Neutral Citation Number: [2019] EWCA Civ 2291

Case No: A4/2019/1493

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
COMMERCIAL COURT (QB)
Mr Justice Robin Knowles
CL-2017-000697

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 20 December 2019

Before:

LORD JUSTICE LEWISON
LORD JUSTICE DAVID RICHARDS
and
LORD JUSTICE NEWEY

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Between:

AUDEN McKENZIE (PHARMA DIVISION) LIMITED	**Respondent/ First Claimant**
- and -	
AMIT PATEL	**Appellant/ First Defendant**

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Christopher Pymont QC and **Ciaran Keller** (instructed by **Maurice Turnor Gardner LLP**) for the **Appellant**
Andrew George QC and **Victoria Windle** (instructed by **Byrne & Partners LLP**) for the **Respondent**

Hearing date: 24 October 2019

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Approved Judgment

Lord Justice David Richards:

1. This is an appeal against a summary judgment on a claim for equitable compensation. The judgment is for £13,149,479, with interest at 2.5% pa compounded annually, making a total of £15,884,230.

2. The appellant, Mr Amit Patel, was a director of the first claimant, Auden McKenzie (Pharma Division) Limited (the company). He and his sister, the second defendant, founded the company in 1999 and they were at all material times the sole directors. Both worked in the business, Mr Patel as managing director and Ms Patel as operations director. Between them, they directly or indirectly owned all the shares in the company.

3. Mr Patel accepts that between 2009 and 2014 he caused the company to pay an aggregate amount of £13,763,452 against sham invoices raised purportedly for "research and development" (the Payments). The company received no value for these payments. They were made in order to extract funds from the company in a way that would evade the payment of corporation tax by the company and the payment of income tax by Mr and Ms Patel (collectively, the Shareholders).

4. Mr Patel caused the sham invoices to be raised by three companies incorporated in Dubai. Those companies retained between 5% and 10% of the invoiced sums and, as Mr Patel accepts and asserts, paid the balance, on the instructions of Mr Patel (or of Mr and Ms Patel), to their personal bank accounts, to them in cash and to third parties for the purchase of an apartment in New York and for goods and services supplied for their personal use. Ms Patel denies knowledge of, or any complicity in, any breach of duty as regards the payments from the company or their subsequent application. She has served a detailed defence, and no application was made for summary judgment against her.

5. By a share purchase agreement dated 23 January 2015 (the SPA), the second claimant (Actavis Holdings UK Limited) (Actavis) agreed to purchase the entire share capital of the company for an initial consideration of £323.5 million, with further amounts payable under earn-out provisions. On 29 May 2015, Activis assigned all its rights under the SPA to the third claimant (Chilcott UK Limited) (Chilcott) which completed the purchase on the same day.

6. Following investigations by HMRC, Mr Patel made disclosures between 1 May and 26 November 2015 to HMRC, which resulted in a settlement under which the Payments were treated as undeclared remuneration and he paid £14.6 million to HMRC, in respect of income tax and National Insurance contributions on that deemed income, and corporation tax which, on the agreed basis, would have been payable by the company, together in each case with interest and penalties. HMRC confirmed that there would be no tax implications for the company's future accounting periods arising from the investigation and that the company started again "with a clean slate". The company and Chilcott, its holding company since 29 May 2015, were not involved in or aware of these disclosures or the negotiations or settlement with HMRC.

7. The present proceedings were issued in November 2017. The company claims relief in respect of the Payments against Mr and Ms Patel, comprising (i) "Damages and/or

equitable compensation for breach of fiduciary duties" and (ii) "An order that the Defendants hold the Extracted Sums and/or their traceable proceeds on constructive trust for the [company]". There is also a claim for all "such further orders, accounts, inquiries and declarations as shall be necessary or appropriate in order to fully compensate the Claimants for the Defendants' wrongs". In addition, Actavis and Chilcott claim damages for fraudulent misrepresentation and for breach of warranty, but these claims are not relevant to this appeal.

8. The company applied for summary judgment in the sum of £13,149,479 plus interest on its claim "for damages and/or equitable compensation for breach of statutory fiduciary duties" against Mr Patel pursuant to CPR 24.2. Mr Patel made strike-out and summary judgment applications on part of the claims brought by Actavis and Chilcott and applied for summary judgment on a counterclaim in respect of the earn-out provisions.

9. Mr Patel accepts, as inevitably he must, that in procuring the Payments to be made by the company, he acted in breach of his fiduciary duties as a director. He advanced two defences in opposition to the summary judgment application. First, he relied on the principle in *Re Duomatic Ltd* [1969] 2 Ch 365 that actions that would otherwise amount to breaches of duty by directors may be authorised or ratified by the unanimous consent of the shareholders, although given informally. Second, he asserted that, if the Payments had not been made unlawfully, the Shareholders would have caused the company to make equivalent payments to them as dividends or in some other lawful manner. Accordingly, it was submitted that the company could show no loss flowing from the Payments.

10. The applications were heard by Robin Knowles J on 20 to 22 November 2018. In a judgment handed down on 17 May 2019, he dismissed Mr Patel's application, from which there is no appeal, and he gave summary judgment on the company's application. In fixing the judgment at £13,149,479, credit was given in the agreed amount of £613,973 for corporation tax paid by Mr Patel as part of his settlement with HMRC.

11. The judge rejected Mr Patel's defence based on the principle in *Re Duomatic*, on the grounds that it is applicable only to honest and lawful transactions. There is no challenge to that part of the judgment.

12. The principal challenge on this appeal is to the judge's decision that Mr Patel had no real prospect of successfully defending the claim on the basis of his second line of defence. He also challenges the judge's decision not to reduce the amount of the judgment by reference to the corporation tax that the company would have paid if the Payments had not been made.

13. I deal first with the principal ground of appeal. Mr Patel pleads in his defence that, if the Payments had not been made pursuant to the sham invoices, "they would in any event have been paid by [the company] to the defendants at their instruction as properly paid dividends or bonus or other remuneration". This is an allegation of fact that, for the purposes of the company's application for summary judgment, must be assumed to be true. Given that Mr Patel and his sister were the only shareholders and at all material times the company had sufficient distributable reserves to pay such dividends, this could not be said to be so implausible as to be discounted on a

summary judgment application. That position is the stronger in view of provisions in the SPA which entitled the vendor shareholders to procure the company to pay a pre-completion dividend, provided that the company had cash balances of not less than £6 million at completion. Pursuant to that provision, a pre-completion dividend of £51 million was paid.

14. In its skeleton argument in this court, the company explicitly accepts that this allegation is to be assumed to be true for present purposes, and I am not aware that it took a different position before the Judge.

15. The Judge held that Mr Patel's allegation that sums equivalent to the Payments would lawfully have been paid to the Shareholders did not provide a defence to the claim.

16. In his judgment at [18] – [19], the Judge cited two short passages from *Target Holdings v Redferns (a firm)* [1996] AC 421 (*Target Holdings*) and *AIB Group (UK) plc v Mark Redler & Co* [2014] UKSC 58, [2015] AC 1503 (*AIB*), authorities on which Mr Patel strongly relies and to which I will return.

17. The Judge gave his reasons for rejecting the submission that the company could show no loss as follows:

> "21. These arguments for the First Defendant do not assist him. The period for the factual inquiry that the authorities contemplate is now complete in a part of the case otherwise suitable for summary judgment. There is no question that the First Defendant caused loss in the amount of the payments by reason of the breaches. If the payments had not been made unlawfully then the company would still have the money "in the till".
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> 22. The court is as well placed now as it will be at trial to make an assessment with the full benefit of hindsight and one that takes a practical and common sense view of causation. None of the avenues to which the First Defendant now refers were in fact pursued at any point when it was in the power of the Defendants to do so, including by reversing the unlawful payments and then taking the steps to which the First Defendant refers. The availability of the avenues was as apparent at the time as it is now, and yet the Defendants chose not to pursue those avenues. It would be wrong to treat them as having been pursued. The First Defendant has no foundation for a claim that there was an obligation on the First Claimant to make a payment of £13 million. This remains the position now. These are the facts. The authorities do not invite speculation."

18. Mr Pymont QC on behalf of Mr Patel criticises the Judge's reasoning. The statement at [21] that "[i]f the payments had not been made unlawfully then the company would

still have the money 'in the till'" was wrong on the assumed facts. On the basis that equivalent payments would have been made by way of dividend or otherwise, the company would *not* have had the money in the till.

19. In part of paragraph [22], the Judge appears to place weight on the consideration that the counterfactual situation alleged by Mr Patel did not occur. For example, he says that "[n]one of the avenues to which [Mr Patel] now refers were in fact pursued" and, by adding that the "availability of the avenues was as apparent at the time as it is now, and yet the Defendants chose not to pursue those avenues", the judge seems to be calling into question, as a matter of fact, whether the assumed counterfactual would have occurred. Mr Pymont submits that this was not open to the Judge, given that it was a summary judgment application and the counterfactual was not so implausible as to be disregarded. Moreover, he says that Mr Patel "has no foundation for a claim that there was an obligation on [the company] to make a payment of £13 million", but that was not part of Mr Patel's case.

20. There is force in these submissions. Moreover, in saying at the start of paragraph [22] that the court must take a practical and common sense view of causation, with the full benefit of hindsight, and in the last sentence that the authorities do not invite speculation, it is unclear whether the judge is rejecting the defence on the alleged facts or, assuming that the counterfactual would have occurred, as a matter of law. Whichever it is, it would have benefitted from a fuller explanation and analysis, for the benefit of the parties and this court.

21. It does not, however, follow from these challenges to the Judge's reasoning that the appeal should be allowed and the summary judgment set aside.

22. The issue that arises on this appeal, and arose on the application before the Judge, is one of law. In a claim for equitable compensation in respect of the misappropriation by a director of a company's funds, is a defence open to the director on the grounds that, if the misappropriation had not occurred, the funds would have been lawfully transferred to the same persons for no value, so that it can be said that the company has sustained no loss as a result of the misappropriation that can be recovered by way of equitable compensation? The question is not, of course, whether that is right as a matter of law but whether the defendant has a real prospect of successfully defending the claim on that basis.

23. In support of the appeal, Mr Pymont submitted as follows.

24. First, the application for summary judgment was limited to the claim for "damages and/or equitable compensation for breach of statutory fiduciary duties in the sum of £13,149,479.24, plus appropriate interest". In the particulars of claim, the company pleaded at paragraph 35 that by reason of the Payments, it had suffered loss and damage, namely the Payments. Summary judgment was not sought on the claim for an order that the Defendants hold the Payments or their traceable proceeds of sale on trust for the company, nor was summary judgment for an account sought.

25. Second, an award of equitable compensation does not seek to put the parties in the position they were in immediately before the impugned payments were made, but in the position they would now (or at trial) be in if those payments had not been made. This is a critical part of the argument, and reliance is in particular placed on the

judgments in *Target Holdings* and *AIB*. Mr Patel's case was said to be simple: "If there had been no breach of duty, the [company] would now be in precisely the same position. The very same sums would have been paid by the [company] to the very same people…There is nothing to "compensate" it for". It is no answer to posit an example where the same payments would not have been made to the same people. Equitable compensation is a flexible remedy, as the company itself asserts, and its aim is "to do what is practically just as between the parties. The fiduciary must not be "robbed"; nor must the beneficiary be unjustly enriched.": see *Maguire v Makaronis* (1997) 188 CLR 449 (High Court of Australia) at 496 per Kirby J, cited with approval by Lord Neuberger MR in *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* [2011] EWCA Civ 347, [2012] Ch 453, at [47]. This would be achieved by rejecting the present claim for compensation.

26. Third, and this involves a variation of the second submission summarised, the relevant inquiry is whether the claimant for equitable compensation is in any different position at the date of trial than it would have been but for the breach. The court should not shut its eyes to subsequent events or ignore the reality of what would have actually happened. This way of putting the case focuses exclusively on the position of the claimant, rather than also taking into account that the payments would have been made to the same people.

27. Fourth, the claimant in this case is a company, not a traditional trust or even, as in *Target Holdings* and *AIB*, a bare trust. Like trustees, directors owe fiduciary duties and their position is in some respects analogous to the position of trustees, but it would not be right to import into this context the approach taken with regard to traditional express trusts.

28. Fifth, there is no question of any third party interests, such as those of other shareholders or creditors, being affected either by the payments that were made or by the payments that would have been made. HMRC, but not the company, were defrauded. HMRC has reached a comprehensive settlement with Mr Patel which leaves the company with no liability to HMRC.

29. In conclusion, therefore, the company has suffered no loss and it would be unjust to require Mr Patel to pay compensation to the company.

30. In considering these submissions, and those of Mr George QC to which I will refer when dealing with this issue, it is helpful to start with the nature of equitable compensation as a remedy. It is, as Mr Pymont himself submitted, a wide concept capable of more than one application.

31. Equitable compensation is the personal remedy (as opposed to a tracing or proprietary remedy) available against trustees, or others in a fiduciary position, whose acts or omissions amount to a breach of trust or fiduciary duty. Breaches of duty may take many forms, but in broad terms they are often with good reason analysed as falling within one of three main categories: first, transactions involving the unauthorised payment or disposal of or damage to trust assets, causing loss to the trust; second, breaches of duties of loyalty, involving the trustee in making profits at the expense of the trust or by the use of information or opportunities available to the trustee in that capacity; third, breaches of duties of skill and care, resulting in loss to the trust. In the

case of breaches in the second category, an account of profits may be the appropriate remedy, and is the only remedy where the trust could not itself have made the profit.

32. The present case clearly falls within the first category. Using his fiduciary powers as a director, Mr Patel dishonestly caused the company to make the Payments for the personal benefit of himself and his sister. On the face of it, the loss to the company was the amount of the Payments, being the amount by which its cash assets were depleted. If an account in common form were ordered to be taken, the Payments would be disallowed (or "falsified") as legitimate expenditure and Mr Patel would be ordered to make good the loss. Subject to any question that might be relevant to the ascertainment of that loss, which lies at the heart of the present appeal, and assuming no other expenditure was falsified, the order would be to pay a sum equal to the Payments plus interest.

33. This order to make good the loss would be a form of equitable compensation. In *Target Holdings*, Lord Browne-Wilkinson said at p.434 that in the case of traditional trusts, usually those involving successive interests:

> "the basic rule is that a trustee in breach of trust must restore or pay to the trust estate either the assets which have been lost to the estate by reason of the breach or compensation for such loss. Courts of Equity did not award damages but, acting in personam, ordered the defaulting trustee to restore the trust estate…If specific restitution of the trust property is not possible, then the liability of the trustee is to pay sufficient compensation to the trust estate to put it back to what it would have been had the breach of trust not been committed."

34. In *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd*, Lord Neuberger MR (with whom Richards and Hughes LJJ agreed) said at [45] "the traditional way in which a non-proprietary claim is assessed in equity is through the medium of an equitable account, which in turn leads to equitable compensation". Reference may also be made to *Interactive Technology Corporation Ltd v Ferster* [2019] EWCA Civ 1594, a decision of Newey LJ and myself sitting as a two-judge court.

35. The use of the phrase "equitable compensation" in this context has attracted some controversy, principally because it has been suggested that it detracts from the basic purpose of the remedy to make good the deficit in the fund. In *Libertarian Investments Ltd v Hall* [2013] HKFCA 93, a decision of the Final Court of Appeal of Hong Kong, Lord Millett said at [168] that the order was "not compensation for loss but restitutionary or restorative" but he accepted that the order is sometimes described as the payment of equitable compensation. While noting this point, it is said in *Lewin on Trusts* (2015, 19th ed.) at para 39-002 that the remedy is generally called equitable compensation.

36. The present appeal is concerned with equitable compensation in this sense. It is not a case concerned with compensation for loss caused by a breach of duties of skill and care. Nor is it a case involving a claim to profits made by Mr Patel and his sister. Although the relief claimed in the particulars of claim includes such further accounts and inquiries as shall be necessary, it is not necessary for the company to seek, first, an order for an account. Given the evidence and Mr Patel's admissions, the company

is entitled to seek, and there is no reason why the court should not proceed to order, payment of equitable compensation. As *Lewin* says at para 39-003: "Very often, however, claims for compensation for breach of trust are not brought by way of action for an account, but simply as a direct claim for such a monetary remedy, by way of equitable compensation or for the return of the missing trust property". See also *AIB* at [90]-[91] (Lord Reed) and *Barnett v Craggy* [2016] EWCA Civ 1004, [2017] Ch 273 at [22] (Patten LJ). Moreover, an order to make good a loss following the taking of an account should not result in liability for a greater sum than an order for payment of equitable compensation without first taking an account: *AIB* at [108] (Lord Reed).

37. The issue that therefore arises on this appeal is whether, in a case of equitable compensation of this kind, the loss to the company resulting from the Payments stands to be reduced or eliminated by reference to the hypothetical payments of lawful dividends or other benefits to the Shareholders.

38. The decisions in *Target Holdings* and *AIB* are of great importance because of the qualification that they introduced to the previously strict application of the obligation of a trustee to restore to the trust fund the value of any assets transferred, or the amount of any payments made, without authority. But it is necessary to be clear as to the qualification established by those cases.

39. Importantly, both cases involved funds being paid to and being held by solicitors on a temporary basis for the purpose only of giving effect to agreements for secured loans. The obligations of the solicitors, and the extent of their obligations as trustees of the loan monies held in their client accounts, were defined by their express or implied instructions. As is to be expected, their instructions were to release the loan monies to the borrowers once the stipulated security was granted. In both cases the solicitors released the funds without the security first being created. In *Target Holdings*, the security was granted a month later, while in *AIB* it was never granted.

40. In *Target Holdings*, the Court of Appeal had ordered the solicitors to pay to Target, by way of compensation, the whole sum paid away in breach of trust, less the sum recovered by Target on realisation of its security. Lord Browne-Wilkinson at p.436 identified the key point in this court's reasoning as that "where moneys are paid away to a stranger in breach of trust, an immediate loss is suffered by the trust estate: as a result, subsequent events reducing that loss are irrelevant", save the receipt of later direct benefits such as the proceeds of sale of the mortgaged property in that case.

41. In criticising this approach, Lord Browne-Wilkinson said at p.437:

> "A trustee who wrongly pays away trust money, like a trustee who makes an unauthorised investment, commits a breach of trust and comes under an immediate duty to remedy such breach. If immediate proceedings are brought, the court will make an immediate order requiring restoration to the trust fund of the assets wrongly distributed or, in the case of an unauthorised investment, will order the sale of the unauthorised investment and the payment of compensation for any loss suffered. But the fact that there is an accrued cause of action as soon as the breach is committed does not in my judgment mean that the quantum of the compensation payable is ultimately

> fixed as at the date when the breach occurred. The quantum is fixed at the date of judgment at which date, according to the circumstances then pertaining, *the compensation is assessed at the figure then necessary to put the trust estate or the beneficiary back into the position it would have been in had there been no breach*. I can see no justification for "stopping the clock" immediately in some cases but not in others: to do so may, as in this case, lead to compensating the trust estate or the beneficiary for a loss which, on the facts known at trial, it has never suffered." (emphasis added)

42. The words which I have italicised appear to me to be the core of Lord Browne-Wilkinson's reasoning in this passage. I will look more at their significance later in this judgment, but it is instructive to consider the authority to which he immediately referred in the next paragraph, as being consistent with his approach. In the New South Wales case of *In re Dawson, decd* [1966] 2 NSWR 211, there were separate executors of the deceased's New Zealand and Australian estates. In 1939, an executor of the New Zealand estate, in breach of duty, paid a sum of NZ£4,700 to a third party who was supposed to lend it to an Australian company but who absconded with the money. At a time when judgment could not be given in a foreign currency, the issue before Street J was whether judgment against the executor should be the Australian dollar equivalent of the missing sum at the rate of exchange ruling at the date of breach, when there was parity, or at the date of judgment, when the Australian dollar had depreciated against the New Zealand pound. Street J held that it should be the latter. This, Lord Browne-Wilkinson said, showed that "[t]he equitable compensation for breach of trust has to be assessed as at the date of judgment and not at an earlier date".

43. Drawing on *In re Dawson, decd* and McLachlin J's judgment in the decision of the Supreme Court of Canada in *Canson Enterprises Ltd v Broughton & Co* (1991) 85 DLR (4th) 129, Lord Browne-Wilkinson said at p.439:

> "Equitable compensation for breach of trust is designed to achieve exactly what the word compensation suggests: to make good a loss in fact suffered by the beneficiaries and which, using hindsight and common sense, can be seen to have been caused by the breach."

44. In my view, there is nothing in Lord Browne-Wilkinson's speech to suggest that in ascertaining the loss suffered in these circumstances account was to be taken of hypothetical events, as opposed to actual events which go to establish the quantum of the loss to the trust or its beneficiaries. The security for which Target Holdings had bargained was provided to it, albeit one month after Redferns had, in breach of trust, released the loan monies. It was the fact that Target Holdings had actually obtained that security which was taken into account in concluding that no loss flowed from the breach of trust in the premature release of the loan monies. This was the context of the question posed by Lord Browne-Wilkinson at the start of his speech: "Is the trustee liable to compensate the beneficiary not only for losses caused by the breach but also for losses which the beneficiary would, in any event, have suffered even if there had been no breach?". As Lord Toulson said in *AIB* at [67], "the finance company was

seeking to be put in a better position on the facts…than if the solicitors had done as they ought to have done".

45. In contrast to *Target Holdings*, the impact of subsequent hypothetical events arose in *AIB*, because in that case the claimant bank did not at any time receive the first legal charge that was a condition of the release of the loan monies. As in *Target Holdings*, the essential background was that by agreeing to make the loan, the bank was taking the risk of the borrowers defaulting and that the action of the solicitors in releasing the loan monies without obtaining the first charge was to increase the amount of the bank's exposure, but was not to create the underlying risk: see Lord Toulson at [58].

46. Lord Toulson and Lord Reed gave reasoned judgments. They agreed with each other's judgments and the other members of the court agreed with both judgments. In rejecting the claim for compensation equal to the loan monies released by the solicitors, Lord Toulson fixed the amount of compensation by reference to the value of the legal charge which the bank bargained for, but never received. The basis for doing so was that this reflected what the bank's financial position would have been if the solicitors had properly performed their obligations. The borrowers would still have defaulted but the bank would have obtained some recovery under the charge. At [62], Lord Toulson said:

> "…absent fraud, which might give rise to other public policy considerations that are not present in this case, it would not in my opinion be right to impose or maintain a rule that gives redress to a beneficiary for loss which would have been suffered *if the trustee had properly performed its duties*." (my emphasis)

47. In the context of a trust established to give effect to a particular transaction, where "[t]he contract defines the parameters of the trust" (Lord Toulson at [70]) and where the trustee has prescribed duties for that purpose, the trustee's obligation to make good any unauthorised application of the trust funds is limited by the loss which the beneficiary would have suffered if the trustee had fully performed its duties. Lord Toulson repeatedly made this point, which represents the *ratio* of his judgment; see paragraphs [65], [70], [71] and [73].

48. Lord Reed's conclusion was the same. He said at [134]: "the model of equitable compensation, where trust property has been misapplied, is to require the trustee to restore the trust fund to the position it would have been in if the trustee had performed his obligations". Lord Reed was also clear that, although in a general sense common law damages and equitable compensation share the same aim of compensating for loss caused by the relevant tortious conduct, breach of contract or breach of trust or fiduciary duty, the liability of the defendant is not generally the same: see [92]-[93] and [136]-[138].

49. While *Target Holdings* and *AIB* establish that equitable compensation in respect of unauthorised payments is not *invariably* for a sum equal to the payments, the decisions in those cases provide no further direct assistance to Mr Patel's case. They are restricted to circumstances where the beneficiary obtained the full benefit for which it bargained or where, if the trustee had fully performed its obligations, the loss would have been less than the amount of the unauthorised payment made by the

trustee. In each case, the reduced figure is the loss that flowed directly from the breach of trust. In the case of Mr Patel, not only were the hypothetical dividends not paid but there was no obligation on the company or its directors to pay any such dividends. There is no analogy with the decision in *AIB*.

50. Mr Pymont relies on statements in the judgments in *Target Holdings* and *AIB* for his broad proposition that in identifying the loss caused by a misappropriation of trust assets, the court looks at the claimant's position at the date of trial and compares it with its position immediately following the misappropriation. If the claimant would not in any event have had the misappropriated asset or funds, or any valuable assets in their place, at the date of trial, the claimant has suffered no recoverable loss. So, for example, Mr Pymont relies on statements made by Lord Browne-Wilkinson at p.434 that "there does have to be some causal connection between the breach of trust and the loss to the trust estate for which compensation is recoverable, viz. the fact that the loss would not have occurred but for the breach"; at p.436 that "the basic equitable principle applicable to breach of trust is that the beneficiary is entitled to be compensated for any loss he would not have suffered but for the breach"; and at p.439 that "[e]quitable compensation for breach of trust is designed to achieve exactly what the word compensation suggests: to make good a loss in fact suffered by the beneficiaries and which, using hindsight and common sense, can be seen to have been caused by the breach".

51. In my judgment, these statements do not support Mr Pymont's broad submission. They are not directed at the effect that hypothetical intervening events might have had on the claimant's "loss". Their meaning is illustrated by what Lord Browne-Wilkinson said at p.437:

> "The quantum is fixed at the date of judgment at which date, according to the circumstances then pertaining, the compensation is assessed at the figure then necessary to put the estate back into the position it would have been in had there been no breach."

52. As already mentioned, the point is illustrated by Lord Browne-Wilkinson's citation of *In re Dawson, decd*. If the amount required to replace the misappropriated asset is less or more at the date of trial than it was at the date of misappropriation, either as a result of changes in value or (as in *Target Holdings*) the grant of security, it is that amount which will be awarded as compensation. This was extended in *AIB* to the limited extent discussed above.

53. The fallacy in Mr Pymont's broad submission may be shown by the example put in argument to him. If one supposes that the shareholders of the company had been a different body of persons from the directors, would a claim against the directors who had misappropriated company funds be rejected if it were established that, if the funds had not been misappropriated, they would have been paid as dividends to the shareholders? In that case the effect of the misappropriation is to deprive the company of funds which it would otherwise have been free to apply as it, whether acting by its shareholders or by its directors in accordance with their duties, thought fit. That could, of course, include the payment of dividends to shareholders or of charitable or other donations to third parties. The company has suffered a real loss, measured by the

amount misappropriated, and it is no answer to say that at the date of trial the company would not have had those funds.

54. Mr Pymont suggested that the company's remedy might lie in an account of profits against the directors, but that cannot in my view be right. An account of profits is, as its name indicates, an account of the *profits* made by the director at the expense of the company. Money taken by a director from the company without authority is not a profit in the director's hands. It would be open to the company to seek an account of the profits made by Mr Patel through the use of the Payments. For example, if he had invested the full amount in the purchase of an apartment in New York which he had later sold at a profit, the company could have treated the purchase as made on its behalf (which on the taking of an account would involve Mr Patel being surcharged in that respect), entitling the company to the total net proceeds of sale of the apartment. There is, however, no question of the company adopting that course in the present case.

55. There remains the narrower submission, which to be fair was Mr Pymont's primary submission. He submits that justice is not done by requiring Mr Patel to refund the Payments if he can establish, as must at present be assumed, that the same amounts would have been paid to himself and his sister as shareholders by way of dividends or perhaps in some other way. In that event, the position at trial would be exactly the same whether or not there had been the misappropriation: the company would no longer have the funds and they would have been paid to Mr Patel and his sister. Compensation could of course be recovered for any liabilities of the company arising as a result of the misappropriation. In the present case, such liabilities would be to HMRC but they have been discharged by the settlement with Mr Patel.

56. As counsel for both parties emphasised, the present case concerns not a trust, but a company. It is unnecessary to cite authority for the basic propositions that a company is a separate legal person, distinct from its members, and that, in the absence of special circumstances, it is the beneficial owner of its assets and they are not held on trust for its members. The "beneficiary" to which the directors owe their duties is the company and payment to the shareholders is not the same as payment to the company.

57. It is not in doubt that directors, while not strictly trustees because title to their company's assets are not vested in them, are in a closely analogous position to trustees by reason of their fiduciary duties to the company and are treated as trustees as respects company assets which are under their control: *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* at [34].

58. Where a director causes a company to make unauthorised payments for which the company receives no value, the director is liable to the company to pay compensation equal in amount to the payments. This is established in authorities dealing with the payment of unauthorised dividends. In *Bairstow v Queens Moat Houses plc* [2001] EWCA Civ 712, [2001] 2 BCLC 531, the directors were held liable to pay compensation equal to the full amount of unlawful dividends which they had procured to be paid. This was confirmed to be the correct remedy by this court in *HMRC v Holland* [2009] EWCA Civ 625, [2010] Bus LR 259, at [98] per Rimer LJ and at [125] per Elias LJ. In both cases, a submission based on *Target Holdings* that recovery should be restricted to the loss calculated by reference to what would have been the financial position of the company if the dividends had not been paid was

rejected. On the appeal to the Supreme Court in *HMRC v Holland* [2010] UKSC 51, [2011] Bus LR 111, it was not necessary to decide this point but three members of the court agreed with this court, while the other two Justices expressed no view: see Lord Hope at [49], Lord Walker (who as Robert Walker LJ gave the only reasoned judgment in *Bairstow v Queens Moat Houses*) at [124-125] and Lord Clarke at [146]. I can see no reason why there should be a difference in remedy where the unauthorised payment is not a dividend, but, as here, a misappropriation of funds paid against bogus invoices.

59. The above analysis provides grounds for concluding that Mr Patel is not entitled to rely on the assumed fact that dividends equal to the Payments would have been paid to his sister and himself in response to the claim for equitable compensation. However, the order below was for summary judgment, not judgment on a preliminary issue, and we must be satisfied that Mr Patel's defence is unsustainable in law.

60. The assumed facts are striking. Mr Pymont is right to say that the position of all parties would by now have been precisely the same as it was immediately after the Payments were made. The company would not have the money and Mr Patel and his sister would have received the money (whether directly or through companies controlled by them). Moreover, as the only shareholders, Mr Patel and his sister were able at all material times to procure this result. No case of which counsel or the court are aware has raised facts as stark as these. While the decisions in *Target Holdings* and *AIB* do not directly assist Mr Patel for the reasons I have given, they do demonstrate a willingness on the part of the courts to develop the equitable remedies for breach of trust and breach of fiduciary duty and, where required to do what is practically just, to entertain some departure from the strict obligation of trustees and fiduciaries to restore the fund under their control. This potential for flexibility has been emphasised in many cases and commentaries, not least *Target Holdings*, *AIB* and *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* at [47].

61. In *Bairstow v Queens Moat Houses*, the directors defended the claim in part on the basis that, if the unlawful dividends had not been paid, accounts showing distributable profits could properly have been prepared and at least some of the dividends could and would have been lawfully paid. While this defence was rejected in the Court of Appeal, the directors were granted leave to appeal by the House of Lords on an application which had as one of its principal grounds that this court had been wrong not to apply or extend the decision in *Target Holdings*. The case settled before the appeal was heard. The present case raises the issue in starker form than *Bairstow* because in that case the shares in Queens Moat Houses plc were listed on the Stock Exchange and there was a constantly changing share register, so there was far from an exact identity between the shareholders who received the unlawful dividends and those who would have received the lawful dividends.

62. Mr George advanced as his central submission that none of the counterfactual payments of dividends would have constituted a loss, properly so called, to the company. While that is right, it does not seem to be a conclusive point in his favour. The converse example of a counterfactual payment which constituted a loss would clearly not assist Mr Patel. Mr Patel could not defend the claim on the basis that, if he and (as he says) his sister had not misappropriated the Payments, someone else would have done: see *AIB* at [58]. That, however, is different from the counterfactual of a

lawful payment properly made to the defendants who in fact received the same amount by way of misappropriation.

63. Mr George also submitted that if Mr Patel could rely on his proposed defence, it would enable a dishonest director who in effect steals money from the company to escape without redress. This consideration echoes what was said by Lord Toulson in *AIB* at [62] that the principle underlying the decision applied "absent fraud, which might give rise to other public policy consideration". The possibility of a fraud exception has been criticised; see *Lewin* at 39-014. It does not seem to accord with principle that equitable compensation should be payable only because the defendant has acted dishonestly.

64. I am far from saying that Mr Patel has a defence that will succeed if he establishes the facts on which he relies, but nor I am prepared to say that it is unsustainable in law. As with many questions in a developing area of the law, it is an issue which requires much fuller submissions than is normally appropriate on a summary judgment application. It is also an issue best decided on the facts as found at trial.

65. I would accordingly allow the appeal and set aside the summary judgment against Mr Patel.

66. The second issue is whether the quantum of the judgment should be net of the corporation tax that the company would have paid if the Payments had not been made and the profits of the company had increased accordingly. For present purposes, the parties have agreed such corporation tax at £3,624,180.68. The judge rejected Mr Patel's case that such reduction should be made, on the basis that the company "will be left with whatever tax liability it has by reference to the true position (that is, (a) that it did not spend £13,763,542 of its earnings on research and development, and (b) it will recover £13,763,542 (less credit for £613,973) now". This was an application of the general approach summarised by Pearson LJ in *Parsons v BNM Laboratories Ltd* [1964] 1 QB 95 at 139:

> "In my judgment these objections are sufficient to show that, as a general rule at any rate, in a case where both the lost earnings or profits and the damages are taxable, no account should be taken of taxation in such a case is sound and should not be disturbed. That is my conclusion, subject to a proviso that there may be exceptional cases in which a departure from the practice may be required for the doing of justice in special circumstances."

67. The judgments of Sellers LJ, dissenting in the result, and Harman LJ were to similar effect. Although *obiter,* this statement of general approach carries considerable authority and has been followed in subsequent decisions at first instance, including *Deeny v Gooda Walker Ltd (No 2)* [1996] 1 WLR 426 and *Nagel v Pluczenik Diamond Co NV* [2017] EWHC 2104 (Comm). It also reflects the fact that, in a case where the judgment sum will be chargeable to tax in the year in which it is payable, the rate of tax will in many cases not be known until after the end of that year.

68. However, in other first instance decisions, this general approach has not been followed in cases where the judgment sum will be chargeable to tax at a lower rate

than the rate at which the lost profits or income would have been taxed: see the carefully reasoned judgments of Judge Humphrey Lloyd QC in *Amstrad plc v Seagate Technology Inc* (1997) 86 BLR 34 and of Ramsay J in *BSkyB Ltd v HP Enterprise Services UK Ltd* [2010] EWHC 862 (TCC), 131 Con LR 42. Their judgments receive strong support in *McGregor on Damages* (2018, 20th ed) at 18-016 – 18-024. Neither case is mentioned in the judgment in *Nagel v Pluczenik Diamond Co NV*.

69. Mr Pymont submitted that any equitable compensation which Mr Patel is ordered to pay will not be chargeable to tax because Mr Patel settled the company's tax liabilities under the settlement with HMRC. While that was the effect of the settlement as regards the tax years in which the Payments were made, Mr Pymont was unable to show that it applied to the tax year in which such compensation would become payable. In the alternative, he relied on the lower corporation tax rates now in force as against those in force when the Payments were made, submitting that the correct approach was that taken in the *Amstrad* and *BSkyB* cases.

70. Because, if my Lords agree, the summary judgment in this case will be set aside, the correct treatment of tax as regards the quantum of any judgment does not arise for decision by us. However, it was the subject of some argument before us. In my view, the treatment of tax on the basis of differential tax rates in the years of the Payments and in the year in which any compensation falls for payment raises an issue which is open to serious argument on both sides.

Newey LJ:

71. I agree.

Lewison LJ:

72. I agree that the appeal should be allowed for the reasons given by David Richards LJ.

73. It is clear from his judgment that, whether or not it ultimately succeeds, the argument advanced on Mr Patel's behalf is a serious one. Although conciseness in judgments is admirable, that argument deserved more focussed consideration than the judge gave it in the two brief paragraphs of his judgment which contain his reasoning.