Conflict resolved?

Rory Cochrane provides an update on bribes, agents & principals

IN BRIEF

- *FHR European Ventures LLP and others v Cedar Capital Partners LLC* resolves whether a fiduciary holds a bribe or secret commission, received in breach of fiduciary obligation, on trust for the beneficiary.
- The court has come down on the side of the Privy Council in *Attorney-General for Hong Kong v Reid*, rather than the Court of Appeal in *Lister v Stubbs* and held that a fiduciary does hold a bribe or secret commission on trust for the beneficiary of the fiduciary obligations.

The Supreme Court has handed down its judgment in *FHR European Ventures LLP and others v Cedar Capital Partners LLC* [2014] UKSC 45, [2014] 4 All ER 79. The judgment finally resolves the much debated question (the subject of recent conflicting Court of Appeal authorities, and several forests' worth of academic discussion) of whether a fiduciary (in this case a purchaser's agent) holds a bribe or secret commission, received in breach of fiduciary obligation, on trust for the beneficiary.

Anticipation

The judgment has been keenly anticipated by a wide range of practitioners. It is of interest to commercial litigators in general, and of particular interest to fraud and insolvency lawyers. Employment lawyers will also be interested in its application in the context of bribed employees and agents.

In *FHR European Ventures*, the Supreme Court has stated that a fiduciary (in this case, a property purchaser's agent) holds a bribe or secret commission received in breach of fiduciary obligation on trust for their beneficiary. In doing so the court has followed the Privy Council in *Attorney-General v Reid* [1994] 1 AC 324, [1994] 1 All ER 1, in preference to the Court of Appeal in *Lister v Stubbs* (1890) 45 Ch D 1, [1886-90] All ER Rep 797 and, latterly, the Court of Appeal in *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* [2011] EWCA Civ 347, [2011] 4 All ER 335.

> *"The court based its decision on 'considerations of practicality & principle'"*

For those unfamiliar with the recent debate, it may sound surprising that such an apparently fundamental question has remained unresolved. However, after reviewing the authorities, Lord Neuberger (delivering the judgment of the court) stated that it was "not possible to identify any plainly right or plainly wrong answer… as a matter of pure legal authority" (para 32). Indeed, Lord Neuberger had, as Master of the Rolls delivering the judgment of the Court of Appeal in *Sinclair*, sided with *Lister* rather than *Reid*.

As the question could not be resolved by reference to authority, the court based its decision on "considerations of practicality and principle" (para 46). These included (paras. 34-45): (i) the desirability of simplicity in the law; (ii) the need for consistency with cases such as *Boardman v Phipps* [1967] 2 AC 46, [1966] 3 All ER 721 in which courts have jealously guarded the observance of fiduciary obligations by imposing proprietary remedies against those in default; (iii) wider policy considerations, such as the need to discourage bribery (as Lord Templeman stated in *Reid*, bribery "is an evil practice which threatens the foundations of any civilised society"); and (iv) the desirability of harmonising the development of the common law round the world.

Controversial

Perhaps the most controversial aspect of the decision arises from the consequence that if the beneficiary has a proprietary claim in respect of a bribe (and, accordingly, to the traceable proceeds), as opposed to a merely personal claim, then that claim will rank ahead of the claims of any unsecured

creditors of the defaulting fiduciary. In effect, if a defaulting fiduciary's bribe is subject to a constructive trust, it gives the fiduciary's beneficiary security over that bribe (and its traceable proceeds) ahead of other creditors who may have been dealing with the defaulting fiduciary without knowledge that the assets of the fiduciary would become subject to a trust imposed by law. Much academic debate has focused on whether that is a just outcome.

Lord Neuberger stated three reasons why the potential prejudice to the fiduciary's unsecured creditors was outweighed by the beneficiary's proprietary claim (paras 43-44). First, the proceeds of the bribe or secret commission should not be in the fiduciary's estate in the first place. Second, the bribe or commission will very often have reduced the benefit from the relevant transaction which the beneficiary will have obtained, and therefore can fairly be said to be the beneficiary's property. Finally, it is "just" that a beneficiary whose agent has obtained a bribe or secret commission should be able to trace the proceeds into other assets and to follow them into the hands of knowing recipients.

Unfortunately, the court did not address a number of objections to these points. As to the first point, a bribe received by a non-fiduciary also should not be in their estate, but it would be available for distribution amongst unsecured creditors in the event of insolvency. Is the same result now to follow in cases involving non-fiduciaries?

As to the second point, leaving aside the fact that it may not always be the case that the receipt of the bribe will in fact have reduced the benefit to the beneficiary, the court's statement that a bribe in those circumstances can be "fairly said" to be the beneficiary's property is highly problematic from the perspective of the law of property. The previous problems in this area arose by virtue of the difficulty of ascribing to the beneficiary a proprietary interest in a bribe that was never intended to be conveyed to him and was never received by him. The court identifies that difficulty (eg at para 10), but does not in substance address it.

The third point, of course, is circular: for whether it is "just" or not that a beneficiary has a right to trace depends entirely on whether or not it is "just" that the beneficiary has a proprietary claim to the bribe in the hands of the defaulting fiduciary to begin with: rules of tracing are entirely neutral as to substantive rights.

Welcomed

Despite these difficulties, the judgment will be welcomed by practitioners for providing certainty as to the status of a bribe, particularly in the event of the insolvency of the defaulting fiduciary. However, the reasoning is unlikely to bring an end to broader academic debate about the nature of constructive trusts and the circumstances in which they will be imposed. As Sir Terance Etherton noted in a speech to the Chancery Bar Association earlier this year (published at (2014) *Birkbeck Law Review* Volume 2(1), 59) the principal reason for the interest in this very narrow point is that it "plays out a modern confrontation between those who espouse an essentially restrictive and tightly principled common law view of proprietary relief and those who favour more fluid, flexible equitable principles grounded on concepts of unconscionability and fiduciary relationships". That debate will undoubtedly go on. **NLJ**

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