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CASE COMMENTARY

BRIBES AND SECRET COMMISSIONS

FHR European Ventures LLP v Cedar Capital Partners LLC
[2014] UKSC 45

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1. INTRODUCTION

If an agent receives a bribe or a secret commission, does his principal have a proprietary claim? That is a question which has divided both the judiciary and academic opinion. The Supreme Court has now in *FHR European Ventures LLP v Cedar Capital Partners LLC*[1] given a clear and unequivocal decision. The case holds that the principal does have a proprietary remedy: an agent holds the proceeds of any bribe or secret commission on constructive trust for his principal.

2. THE FACTS

FHR European Ventures LLP ("FHR") represented a number of investors, including ultimately the Bank of Scotland, Prince Alwaleed bin Talal bin AbdulAziz al Saud, a well-established investor in luxury hotels around the world, and Fairmont Hotels and Resorts Inc, a hotel investment and operating company.[2] FHR acquired the shares in the company which owned the Monte Carlo Grand Hotel. Cedar Capital Partners LLC ("Cedar"), a company established to provide hotel industry consultancy services, acted as its agent in the purchase, and was paid a commission. Cedar had also entered into an exclusive brokerage agreement with the sellers to procure the sale of the hotel, in return for which Cedar would receive €10m. Cedar failed to disclose to FHR the €10m commission which was duly paid on the sale. FHR sought a proprietary remedy.

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[1] [2014] UKSC 45. The case is referred to in the text as the Monte Carlo Grand Hotel case.

[2] The companies forming part of the investment group were also joined as claimants, but for convenience FHR is treated in this commentary as if it were the only claimant.

3. THE DECISION

By the time of the hearing by the Supreme Court, a number of matters were not in dispute. It was not in doubt that a fiduciary may not retain the benefit of any unauthorised profit made in breach of fiduciary duty; it was not in doubt that Cedar, as an agent, owed fiduciary duties to both the seller and to FHR; it was not in doubt that as agent for both seller and buyer, there was a conflict of interest[3]; and finally, it was not in doubt that "an agent may not put himself in a position or enter into a transaction in which his personal interest, or his duty to another principal may conflict with his duty to his principal, unless his principal, with full knowledge of all the material circumstances and of the nature and extent of the agent's interest, consents".[4]

One of the main issues at first instance was whether Cedar had made sufficient disclosure to FHR of its arrangement with the sellers to allow it to retain the €10m commission. Simon J held that Cedar had failed to discharge the burden of proving that it had sufficiently disclosed the arrangement, and as a result it did not have the informed consent of FHR to retain the commission.[5] The finding of fact that there had been insufficient disclosure was not appealed.

The key issue on appeal became the appropriate remedy. The judge at first instance felt constrained by the decision of the Court of Appeal in *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd*[6] to hold that the claimants were entitled only to a personal remedy of an account in equity. By the time of the appeal to the Court of Appeal the issue became simply whether the claimants were entitled to a proprietary remedy. The claimants sought a proprietary remedy because they believed that it would improve their chances of recovery: a primary advantage of a proprietary right is that it permits the asset claimed to be followed into the hands of third parties or traced into new assets.[7]

The Court of Appeal similarly considered that it was bound to follow the decision in *Sinclair v Versailles.* This decision held that the ordinary remedy for breach of fiduciary duty was the personal remedy of compensation based on an account in equity. A claimant could not succeed in claiming a

[3] An argument to the contrary was summarily and correctly dismissed by the trial judge: *FHR European Ventures LLP v Mankarious* [2011] EWHC 2308 at [102].

[4] *FHR European Ventures LLP v Mankarious* [2011] EWHC 2308 at [75] per Simon J at first instance.

[5] *FHR European Ventures LLP v Mankarious* [2011] EWHC 2308 at [107].

[6] [2011] EWCA Civ 347 [2012] Ch 453 See the commentary by Pearce and Shearman (2012) 24 Denning Law Journal 191-205.

[7] This was one of the main reasons why a proprietary claim was made in *Attorney General for Hong Kong v Reid* [1994] 1 AC 324.

proprietary interest in assets acquired in breach of fiduciary duty 'unless the asset or money is or has been beneficially the property of the beneficiary or the trustee acquired the asset or money by taking advantage of an opportunity or right which was properly that of the beneficiary'.[8] The trial judge considered that the commission received by Cedar in the Monte Carlo Grand Hotel case could not be characterised as taking advantage of an opportunity that was properly that of FHR. The Court of Appeal disagreed and held that by taking a commission from the seller, Cedar had diverted an opportunity, properly that of the claimants, to purchase at the lowest possible price.[9] In doing this, it has been said that "the Court made the facts fit the law, rather than applying the law to the facts".[10]

The Supreme Court upheld the outcome, but for different reasons. Lord Neuberger, delivering the judgment of the court, took the opposite position from that which he had adopted in *Sinclair v Versailles.* The Supreme Court held that the general rule was that 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.[11] This would give the principal the right to choose either a proprietary claim against the asset or its proceeds, or the remedy of account in equity. The Supreme Court therefore reintroduced the rule applied in *Attorney General for Hong Kong v Reid*[12] where the Privy Council had held that a corrupt official who took bribes to tamper with the administration of criminal justice held those bribes on trust for his employer. Lord Neuberger in the Monte Carlo Grand Hotel case said that "it is not possible to identify any plainly right or plainly wrong answer to the issue of the extent of the Rule [ie, when a principal will have a proprietary interest in assets acquired in breach of fiduciary duty], as a matter of pure legal authority."[13] The rule adopted by the Supreme Court was supported by a number of policy considerations. It had the merit of simplicity, as opposed to the contrary view, which was more likely to result in uncertainty.[14] It meant that there were particularly stringent rules relating to bribes and secret commissions, which undermined trust in the business world.[15] It also made it possible to trace or follow into other assets or

[8] *Sinclair v Versailles* [2011] EWCA Civ 347at [88] (Lord Neuberger) applied in *Cadogan Petroleum plc v. Tolley* [2011] EWHC 2286 (Ch) at [23] (Newey J)
[9] [2013] EWCA Civ 17, at [24].
[10] Hedlund, 'Secret Commissions and Constructive Trusts: Yet Again!' (2013) JBL 747, 755.
[11] [2014] UKSC 45 [35].
[12] [1994] 1 AC 324.
[13] [2014] UKSC 45 [32].
[14] [2014] UKSC 45 [35].
[15] [2014] UKSC 45 [42].

other recipients.[16] (Although Lord Neuberger spoke of following into the hands of knowing recipients, the right to follow applies more generally subject to the defence of bona fide purchase without knowledge.)

It was acknowledged that unsecured creditors might be affected, but they lost only the right to claim assets which the agent should never have received, and "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."[17]

The arguments for and against imposing a constructive trust on all unauthorised benefits could both draw upon supporting caselaw. However, the majority of the earlier cases supported the general rule adopted by the Supreme Court. The contrary view could be traced to three decisions, *Tyrrell v Bank of London*[18], *Metropolitan Bank v Heiron*[19] and *Lister & Co v Stubbs*[20], all of which could be criticised.[21] Those cases and any other cases applying them should therefore be treated as overruled.

4. COMMENTARY

The question of whether bribes and secret commissions are held by a fiduciary in breach of fiduciary duty on trust for his principal has been a matter of strongly held opposing views. The Supreme Court quoted the comment of Sir Terence Etherton about "this relentless and seemingly endless debate" in his article "The Legitimacy of Proprietary Relief",[22] and to the description by Pill LJ in the Court of Appeal of the debate as revealing "passions of a force uncommon in the legal world."[23] Much of that debate should be stilled by the very clear, unequivocal and emphatic decision of the Supreme Court. In addition, some of the wind is taken from the sails of those[24] who advocated a narrower approach to imposing a proprietary constructive trust because Lord Neuberger gave the leading judgment in *Sinclair v Versailles* supporting that view and also the judgment of the Supreme Court in the Monte Carlo Grand Hotel case overruling his own earlier decision. This does not mean that there will be no continuing debate,

[16] [2014] UKSC 45 [44].
[17] [2014] UKSC 45 [43].
[18] (1862) 10 HL Cas 26.
[19] (1880) 5 Ex D 319.
[20] (1890) 45 Ch D 1.
[21] [2014] UKSC 45 [47]-[49].
[22] (2014) 2 Birkbeck Law Review 59, 62.
[23] [2014] Ch 1at [61].
[24] Like the author of this commentary: see Pearce, 'Personal and Proprietary Claims against Bribees' [1994] LMCLQ 189.

because there are still some questions which can arise of which will need to be resolved.

(i) Unauthorised profits other than bribes and secret commissions

Because of the context, the focus of the Supreme Court in the Monte Carlo Grand Hotel case was on the treatment of bribes and secret commissions by expressly appointed agents, but it can reasonably be assumed that the Court's decision applies to all unauthorised profits made in breach of fiduciary duty. Of course, the creation of proprietary rights in favour of the principal by means of a constructive trust, applying the general principles of equity, requires that there are specifically identifiable assets to which the trust can attach. Where the gains made in breach of fiduciary duty lack the discrete substance of the single payment which would typically characterise a bribe or commission, a claim to a proprietary right may fail not on principle, but on the question of identification. The principal may therefore be left with only a personal claim for the benefits received by the agent.

(ii) Agent permitted to mix funds

The contractual arrangements under which an agent is employed may sometimes require the agent to segregate the principal's money from his own (and therefore hold it upon trust); in other cases the agent may be permitted to mix funds received on the principal's behalf with his own, in which case the assets received by the agent are not held upon trust, and the agent has only a duty to account to the principal for the sums received. Millet LJ in *Paragon Finance v DB Thakerar & Co*[25]considered that the arrangement in *Nelson v Rye*[26] was properly characterised in this way:

> "…it would appear that the defendant was entitled to pay receipts into his own account, mix them with his own money, use them for his own cash-flow, deduct his own commission, and account for the balance to the plaintiff only at the end of the year. It is fundamental to the existence of a trust that the trustee is bound to keep the trust property separate from his own and apply it exclusively for the benefit of his beneficiary."

The obligation to account only on an annual basis was also, in Millett LJ's view, inconsistent with a trust because a trustee "is obliged to account to his beneficiary and pay over the trust property on demand."

[25] [1999] 1 All ER 400.
[26] [1996] 1 WLR 1378.

This leads to the question as to whether a constructive trust can be imposed upon an agent of this description who improperly fails to account for all of the money for which he should have accounted at the year end. Millett LJ was clear that, at least in respect of the sums for which the fiduciary does account, there can be no constructive trust, for the agent is permitted to retain and use the money as his own. What of any additional sums received by the agent? The answer should probably be that this is not substantially different from the Monte Carlo Grand Hotel case. If Cedar had made full disclosure to FHR of the commission it was receiving from the seller, it could have kept the whole of that commission as its own. Because the commission was to be treated as secret (in other word, unauthorised), it was held on trust. Again, however, there may be an issue about identification: if the fiduciary is not obliged to account for sums received immediately, it is only after the later failure to account that it can be determined that the agent has made a secret profit, and at that stage there may be no specifically identifiable asset to which the proprietary right can attach.

(iii) Causal links

In order for a constructive trust to attach to profits made by a fiduciary, it must be shown that that the profits relate to a breach of fiduciary duty. There could be significant issues involved in identifying indirect gains where mixed funds have been used to generate a profit or other factors have influenced the achievement of the gains. In *Sinclair v Versailles* trust funds (of which TPL, an investment intermediary, was the beneficiary) were received by a company in breach of trust and were used to finance "cross fired" trading (a web of inter-related sham transactions) which gave the appearance that the company was much more successful than was really the case. No profits were made directly by the use of those funds, but the fiduciary (Mr Cushnie) did make profits from selling shares in the company at prices substantially higher than their true worth. Lord Neuberger held that "there was undoubtedly a close commercial causal connection between Mr Cushnie's misuse of the funds in respect of which he owed fiduciary duties to TPL, and the money which he made on the sale of the shares."[27] That causal link was essential to establishing an obligation to account; it would equally be essential to establishing a proprietary claim. Similarly, in *Boardman v Phipps*[28] Lord Boardman could only be held liable as a constructive trustee for profits made by the reorganisation of a private company because he would not have had that opportunity but for being the solicitor to the trust which had a shareholding in the company.

[27] [2012] Ch 453 [51].
[28] [1967] 2 AC 46.

(iii) Criminal offences

In *Attorney-General's Reference (No 1 of 1985)*[29] a pub manager was charged with offences under the Theft Act 1968 for purchasing his own barrels of beer, selling them in his managed pub, and retaining the proceeds. He was acquitted on the basis that, although he might have a civil duty to account for the profits he made, he was not a constructive trustee of the proceeds. In so far as the decision was based upon *Lister v Stubbs*, which has been overruled, the decision must also be considered to be unsound. However, the Court of Appeal also raised two further objections to finding the pub manager guilty of theft: because the sums he received from customers consisted of reimbursement for the cost of acquiring the beer and a possible profit element, but it was only for the latter that he was accountable, there could never have been a time when the manager had separate property of which he could be a trustee.

> "The profit element … remained part of a mixed fund. Therefore there never was a moment at which [the manager] was trustee of a definite fund. It follows that there never was a moment when the employers had any proprietary interest in any of the money. The money did not belong to another. There was therefore no theft."[30]

In addition, the Court was wary of the concept that a person could be considered guilty of theft on the basis of importing the equitable doctrine of constructive trust. "There are topics of conversation more popular in public houses than the finer points of the equitable doctrine of the constructive trust. ... If something is so abstruse and so far from the understanding of ordinary people as to what constitutes stealing, it should not amount to stealing."[31] That view, which relates essentially to the requirement of dishonesty, should be unaffected by the Monte Carlo Grand Hotel case.

[29] [1986] 1 QB 491.

[30] [1986] 1 QB 491 [506].

[31] [1986] 1 QB 491 [506]-[507]. See also *R v Abdul Rashid* [1977] 1 WLR 298 (not a criminal offence for a rail steward to "go equipped" with sliced bread and tomatoes with a view to making and selling sandwiches on a train).