Trinity Term
[2014] UKSC 45
On appeal from: [2013] EWCA Civ 17

JUDGMENT

FHR European Ventures LLP and others (Respondents) *v* Cedar Capital Partners LLC (Appellant)

before

Lord Neuberger, President
Lord Mance
Lord Sumption
Lord Carnwath
Lord Toulson
Lord Hodge
Lord Collins

JUDGMENT GIVEN ON

16 July 2014

Heard on 17-19 June 2014

Appellant	*Respondent*
Matthew Collings QC Duncan McCombe (Instructed by Farrer and Co LLP)	Christopher Pymont QC (Instructed by Hogan Lovells International LLP)

LORD NEUBERGER, DELIVERING THE JUDGMENT OF THE COURT

1. This is the judgment of the Court on the issue of whether a bribe or secret commission received by an agent is held by the agent on trust for his principal, or whether the principal merely has a claim for equitable compensation in a sum equal to the value of the bribe or commission. The answer to this rather technical sounding question, which has produced inconsistent judicial decisions over the past 200 years, as well as a great deal of more recent academic controversy, is important in practical terms. If the bribe or commission is held on trust, the principal has a proprietary claim to it, whereas if the principal merely has a claim for equitable compensation, the claim is not proprietary. The distinction is significant for two main reasons. First, if the agent becomes insolvent, a proprietary claim would effectively give the principal priority over the agent's unsecured creditors, whereas the principal would rank pari passu, ie equally, with other unsecured creditors if he only has a claim for compensation. Secondly, if the principal has a proprietary claim to the bribe or commission, he can trace and follow it in equity, whereas (unless we develop the law of equitable tracing beyond its current boundaries) a principal with a right only to equitable compensation would have no such equitable right to trace or follow.

The facts

2. On 22 December 2004, FHR European Ventures LLP purchased the issued share capital of Monte Carlo Grand Hotel SAM (which owned a long leasehold interest in the Monte Carlo Grand Hotel) from Monte Carlo Grand Hotel Ltd ("the Vendor") for €211.5m. The purchase was a joint venture between the claimants in these proceedings, for whom FHR was the vehicle. Cedar Capital Partners LLC provided consultancy services to the hotel industry, and it had acted as the claimants' agent in negotiating the purchase. It is common ground that Cedar accordingly owed fiduciary duties to the claimants in that connection. Cedar had also entered into an agreement with the Vendor ("the Exclusive Brokerage Agreement") dated 24 September 2004, which provided for the payment to Cedar of a €10m fee following a successful conclusion of the sale and purchase of the issued share capital of Monte Carlo Grand Hotel SAM. The Vendor paid Cedar €10m on or about 7 January 2005.

3. On 23 November 2009 the claimants began these proceedings for recovery of the sum of €10m from Cedar (and others). The trial took place before Simon J, and the main issue was whether, as it contended, Cedar had made proper disclosure to the claimants of the Exclusive Brokerage Agreement. Simon J gave a judgment in which he found against Cedar on that issue – [2012] 2 BCLC 39. There was then a further hearing to determine what order should be made in the light of that

judgment, following which Simon J gave a further judgment – [2013] 2 BCLC 1. In that judgment he concluded that he should (i) make a declaration of liability for breach of fiduciary duty on the part of Cedar for having failed to obtain the claimants' fully informed consent in respect of the €10m, and (ii) order Cedar to pay such sum to the claimants, but (iii) refuse to grant the claimants a proprietary remedy in respect of the monies.

4. The claimants appealed to the Court of Appeal against conclusion (iii), and it allowed the appeal for reasons given in a judgment given by Lewison LJ, with supporting judgments from Pill LJ and Sir Terence Etherton C - [2014] Ch 1. Accordingly, the Court of Appeal made an order which included a declaration that Cedar received the €10m fee on constructive trust for the claimants absolutely. Cedar now appeals to the Supreme Court on that issue. There is and was no challenge by Cedar to the Judge's conclusions (i) and (ii), so the only point on this appeal is whether, as the Court of Appeal held, the claimants are entitled to the proprietary remedy in respect of the €10m received by Cedar from the Vendor.

Prefatory comments

5. The following three principles are not in doubt, and they are taken from the classic summary of the law in the judgment of Millett LJ in *Bristol and West Building Society v Mothew* [1998] Ch 1, 18. First, an agent owes a fiduciary duty to his principal because he is "someone who has undertaken to act for or on behalf of [his principal] in a particular matter in circumstances which give rise to a relationship of trust and confidence". Secondly, as a result, an agent "must not make a profit out of his trust" and "must not place himself in a position in which his duty and his interest may conflict" - and, as Lord Upjohn pointed out in *Boardman v Phipps* [1967] 2 AC 46, 123, the former proposition is "part of the [latter] wider rule". Thirdly, "[a] fiduciary who acts for two principals with potentially conflicting interests without the informed consent of both is in breach of the obligation of undivided loyalty; he puts himself in a position where his duty to one principal *may* conflict with his duty to the other". Because of the importance which equity attaches to fiduciary duties, such "informed consent" is only effective if it is given after "full disclosure", to quote Sir George Jessel MR in *Dunne v English* (1874) LR 18 Eq 524, 533.

6. Another well established principle, which applies where an agent receives a benefit in breach of his fiduciary duty, is that the agent is obliged to account to the principal for such a benefit, and to pay, in effect, a sum equal to the profit by way of equitable compensation. The law on this topic was clearly stated in *Regal (Hastings) Ltd v Gulliver (Note)* (1942) [1967] 2 AC 134, 144-145, by Lord Russell, where he said this:

> "The rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of bona fides; or upon such questions or considerations as whether the profit would or should otherwise have gone to the plaintiff, or whether the profiteer was under a duty to obtain the source of the profit for the plaintiff, or whether he took a risk or acted as he did for the benefit of the plaintiff, or whether the plaintiff has in fact been damaged or benefited by his action. The liability arises from the mere fact of a profit having, in the stated circumstances, been made."

7. The principal's right to seek an account undoubtedly gives him a right to equitable compensation in respect of the bribe or secret commission, which is the quantum of that bribe or commission (subject to any permissible deduction in favour of the agent – eg for expenses incurred). That is because where an agent acquires a benefit in breach of his fiduciary duty, the relief accorded by equity is, again to quote Millett LJ in *Mothew* at p 18, "primarily restitutionary or restorative rather than compensatory". The agent's duty to account for the bribe or secret commission represents a personal remedy for the principal against the agent. However, the centrally relevant point for present purposes is that, at least in some cases where an agent acquires a benefit which came to his notice as a result of his fiduciary position, or pursuant to an opportunity which results from his fiduciary position, the equitable rule ("the Rule") is that he is to be treated as having acquired the benefit on behalf of his principal, so that it is beneficially owned by the principal. In such cases, the principal has a proprietary remedy in addition to his personal remedy against the agent, and the principal can elect between the two remedies.

8. Where the facts of a particular case are within the ambit of the Rule, it is strictly applied. The strict application of the Rule can be traced back to the well-known decision in *Keech v Sandford* (1726) Sel Cas Ch 61, where a trustee held a lease of a market on trust for an infant, and, having failed to negotiate a new lease on behalf of the infant because the landlord was dissatisfied with the proposed security for the rent, the trustee negotiated a new lease for himself. Lord King LC concluded at p 62 that, "though I do not say there is a fraud in this case" and though it "may seem hard", the infant was entitled to an assignment of the new lease and an account of the profits made in the meantime – a conclusion which could only be justified on the basis that the new lease had been beneficially acquired for the infant beneficiary.

9. Since then, the Rule has been applied in a great many cases. The question on this appeal is not so much concerned with the application of the Rule, as with its limits or boundaries. Specifically, what is in dispute is the extent to which the Rule applies where the benefit is a bribe or secret commission obtained by an agent in breach of his fiduciary duty to his principal.

10. On the one hand, Mr Collings QC contends for the appellant, Cedar, that the Rule should not apply to a bribe or secret commission paid to an agent, because it is not a benefit which can properly be said to be the property of the principal. This has the support of Professor Sir Roy Goode, who has suggested that no proprietary interest arises where an agent obtains a benefit in breach of his duty unless the benefit either (i) flows from an asset which was (a) beneficially owned by the principal, or (b) intended for the principal, or (ii) was derived from an activity of the agent which, if he chose to undertake it, he was under an equitable duty to undertake for the principal. Sir Roy suggested that "to treat [a principal] as having a restitutionary proprietary right to money or property not derived from any asset of [the principal] results in an involuntary grant by [the agent] to [the principal] from [the agent's] pre-existing estate" - *Proprietary Restitutionary Claims* in *Restitution*: *Past, Present and Future* (1998) ed Cornish, p 69 - and see more recently (2011) 127 LQR 493. Professor Sarah Worthington has advanced a slightly different test. She suggests (summarising at the risk of oversimplifying) that proprietary claims arise where benefits are (i) derived from the principal's property, or (ii) derived from opportunities in the scope of the agent's endeavours on behalf of the principal, but not (iii) benefits derived from opportunities outside the scope of those endeavours – *Fiduciary Duties and Proprietary Remedies: Addressing the Failure of Equitable Formulae* (2013) 72 CLJ 720.

11. On the other hand, it is suggested by Mr Pymont QC on behalf of the respondent claimants in this appeal, that the Rule does apply to bribes or secret commissions received by an agent, because, in any case where an agent receives a benefit, which is, or results from, a breach of the fiduciary duty owed to his principal, the agent holds the benefit on trust for the principal. This view has been supported by Lord Millett writing extra-judicially. In "Bribes and Secret Commissions" [1993] Rest LR 7, he suggested that, on grounds of practicality, policy and principle, a principal should be beneficially entitled to a bribe or secret commission received by his agent - and see more recently, (2012) 71 CLJ 583. He bases his conclusion on the proposition that equity will not permit the agent to rely on his own breach of fiduciary duty to justify retaining the benefit on the ground that it was a bribe or secret commission, and will assume that he acted in accordance with his duty, so that the benefit must be the principal's. This approach is also supported by Lionel Smith, "Constructive trusts and the no-profit rule" (2013) 72 CLJ 260, whose view, in short, is that the basic rule should be that an agent who obtains a benefit in breach of his fiduciary duty to his principal holds that benefit on trust for his principal.

12. The decision as to which view is correct must be based on legal principle, decided cases, policy considerations, and practicalities. We start by summarising the effect of many of the cases which touch on the issue; we then turn to the policy and practical arguments, and finally we express our conclusion.

The decided cases

13. There is a number of 19th century cases not involving bribes or secret commissions, where an agent or other fiduciary makes an unauthorised profit by taking advantage of an opportunity which came to his attention as a result of his agency and judges have reached the conclusion that the Rule applied. Examples include *Carter v Palmer* (1842) 8 Cl & F 657, where a barrister who purchased his client's bills at a discount was held by Lord Cottenham to have acquired them for his client. The Privy Council in *Bowes v City of Toronto* (1858) 11 Moo PC 463 concluded that the mayor of a city who bought discounted debentures issued by the city was in the same position as an agent vis-à-vis the city, and was to be treated as holding the debentures on trust for the city. *Bagnall v Carlton* (1877) 6 Ch D 371 involved complex facts, but, pared to a minimum, agents for a prospective company who made secret profits out of a contract made by the company were held to be "trustees for the company" of those profits (per James, Baggallay and Cotton LJJ).

14. In the Privy Council case of *Cook v Deeks* [1916] 1 AC 554, a company formed by the directors of a construction company was held to have entered into a contract on behalf of the construction company as the directors only knew of the contractual opportunity by virtue of their directorships. In *Phipps v Boardman* [1964] 1 WLR 993 (affirmed [1965] Ch 992, and [1967] 2 AC 46), where agents of certain trustees purchased shares, in circumstances where they only had that opportunity because they were agents, Wilberforce J held that the shares were held beneficially for the trust. More recently, in *Bhullar v Bhullar* [2003] 2 BCLC 241, the Court of Appeal reached the same conclusion on similar facts to those in *Cook* (save that the asset acquired was a property rather than a contract). Jonathan Parker LJ said this at para 28:

> "[W]here a fiduciary has exploited a commercial opportunity for his own benefit, the relevant question, in my judgment, is not whether the party to whom the duty is owed (the company, in the instant case) had some kind of beneficial interest in the opportunity: in my judgment that would be too formalistic and restrictive an approach. Rather, the question is simply whether the fiduciary's exploitation of the opportunity is such as to attract the application of the rule."

15. Turning now to cases concerned with bribes and secret commissions, the effect of the reasoning of Lord Lyndhurst LC in *Fawcett v Whitehouse* (1829) 1 Russ & M 132 was that an agent, who was negotiating on behalf of a prospective lessee and who accepted a "loan" from the lessor, held the loan on trust for his principal, the lessee. In *Barker v Harrison* (1846) 2 Coll 546, a vendor's agent had secretly negotiated a sub-sale of part of the property from the purchaser at an advantageous price, and Sir James Knight-Bruce V-C held that that asset was held on trust for the vendor. In *In re Western of Canada Oil, Lands and Works Co, Carling, Hespeler, and Walsh's Cases* (1875) 1 Ch D 115, the Court of Appeal (James and Mellish LJJ, Bramwell B and Brett J) held that shares transferred by a

person to individuals to induce them to become directors of a company and to agree that the company would buy land from the person, were held by the individuals on trust for the company. In *In re Morvah Consols Tin Mining Co, McKay's Case* (1875) 2 Ch D 1, the Court of Appeal (Mellish and James LJJ and Brett J) decided that where a company bought a mine, shares in the vendor which were promised to the company's secretary were held by him for the company beneficially. The Court of Appeal (Sir George Jessel MR and James and Baggallay LJJ) in *In re Caerphilly Colliery Co, Pearson's Case* (1877) 5 Ch D 336 concluded that a company director, who received shares from the promoters and then acted for the company in its purchase of a colliery from the promoters, held the shares on trust for the company. In *Eden v Ridsdale Railway Lamp and Lighting Co Ltd* (1889) 23 QBD 368, a company was held by the Court of Appeal (Lord Esher MR and Lindley and Lopes LJJ) to be entitled as against a director to shares which he had secretly received from a person with whom the company was negotiating. There are a number of other 19th century decisions to this effect, but it is unnecessary to cite them.

16. Inducements and other benefits offered to directors and trustees have been treated similarly. In *Sugden v Crossland* (1856) 2 Sm & G 192, Sir William Page Wood V-C held that a sum of money paid to a trustee to persuade him to retire in favour of the payee was to be "treated as a part of the trust fund". Similarly, in *Nant-y-glo and Blaina Ironworks Co v Grave* (1878) 12 Ch D 738, shares in a company given by a promoter to the defendant to induce him to become a director were held by Sir James Bacon V-C to belong to the company. In *Williams v Barton* [1927] 2 Ch 9, Russell J decided that a trustee, who recommended that his co-trustees use stockbrokers who gave him a commission, held the commission on trust for the trust.

17. The common law courts were meanwhile taking the same view. In *Morison v Thompson* (1874) LR 9 QBD 480, Cockburn CJ, with whom Blackburn and Archibald JJ agreed, held that a purchaser's agent who had secretly agreed to accept a commission from the vendor of a ship, held the commission for the benefit of his principal, the purchaser, in common law just as he would have done in equity – see at p 484, where Cockburn CJ referred to the earlier decision of Lord Ellenborough CJ to the same effect in *Diplock v Blackburn* (1811) 3 Camp 43. In *Whaley Bridge Calico Printing Co v Green* (1879) 5 QBD 109, Bowen J (albeit relying on equity at least in part) held that a contract between the vendor and a director of the purchaser, for a secret commission to be paid out of the purchase money, was to be treated as having been entered into for the benefit of the purchaser without proof of fraud.

18. It is fair to say that in the majority of the cases identified in the previous five paragraphs it does not appear to have been in dispute that, if the recipient of the benefit had received it in breach of his fiduciary duty to the plaintiff, then he held it on trust for the plaintiff. In other words, it appears to have been tacitly accepted that

the Rule applied, so that the plaintiff was entitled not merely to an equitable account in respect of the benefit, but to the beneficial ownership of the benefit.

19. However, many of those cases contain observations which specifically support the contention that the Rule applies to all benefits which are received by an agent in breach of his fiduciary duty. In *Sugden* at p 194, Sir William Page Wood V-C said that "it is a well-settled principle that if a trustee make a profit of his trusteeship, it shall enure to the benefit of his cestuique trusts". And in *McKay's Case* at p 5, Mellish LJ said that it was "quite clear that, according to the principles of a Court of Equity, all the benefit which the agent of the purchaser receives under such circumstances from the vendor must be treated as received for the benefit of the purchaser". In *Carling's Case* at p 124, James LJ said the arrangement amounted to a "a simple bribe or present to the directors, constituting a breach of trust on their part" and that "the company would be entitled to get back from their unfaithful trustees what the unfaithful trustees had acquired by reason of their breach of trust". In *Pearson's Case* Sir George Jessel MR said at pp 340-341 that the director as agent could not "retain that present as against the actual purchasers" and "must be deemed to have obtained [the benefit] under circumstances which made him liable, at the option of the cestuis que trust, to account either for the value … or … for the thing itself …". In *Eden*, Lord Esher said at p 371 that if an agent "put[s] himself in a position which the law does not allow [him] to assume … he commit[s] a wrong against his principal", and "[i]f that which the agent has received is money he must hand it over to his principal, if it is not money, but something else, the principal may insist on having it". Lindley and Lopes LJJ each said that they were "of the same opinion" as Lord Esher, and Lindley LJ observed at p 372 that it would be "contrary to all principles of law and equity to allow the plaintiff to retain the gift".

20. It is also worth noting that in *Morison* at pp 485-486, Cockburn CJ quoted with approval from two contemporary textbooks. First, he cited *Story on Agency*, para 211, where it was said that it could be "laid down as a general principle, that, in all cases when a person is … an agent for other persons, all profits and advantages made by him in the business, beyond his ordinary compensation, are to be for the benefit of his employers." Secondly, he referred to *Paley on Principal and Agent*, p 51, which stated that "not only interest, but every other sort of profit or advantage, clandestinely derived by an agent from dealing or speculating with his principal's effects, is the property of the latter, and must be accounted for".

21. The cases summarised in paras 13-17 above and the observations set out in paras 19-20 above are all consistent with the notion that the Rule should apply to bribes or secret commissions paid to an agent, so that the agent holds them on trust for his principal, rather than simply having an equitable duty to account to his principal. It is true that in many of those cases there was apparently no argument as to whether the benefit obtained by the fiduciary was actually held on trust for the principal. However, in some of the cases there was a dispute on the nature of the

relief; in any event, the fact that it was assumed time and again by eminent barristers and judges must carry great weight.

22. However, there is one decision of the House of Lords which appears to go the other way, and several decisions of the Court of Appeal which do go the other way, in that they hold that, while a principal has a claim for equitable compensation in respect of a bribe or secret commission received by his agent, he has no proprietary interest in it.

23. The House of Lords decision is *Tyrrell v Bank of London* (1862) 10 HL Cas 26. The facts of the case are somewhat complex and the reasoning of the opinions of Lord Westbury LC, Lord Cranworth and Lord Chelmsford is not always entirely easy to follow. The decision has been carefully and interestingly analysed by Professor Watts, "Tyrrell v Bank of London – an Inside Look at an Inside Job" (2013) 129 LQR 527. In very brief terms, a solicitor retained to act for a company in the course of formation secretly arranged to benefit from his prospective client's anticipated acquisition of a building called the "Hall of Commerce" by obtaining from the owner a 50% beneficial interest in a parcel of land consisting of the Hall and some adjoining land. After the client had purchased the Hall from the owner, it discovered that the solicitor had secretly profited from the transaction and sued him. Sir John Romilly MR held that the solicitor had held on trust for the client both (i) his interest in (and therefore his subsequent share of the proceeds of sale of) the Hall, and (ii) with "very considerable hesitation", his interest in the adjoining land – (1859) 27 Beav 273, especially at p 300. On appeal, the House of Lords held that, while the Master of the Rolls was right about (i), he was wrong about (ii): although the client had an equitable claim for the value of the solicitor's interest in the adjoining land, it had no proprietary interest in that land.

24. Lord Westbury LC made it clear at pp 39-40 that the fact that the client had not been formed by the time that the solicitor acquired his interest in the land did not prevent the claim succeeding as the client had been "conceived, and was in the process of formation". He also made it clear at p 44 that, in respect of the profit which the solicitor made from his share of the Hall (which he described as "the subject matter of the transaction", and, later at p 45, "that particular property included in the [client's] contract"), the solicitor "must be converted into a trustee for the [client]". However, he was clear that no such trust could arise in relation to the adjoining land, which was outside "the limit of the agency", and so "there [was] no privity, nor any obligation", although the solicitor "must account for the value of that property" – p 46. Lord Cranworth agreed, making it clear that the financial consequences for the solicitor were no different from those that followed from the Master of the Rolls' order, although he had "thought that possibly we might arrive at the conclusion that the decree was, not only in substance, but also in form, perfectly correct" – p 49. Lord Chelmsford agreed, and discussed bribes at pp 59-60, holding that the principal had no right to a bribe received by his agent.

25. Although there have been suggestions that, with the exception of Lord Chelmsford's obiter dicta about bribes, the decision of the House of Lords in *Tyrrell* was not inconsistent with the respondents' case on this appeal, it appears clear that it was. If, as the House held, the solicitor was liable to account to the client for the profit which he had made on the adjoining land, that can only have been because it was a benefit which he had received in breach of his fiduciary duty; and, once that is established, then, on the respondents' case, the Rule would apply, and that profit would be held on trust for the client (or, more accurately, his share of the adjoining land would be held on trust), as in *Fawcett*, *Sugden*, *Carter*, *Bowes* and *Barker*, all of which had been decided before *Tyrrell*, and of which only *Fawcett* was cited to the House.

26. We turn to the Court of Appeal authorities which are inconsistent with the notion that the Rule applies to bribes or secret commissions. In *Metropolitan Bank v Heiron* (1880) 5 Ex D 319, the Court of Appeal held that a claim brought by a company against a director was time-barred: the claim was to recover a bribe paid by a third party to induce the director to influence the company to negotiate a favourable settlement with the third party. It was unsuccessfully argued by the bank that its claim was proprietary. Brett LJ said at p 324 "[n]either at law nor in equity could this sum … be treated as the money of the company", but he apparently considered that, once the company had obtained judgment for the money there could be a trust. Cotton LJ expressed the same view. James LJ simply thought that there was an equitable debt and applied the Limitation Acts by analogy. This approach was followed in *Lister & Co v Stubbs* (1890) 45 Ch D 1, where an agent of a company had accepted a bribe from one of its clients, and an interlocutory injunction was refused on the ground that the relationship between the company and its agent was that of creditor and debtor not beneficiary and trustee. Cotton LJ said at p 12 that "the money which [the agent] has received … cannot … be treated as being the money of the [company]". Lindley LJ agreed and said at p 15 that the notion that there was a trust "startle[d]" him, not least because it would give the company the right to the money in the event of the agent's bankruptcy. Bowen LJ agreed.

27. *Lister* was cited with approval by Lindley LJ in *In re North Australian Territory Co, Archer's case* [1892] 1 Ch 322, 338, and it was followed in relation to a bribe paid to an agent by Sir Richard Henn Collins MR (with whom Stirling and Mathew LJJ agreed) in *Powell & Thomas v Evan Jones & Co* [1905] 1 KB 11, 22, where the principal was held entitled to an account for the bribe, but not to a declaration that the bribe was held on trust. The same view was taken in the Court of Appeal in *Attorney General's Reference (No 1 of 1985)* [1986] QB 491, 504-505, where Lord Lane CJ quoted from the judgments of Cotton and Lindley LJJ in what he described as "a powerful Court of Appeal in *Lister*", and followed the reasoning. In *Regal (Hastings)*, the decision in *Lister* was referred to by Lord Wright at p 156, as supporting the notion that "the relationship in such a case is that of debtor and

creditor, not trustee and cestui que trust". However, that was an obiter observation, and it gets no support from the other members of the committee.

28. More recently, in 1993, in *Attorney General for Hong Kong v Reid*, the Privy Council concluded that bribes received by a corrupt policeman were held on trust for his principal, and so they could be traced into properties which he had acquired in New Zealand. In his judgment on behalf of the Board, Lord Templeman disapproved the reasoning in *Heiron*, and the reasoning and outcome in *Lister*, and he thought his conclusion inconsistent with only one of the opinions, that of Lord Chelmsford, in *Tyrrell*. In *Daraydan Holdings Ltd v Solland International Ltd* [2005] Ch 119, paras 75ff, Lawrence Collins J indicated that he would follow *Reid* rather than *Lister*, as did Toulson J in *Fyffes Group Ltd v Templeman* [2000] 2 Lloyd's Rep 643, 668-672. But in *Sinclair Investments Ltd v Versailles Trade Finance Ltd* [2012] Ch 453, in a judgment given by Lord Neuberger MR, the Court of Appeal decided that it should follow *Heiron* and *Lister*, and indeed *Tyrrell*, for a number of reasons set out in paras 77ff, although it accepted that this Court might follow the approach in *Reid*. In this case, Simon J considered that he was bound by *Sinclair*, whereas the Court of Appeal concluded that they could and should distinguish it.

Legal principle and academic articles

29. As mentioned above, the issue raised on this appeal has stimulated a great deal of academic debate. The contents of the many articles on this issue provide an impressive demonstration of penetrating and stimulating legal analysis. One can find among those articles a powerful case for various different outcomes, based on analysing judicial decisions and reasoning, equitable and restitutionary principles, and practical and commercial realities. It is neither possible nor appropriate to do those articles justice individually in this judgment, but the court has referred to them for the purpose of extracting the principle upon which the Rule is said to be based. In addition to those referred to in paras 10, 11 and 23 above, those articles include Hayton, "The Extent of Equitable Remedies: Privy Council versus the Court of Appeal" [2012] Co Law 161, Swadling, "Constructive trusts and breach of fiduciary duty" (2012) 18 Trusts and Trustees 985, Virgo, "Profits Obtained in Breach of Fiduciary Duty: Personal or Proprietary Claim?" (2011) 70 CLJ 502, Edelman "Two Fundamental Questions for the Law of Trusts" (2013) 129 LQR 66 and others listed by Sir Terence Etherton, "The Legitimacy of Proprietary Relief", (2014) Birkbeck Law Review vol 2(1), 59, at p 60. At p 62 Sir Terence refers to "this relentess and seemingly endless debate", which, in the Court of Appeal in this case, Pill LJ described as revealing "passions of a force uncommon in the legal world" – [2014] Ch 1, para 61.

30. The respondents' formulation of the Rule, namely that it applies to all benefits received by an agent in breach of his fiduciary duty to his principal, is explained on the basis that an agent ought to account in specie to his principal for any benefit he has obtained from his agency in breach of his fiduciary duty, as the benefit should be treated as the property of the principal, as supported by many judicial dicta including those in para 19 above, and can be seen to be reflected in Jonathan Parker LJ's observations in para 14 above. More subtly, it is justified on the basis that equity does not permit an agent to rely on his own wrong to justify retaining the benefit: in effect, he must accept that, as he received the benefit as a result of his agency, he acquired it for his principal. Support for that approach may be found in Mellish LJ's judgment in *McKay's Case* at p 6, and Bowen J's judgment in *Whaley Bridge* at p 113.

31. The appellant's formulation of the Rule, namely that it has a more limited reach, and does not apply to bribes and secret commissions, has, as mentioned in para 10 above, various different formulations and justifications. Thus, it is said that, given that it is a proprietary principle, the Rule should not apply to benefits which were not derived from assets which are or should be the property of the principal, a view supported by the reasoning of Lord Westbury in *Tyrrell*. It has also been suggested that the Rule should not apply to benefits which could not have been intended for the principal and were, rightly or wrongly, the property of the agent, which seems to have been the basis of Cotton LJ's judgment in *Heiron* at p 325 and *Lister* at p 12. In *Sinclair*, it was suggested that the effect of the authorities was that the Rule should not apply to a benefit which the agent had obtained by taking advantage of an opportunity which arose as a result of the agency, unless the opportunity "was properly that of the [principal]" – para 88. Professor Worthington's subsequent formulation, referred to in para 10 above, is very similar but subtly different (and probably more satisfactory).

32. Each of the formulations set out in paras 30 and 31 above have their supporters and detractors. In the end, it is not possible to identify any plainly right or plainly wrong answer to the issue of the extent of the Rule, as a matter of pure legal authority. There can clearly be different views as to what requirements have to be satisfied before a proprietary interest is created. More broadly, it is fair to say that the concept of equitable proprietary rights is in some respects somewhat paradoxical. Equity, unlike the common law, classically acts in personam (see eg Maitland, *Equity*, p 9); yet equity is far more ready to accord proprietary claims than common law. Further, two general rules which law students learn early on are that common law legal rights prevail over equitable rights, and that where there are competing equitable rights the first in time prevails; yet, given that equity is far more ready to recognise proprietary rights than common law, the effect of having an equitable right is often to give priority over common law claims – sometimes even those which may have preceded the equitable right. Given that equity developed at least in part to mitigate the rigours of the common law, this is perhaps scarcely

surprising. However, it underlines the point that it would be unrealistic to expect complete consistency from the cases over the past 300 years. It is therefore appropriate to turn to the arguments based on principle and practicality, and then to address the issue, in the light of those arguments as well as the judicial decisions discussed above.

Arguments based on principle and practicality

33. The position adopted by the respondents, namely that the Rule applies to all unauthorised benefits which an agent receives, is consistent with the fundamental principles of the law of agency. The agent owes a duty of undivided loyalty to the principal, unless the latter has given his informed consent to some less demanding standard of duty. The principal is thus entitled to the entire benefit of the agent's acts in the course of his agency. This principle is wholly unaffected by the fact that the agent may have exceeded his authority. The principal is entitled to the benefit of the agent's unauthorised acts in the course of his agency, in just the same way as, at law, an employer is vicariously liable to bear the burden of an employee's unauthorised breaches of duty in the course of his employment. The agent's duty is accordingly to deliver up to his principal the benefit which he has obtained, and not simply to pay compensation for having obtained it in excess of his authority. The only way that legal effect can be given to an obligation to deliver up specific property to the principal is by treating the principal as specifically entitled to it.

34. On the other hand, there is some force in the notion advanced by the appellant that the Rule should not apply to a bribe or secret commission paid to an agent, as such a benefit is different in quality from a secret profit he makes on a transaction on which he is acting for his principal, or a profit he makes from an otherwise proper transaction which he enters into as a result of some knowledge or opportunity he has as a result of his agency. Both types of secret profit can be said to be benefits which the agent should have obtained for the principal, whereas the same cannot be said about a bribe or secret commission which the agent receives from a third party.

35. The respondents' formulation of the Rule has the merit of simplicity: any benefit acquired by an agent as a result of his agency and in breach of his fiduciary duty is held on trust for the principal. On the other hand, the appellant's position is more likely to result in uncertainty. Thus, there is more than one way in which one can identify the possible exceptions to the normal rule, which results in a bribe or commission being excluded from the Rule – see the differences between Professor Goode and Professor Worthington described in paras 10 and 32 above, and the other variations there described. Clarity and simplicity are highly desirable qualities in the law. Subtle distinctions are sometimes inevitable, but in the present case, as mentioned above, there is no plainly right answer, and, accordingly, in the absence of any other good reason, it would seem right to opt for the simple answer.

36. A further advantage of the respondents' position is that it aligns the circumstances in which an agent is obliged to account for any benefit received in breach of his fiduciary duty and those in which his principal can claim the beneficial ownership of the benefit. Sir George Jessel MR in *Pearson's Case* at p 341 referred in a passage cited above to the agent in such a case having "to account either for the value … or … for the thing itself …". The expression equitable accounting can encompass both proprietary and non-proprietary claims. However, if equity considers that in all cases where an agent acquires a benefit in breach of his fiduciary duty to his principal, he must account for that benefit to his principal, it could be said to be somewhat inconsistent for equity also to hold that only in some such cases could the principal claim the benefit as his own property. The observation of Lord Russell in *Regal (Hastings)* quoted in para 6 above, and those of Jonathan Parker LJ in *Bhullar* quoted in para 14 above would seem to apply equally to the question of whether a principal should have a proprietary interest in a bribe or secret commission as to the question of whether he should be entitled to an account in respect thereof.

37. The notion that the Rule should not apply to a bribe or secret commission received by an agent because it could not have been received by, or on behalf of, the principal seems unattractive. The whole reason that the agent should not have accepted the bribe or commission is that it puts him in conflict with his duty to his principal. Further, in terms of elementary economics, there must be a strong possibility that the bribe has disadvantaged the principal. Take the facts of this case: if the vendor was prepared to sell for €211.5m, on the basis that it was paying a secret commission of €10m, it must be quite likely that, in the absence of such commission, the vendor would have been prepared to sell for less than €211.5m, possibly €201.5m. While Simon J was not prepared to make such an assumption without further evidence, it accords with common sense that it should often, even normally, be correct; indeed, in some cases, it has been assumed by judges that the price payable for the transaction in which the agent was acting was influenced pro rata to account for the bribe – see eg *Fawcett* at p 136.

38. The artificiality and difficulties to which the appellant's case can give rise may be well illustrated by reference to the facts in *Eden* and in *Whaley Bridge*. In *Eden*, the promoter gave 200 shares to a director of the company when there were outstanding issues between the promoter and the company. The Court of Appeal held that the director held the shares on trust for the company. As Finn J said in *Grimaldi v Chameleon Mining NL (No 2)* (2012) 287 ALR 22, para 570, the effect of that decision, if *Heiron* and *Lister* were rightly decided, would appear to be that where a bribe is paid to an agent, the principal has a proprietary interest in the bribe if it consists of shares but not if it consists of money, which would be a serious anomaly.

39. In *Whaley Bridge*, a director of a company who negotiated a purchase by the company for £20,000 of a property was promised but did not receive £3,000 out of

the £20,000 from the vendor. The outcome according to Bowen J was that the vendor was liable to the company for the £3,000, because the company was entitled to treat the contract between the vendor and the director as made by the director on behalf of the company. Bowen J held that it "could not be successfully denied" that if the £3,000 had been paid to the director he would have held it on trust for the company. Mr Collings suggested that the decision was correct because, unlike in this case, the director and vendor had agreed that the £3,000 would come out of the £20,000 paid by the company. Not only is there no trace of such reasoning in Bowen J's judgment, but it would be artificial, impractical and absurd if the issue whether a principal had a proprietary interest in a bribe to his agent depended on the mechanism agreed between the briber and the agent for payment of the bribe.

40. The notion that an agent should not hold a bribe or commission on trust because he could not have acquired it on behalf of his principal is somewhat inconsistent with the long-standing decision in *Keech*, the decision in *Phipps* approved by the House of Lords, and the Privy Council decision in *Bowes*. In each of those three cases, a person acquired property as a result of his fiduciary or quasi-fiduciary position, in circumstances in which the principal could not have acquired it: yet the court held that the property concerned was held on trust for the beneficiary. In *Keech*, the beneficiary could not acquire the new lease because the landlord was not prepared to let to him, and because he was an infant; in *Boardman*, the trust could not acquire the shares because they were not authorised investments; in *Bowes*, the city corporation would scarcely have been interested in buying the loan notes which it had just issued to raise money.

41. The respondents are also able to point to a paradox if the appellant is right and a principal has no proprietary right to his agent's bribe or secret commission. If the principal has a proprietary right, then he is better off, and the agent is worse off, than if the principal merely has a claim for equitable compensation. It would be curious, as Mr Collings frankly conceded, if a principal whose agent wrongly receives a bribe or secret commission is worse off than a principal whose agent obtains a benefit in far less opprobrious circumstances, eg the benefit obtained by the trustees' agents in *Boardman*. Yet that is the effect if the Rule does not apply to bribes or secret commissions.

42. Wider policy considerations also support the respondents' case that bribes and secret commissions received by an agent should be treated as the property of his principal, rather than merely giving rise to a claim for equitable compensation. As Lord Templeman said giving the decision of the Privy Council in *Attorney General for Hong Kong v Reid* [1994] 1 AC 324, 330H, "[b]ribery is an evil practice which threatens the foundations of any civilised society". Secret commissions are also objectionable as they inevitably tend to undermine trust in the commercial world. That has always been true, but concern about bribery and corruption generally has never been greater than it is now – see for instance, internationally, the OECD

Convention on Combating Bribery of Foreign Public Officials in International Business Transactions 1999 and the United Nations Convention against Corruption 2003, and, nationally, the Bribery Acts 2010 and 2012. Accordingly, one would expect the law to be particularly stringent in relation to a claim against an agent who has received a bribe or secret commission.

43. On the other hand, a point frequently emphasised by those who seek to justify restricting the ambit of the Rule is that the wide application for which the respondents contend will tend to prejudice the agent's unsecured creditors, as it will serve to reduce the estate of the agent if he becomes insolvent. This was seen as a good reason in *Sinclair* for not following *Reid* – see at [2012] Ch 453, para 83. While the point has considerable force in some contexts, it appears to us to have limited force in the context of a bribe or secret commission. In the first place, the proceeds of a bribe or secret commission consists of property which should not be in the agent's estate at all, as Lawrence Collins J pointed out in *Daraydan*, para 78 (although it is fair to add that insolvent estates not infrequently include assets which would not be there if the insolvent had honoured his obligations). Secondly, as discussed in para 37 above, at any rate in many cases, the bribe or commission will very often have reduced the benefit from the relevant transaction which the principal will have obtained, and therefore can fairly be said to be his property.

44. Nonetheless, the appellant's argument based on potential prejudice to the agent's unsecured creditors has some force, but it is, as we see it, balanced by the fact that it appears to be just that a principal whose agent has obtained a bribe or secret commission should be able to trace the proceeds of the bribe or commission into other assets and to follow them into the hands of knowing recipients (as in *Reid*). Yet, as Mr Collings rightly accepts, tracing or following in equity would not be possible, at least as the law is currently understood, unless the person seeking to trace or follow can claim a proprietary interest. Common law tracing is, of course, possible without a proprietary interest, but it is much more limited than equitable tracing. Lindley LJ in *Lister* at p 15 appears to have found it offensive that a principal should be entitled to trace a bribe, but he did not explain why, and we prefer the reaction of Lord Templeman in *Reid*, namely that a principal ought to have the right to trace and to follow a bribe or secret commission.

45. Finally, on this aspect, it appears that other common law jurisdictions have adopted the view that the Rule applies to all benefits which are obtained by a fiduciary in breach of his duties. In the High Court of Australia, Deane J said in *Chan v Zacharia* (1984) 154 CLR 178, 199 that any benefit obtained "in circumstances where a conflict …. existed … or … by reason of his fiduciary position or of opportunity or knowledge resulting from it … is held by the fiduciary as constructive trustee". More recently, the Full Federal Court of Australia has decided not to follow *Sinclair*: see *Grimaldi*, where the decision in *Reid* was preferred – see the discussion at paras 569-584. Although the Australian courts

recognise the remedial constructive trust, that was only one of the reasons for not following *Sinclair*. As Finn J who gave the judgment of the court said at para 582 (after describing *Heiron* and *Lister* as "imposing an anomalous limitation … on the reach of *Keech v Sandford*" at para 569), "Australian law" in this connection "matches that of New Zealand …, Singapore, United States jurisdictions … and Canada". As overseas countries secede from the jurisdiction of the Privy Council, it is inevitable that inconsistencies in the common law will develop between different jurisdictions. However, it seems to us highly desirable for all those jurisdictions to learn from each other, and at least to lean in favour of harmonising the development of the common law round the world.

Conclusions

46. The considerations of practicality and principle discussed in paras 33-44 above appear to support the respondents' case, namely that a bribe or secret commission accepted by an agent is held on trust for his principal. The position is perhaps rather less clear when one examines the decided cases, whose effect we have summarised in paras 13-28 above. However, to put it at its lowest, the authorities do not preclude us adopting the respondents' case in that they do not represent a clear and consistent line of authority to the contrary effect. Indeed, we consider that, taken as a whole, the authorities favour the respondents' case.

47. First, if one concentrates on the issue of bribes or secret commissions paid to an agent or other fiduciary, the cases, with the exception of *Tyrrell*, were consistently in favour of such payments being held on trust for the principal or other beneficiary until the decision in *Heiron* which was then followed in *Lister*. Those two decisions are problematical for a number of reasons. First, relevant authority was not cited. None of the earlier cases referred to in paras 13, 14 or 16 above were put before the court in *Heiron* (where the argument seems to have been on a very different basis) or in *Lister*. Secondly, all the judges in those two cases had given earlier judgments which were inconsistent with their reasoning in the later ones. Brett LJ (who sat in *Heiron*) had been party to the decision in *McKay's* and *Carling's Cases*; Cotton LJ (who sat in *Heiron* and *Lister*) had been party to *Bagnall* (which was arguably indistinguishable), James LJ (who sat in *Heiron*) was party to *Pearson's* and *McKay's Cases*, as well as *Bagnall*; Lindley LJ (who sat in *Lister*) had been party to *Eden*; and Bowen LJ (who sat in *Lister*) had decided *Whaley Bridge*. Thirdly, the notion, adopted by Cotton and Brett LJJ that a trust might arise once the court had given judgment for the equitable claim seems to be based on some sort of remedial constructive trust which is a concept not referred to in earlier cases, and which has authoritatively been said not to be part of English law – see per Lord Browne-Wilkinson in *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669, 714-716. Fourthly, the decisions in *Heiron* and *Lister* are difficult to reconcile with many cases not concerned with bribes or secret commissions paid to agents, such as those set out in paras 12, 13 and 15 above. If the reasoning in

Heiron and *Lister* is correct, then either those other cases were wrongly decided or the law is close to incoherent in this area.

48. As for the domestic cases subsequent to *Lister*, they are all explicable on the basis that it was either conceded or decided that the reasoning in the Court of Appeal in *Lister* was binding. Further, even after *Lister*, cases were being decided in which it seems to have been accepted or decided by Chancery Judges that where an agent or other fiduciary had a duty to account for a benefit obtained in breach of his fiduciary duty, the principal was entitled to a proprietary interest in the benefit – examples include Wilberforce J in *Phipps*, Lord Templeman in *Reid*, and Lawrence Collins J in *Daraydan Holdings Ltd*.

49. Were it not for the decision in *Tyrrell*, we consider that it would be plainly appropriate for this Court to conclude that the courts took a wrong turn in *Heiron* and *Lister*, and to restate the law as being as the respondents contend. Although the fact that the House of Lords decided *Tyrrell* in the way they did gives us pause for thought, we consider that it would be right to uphold the respondents' argument and disapprove the decision in *Tyrrell*. In the first place, *Tyrrell* is inconsistent with a wealth of cases decided before and after it was decided. Secondly, although *Fawcett* was cited in argument at p 38, it was not considered in any of the three opinions in *Tyrrell*; indeed, no previous decision was referred to in the opinions, and, although the opinions were expressed with a confidence familiar to those who read 19th century judgments, they contained no reasoning, merely assertion. Thirdly, the decision in *Tyrrell* may be explicable by reference to the fact that the solicitor was not actually acting for the client at the time when he acquired his interest in the adjoining land – hence the reference in Lord Westbury's opinion to "the limit of the agency" and the absence of "privity [or] obligation" as mentioned in para 24 above. In other words, it may be that their Lordships 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.

50. Quite apart from these three points, we consider that, the many decisions and the practical and policy considerations which favour the wider application of the Rule and are discussed above justify our disapproving *Tyrrell*. In our judgment, therefore, the decision in *Tyrrell* should not stand in the way of the conclusion that the law took a wrong turn in *Heiron* and *Lister*, and that those decisions, and any subsequent decisions (*Powell & Thomas, Attorney-General's Reference (No 1 of 1985)* and *Sinclair*), at least in so far as they relied on or followed *Heiron* and *Lister*, should be treated as overruled.

51. In this case, the Court of Appeal rightly regarded themselves as bound by *Sinclair*, but they managed to distinguish it. Accordingly, the appeal is dismissed.