is an evil practice which threatens the foundations of any civilised society", adding that "[s]ecret commissions are also objectionable as they inevitably tend to undermine trust in the commercial world."[18]

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[10] *FHR* [2014] UKSC 45; [2014] 3 W.L.R. 535 at [12].
[11] *FHR* [2014] UKSC 45; [2014] 3 W.L.R. 535 at [18]–[28], [50].
[12] *FHR* [2014] UKSC 45; [2014] 3 W.L.R. 535 at [21].
[13] *FHR* [2014] UKSC 45; [2014] 3 W.L.R. 535 at [30]–[35].
[14] *FHR* [2014] UKSC 45; [2014] 3 W.L.R. 535 at [43].
[15] *FHR* [2014] UKSC 45; [2014] 3 W.L.R. 535 at [41].
[16] *FHR* [2014] UKSC 45; [2014] 3 W.L.R. 535 at [38].
[17] *FHR* [2014] UKSC 45; [2014] 3 W.L.R. 535 at [39].
[18] *FHR* [2014] UKSC 45; [2014] 3 W.L.R. 535 at [42]; *Attorney-General for Hong Kong v Reid* [1994] A.C. 324 PC.

Commentary

It is surely welcome that the remedy for this specific kind of breach of fiduciary duty has been definitively settled at the highest level. However, it was the bases of policy and practicalities that appear to have carried the most weight. Given the state of the authorities, it must also be right that such a broad brush was taken in overruling the inconsistent ones. That leaves the governing principles. The competing principles were set out and discussed, but the Court did not for the most part explicitly decide which to adopt.

What was Undecided

While FHR advanced the principle that *all* benefits acquired by a fiduciary in breach belong in equity to his principal, the Court did not go so far as to adopt it. Since in reality the fiduciary acts adversely to her principal that would have been endorsing a fiction. In fact, the Court decided the case without explicitly linking it to an underlying principle. Nonetheless, the Court was clearly cognisant of the consequences of its decision, citing Goode, who argued that creating a new proprietary right where there was none before "results in an involuntary grant by [the agent] to [the principal] from [the agent's] pre-existing estate".[19] This assumes that the benefit was the agent's to grant, i.e. that the default position is obligation, not ownership; hence there is a choice to be made between the two determined by some external factors.[20]

Therefore, the Supreme Court left the door open for cases where a proprietary remedy is denied in circumstances which are not clear. The Court suggested "it may be that" a personal remedy only was granted in respect of part of the land the fiduciary acquired in *Tyrrell v Bank of London* because the House of Lords:

> "thought that the principal should not have a proprietary interest in circumstances where the benefit received by the agent was obtained before the agency began and did not relate to the property the subject of the agency."[21]

What Came Before: Sinclair v Versailles

Conversely, this issue was addressed head-on by the test in *Sinclair*. *Sinclair* was not said to be wrongly decided, merely overruled insofar as it relied on *Heiron* and *Lister*. The "opportunity" test did not rely on those

[19] *FHR* [2014] UKSC 45; [2014] 3 W.L.R. 535 at [10]; R. Goode, "Proprietary Restitutionary Claims" in P. Birks and F. Rose (eds), *Restitution and Equity: Resulting trusts and equitable compensation* (Mansfield Press, 2000) at 69.

[20] Gray complains of the circularity of property reasoning where proprietary status – the consequences of that choice – is defined by reference to things such as assignability and enforceability – the consequences of proprietary status. He argues the reasoning can be rescued by reference to "free-standing" criteria: K. Gray, "Property in Thin Air" (1991) 50 C.L.J. 252, 301.

[21] *FHR* [2014] UKSC 45; [2014] 3 W.L.R. 535 at [49], [23]; *Tyrrell v Bank of London* (1862) 10 H.L. Cas. 26.

cases except inasmuch as they suggested the very existence of a personal remedy. Moreover, as Sir Terence Etherton C. observed, "*Sinclair* … was not … a secret commission or bribe case at all."[22]

In order to determine the possible outcomes of all this, it is necessary to go back to first principles. The first issue ("the disgorgement principle") is the imperative to disgorge the defaulting fiduciary of his entire profit in all cases. If a proprietary remedy is denied, personal relief will still do this provided its reach is extended beyond the principal sum abstracted. The second ("the priority issue") concerns just who to disgorge the profits to in the event of the fiduciary's insolvency – either entirely to the principal in priority over the fiduciary's unsecured creditors (via proprietary relief) or *pari passu* between the principal and the unsecured creditors (via personal relief). The third, "the enforcement principle", which is related to the first, is less discussed.[23] It is the imperative to have someone who can effectively compel disgorgement.

It was the second principle that was engaged in *Sinclair v Versailles*. There, the share price of Versailles Group plc ("Versailles") had been grossly inflated in value by a fraudulent scheme to give the impression it had a large turnover (this was a second fraud in addition to Versailles' subsidiaries hosting a Ponzi scheme). The proceeds sought were those of a sale of Versailles' shares at the top of the market by the mastermind of the frauds just before Versailles collapsed. A proprietary remedy was denied because the conditions set out were not met: the proceeds were not traceable to the misapplication of investors' funds in the Ponzi scheme, and the sale was not an opportunity properly belonging to the principal. Only personal relief was awarded, which was useless in practice because Versailles was massively insolvent.

If one reads the many judgments in the *Sinclair* litigation, a rather unattractive picture of a very undeserving claimant appears to whom it was right to deny priority over Versailles' creditors.[24] The key point is this: the claimant had taken an assignment of the other traders' claims and of the company used to process their investments. They had bargained for the chance of proprietary relief over what was left of the traders' investments destined for the Ponzi scheme, which they duly got. They had not bargained for the claim over the share sale which would have been a windfall. The *Sinclair* test was well placed to decide the case fairly because it gave proprietary relief only over the proximate misfeasance.

[22] *FHR* [2013] EWCA Civ 17; [2014] Ch. 1 at [102].

[23] But see, e.g., R. C. Nolan, "The wages of sin: iniquity in equity following A-G for Hong Kong v Reid" (1994) Co. Law 3, 4.

[24] Especially *Sinclair Investment Holdings SA v Cushnie* [2006] EWHC 573 (Ch); [2006] All E.R. (D) 298 (Mar); *Sinclair Investment Holdings SA v Versailles Trade Finance Ltd* [2004] EWHC 2169 (Ch); *Sinclair Investment Holdings SA v Versailles Trade Finance Ltd* [2005] EWCA Civ 722; [2006] 1 B.C.L.C. 60; *Sinclair Investment Holdings SA v Versailles Trade Finance Ltd* [2007] EWHC 915 (Ch); [2007] 2 All E.R. (Comm) 993; *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* [2010] EWHC 1614; [2011] 1 B.C.L.C. 202 (Ch).

The Real Issue in FHR

Conversely, FHR was a deserving claimant. But what *FHR* was really about was described in stark relief during the hearing. Cedar, a Delaware entity (and thus outside the jurisdiction), was said by counsel for FHR to have "no money, no assets, and no business other than the receipt and distribution of the fee. We are facing a dead end in terms of monetary relief." Moreover, even if Cedar did have assets, they would be much more difficult to reach. The issue was not priority, but enforcement. Tracing and following was the only practical solution. Furthermore, because the secret commission did not amount to an illegal bribe, the state would not be able to step in as enforcer under the criminal law.

Opportunity-based reasoning – as extended by the Court of Appeal in *FHR* – would have been perfectly adequate to decide the case in FHR's favour. This reasoning justifies the creation of a property right because the opportunity could and would have been turned into property. Indeed, Goode refers to "deemed agency gains" justifying proprietary relief, where the fiduciary was obliged to undertake the engagement for his principal and not himself.[25]

Consequences

In deciding the case for different reasons the Court must have been concerned with the wider ramifications. Indeed, what is not tackled entirely satisfactorily by the opportunity doctrine is the equivalence problem, which would award a harsher remedy for a lesser wrong. In *Boardman v Phipps* the fiduciary was innocent and the real default was defective consent when he executed his plan to restructure a company the trust held shares in, making himself and the trust a healthy profit. The issue was the possibility, not the reality, of conflict of interest.[26] However, given it was a proper opportunity of sorts, relief would be proprietary. But some of the worst cases of fiduciary default, the "abuse of position" cases, are of the ilk of taking bribes to frustrate the prosecution of organised crime (the Crown Prosecutor *Reid*)[27] or to facilitate smuggling (the army sergeant *Reading*)[28] which would attract only personal relief. In these cases the wrongdoer is more likely to hide his gains. By rejecting the opportunity doctrine the Court appears to have been more interested in ensuring there is an effective enforcer than in the desert of the claimant. Previously, much of the debate has been focused on priority, as Goode's points show.[29]

It also seems that the vulnerability of the fiduciary is also less important. FHR was certainly vulnerable because Mankarious was crafting a deal on its behalf and secretly enriching himself. Conversely, while in one sense

[25] R. Goode, "Property and Unjust Enrichment" in Andrew Burrows (ed), *Essays on the Law of Restitution* (Oxford: Clarendon, 1991) at 230.

[26] *Boardman v Phipps* [1967] A.C. 46 HL.

[27] *Reid* [1994] A.C. 324 PC.

[28] *Reading v Attorney-General* [1951] A.C. 507 HL.

[29] See also Lord P. Millett, "Bribes and Secret Commissions Again" (2012) 71 C.L.J. 583, 611; *Lister* (1890) 45 Ch. D. 1 CA at 15. Cf *Reid* [1994] A.C. 324 PC at 339.

the principals in *Reading* and *Reid* did lose something, they were certainly not faced with a proximate and immediate loss. Nor were they vulnerable in terms of putting their resources in the hands of another. Since the rejected opportunity doctrine would have been sufficient to distinguish between vulnerable and non-vulnerable principals, the decision in *FHR* shows the reduced importance of this issue.

Whence Personal Disgorgement?

What remains is to try to define the uncertain space for the personal disgorgement claim. By this what is meant is a remedy against a fiduciary which disgorges not only the principal sum abstracted but also consequential profits where proprietary relief is refused. This is in contradistinction to the choice to take a personal remedy where proprietary relief is available.[30] If the gravity of the fiduciary default is relatively modest, the priority issue might still be in play. The difficulty is finding a principle to distinguish between the remedies upon. If even an innocent fiduciary like Boardman is still subject to a proprietary remedy, the consequences of *FHR*, even if not spelled out expressly, would be to make the proprietary remedy available in almost every case.

This leaves the Court's thoughts that there may be a personal remedy for transactions out of the scope of the agency. In one sense, the "abuse of position" cases involved transactions out of scope. Therefore what is out of scope following *FHR* would be extremely narrowly drawn. It seems likely that *Sinclair* would then have been wrongly decided notwithstanding the undeserving nature of the claimant. However, the trouble with having such a narrow test is that it close to having reference to activities not occasioned by the fiduciary's office – which are not breaches of fiduciary duty at all.

One alternative is that only personal relief would be available if the fiduciary had acted in good faith. This is in step with the way the equivalence problem was dealt with. It is also in step with the earlier suggestion by the Court of Appeal that the strictness of the fiduciary obligation might one day be loosened for innocent fiduciaries.[31] However, this sits ill with the scope-of-the-agency test. There is also less justification that such gains should be in the insolvent's estate if they are made in connection with the principal's business. Another, but very unlikely, alternative is to introduce discretionary elements into the proprietary remedy, creating a remedial constructive trust. This means arguments that priority might be disapplied in the insolvency situation could be acted upon.[32] While such a vehicle exists in other jurisdictions,[33] and the House

[30] *FHR* [2014] UKSC 45; [2014] 3 W.L.R. 535 at [7].
[31] *Murad v Al-Saraj* [2005] EWCA Civ 959; [2005] W.T.L.R. 1573 at [82].
[32] See, e.g., E. L. Sherwin, "Constructive Trusts in Bankruptcy" [1999] U. Ill. L. Rev. 297, 340.
[33] E.g. Australia: *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6 at [504]; Canada (with an unjust enrichment analysis): *Becker v Pettkus* [1980] 2 SCR 834, 117 D.L.R. (3d) 257; New Zealand: *Regal Castings Ltd v Lightbody* [2008] NZSC 87, [2009] 2 N.Z.L.R. 433.

of Lords once hinted it could be established here,[34] more and more cold water has been poured on the idea.[35]

Given it was not in issue, it is perhaps unsurprising that the Supreme Court did not tackle the question of whether the personal disgorgement claim exists. It went so far as to consider the simplicity of a single, proprietary remedy advantageous, but it did not expressly adopt this position.[36] While in a judgment handed down between *FHR*'s hearing and judgment, the Court of Appeal held in *Novoship (UK) Ltd v Nikitin* that a personal disgorgement remedy *does* exist in equity, it was said to exist as against non-fiduciaries – dishonest assistants and knowing recipients. That no trust and confidence was ever reposed in accessories justifies the lesser remedies against them.[37] This distinction could well turn out to be determinative that the remedies are different vis-à-vis fiduciaries and non-fiduciaries.

Conclusion

FHR must be welcomed for settling the specific issue it set out to settle. It is also, happily, not reliant on legal fictions. Less welcome is its failure to tackle the theoretical justifications for creating a property right. Granted, it must be right to have refused to close the door on the personal disgorgement claim or to have laid down rules without concrete facts upon which to test them. But omitting principled justifications simply puts off taking the first step in answering the big question – precisely how to decide between a personal and a proprietary remedy. *FHR* is a useful fixed point, even if it does not display a signpost to the next stop.

Given the amounts of money at stake ($150m in *Novoship*) and this mix of competing and conflicting principles, it is a good probability that we will see future litigation on this point where the breach of fiduciary duty was not accepting a bribe. It would be most preferable to develop a principled way of deciding instead of flip-flopping as in the past. This may yet be possible, although it is impossible to make concrete predictions – at least until after the next case.

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[34] *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] A.C. 669 HL at 716.

[35] *Re Polly Peck International plc (No 2)* [1998] 3 All E.R. 812 CA; *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch) at [1515]; *Sinclair* [2011] EWCA Civ 347; [2012] Ch. 453 at [37].

[36] *FHR* [2014] UKSC 45; [2014] 3 W.L.R. 535 at [35].

[37] *Novoship (UK) Ltd v Nikitin* [2014] EWCA Civ 908; [2014] W.L.R. (D) 297 especially at [104]–[106]. See also *Williams v Central Bank of Nigeria* [2014] UKSC 10; [2014] 2 W.L.R. 355 at [30].

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