Essay question

In his book, *Property and Justice* (Clarendon Press, Oxford, 1996), Professor J. W. Harris observed that the strict rule that a fiduciary must account for unauthorised profit 'confers the windfall constituted by the fiduciary's profit, not on the community, but on his principal', with the result that the principal is entitled to claim it in preference to the fiduciary's creditors. Professor Harris asks: 'Why should the principal take a windfall in priority to those to whom the fiduciary owes purchased obligations?'

Can you answer Professor Harris' question?

Guidance

In *AG for Hong Kong* v *Reid* [1994] 1 All ER 1, the Privy Council held that whenever a fiduciary receives property of his principal in breach of his fiduciary duty, he is a constructive trustee of it, and of any traceable profit from and proceeds of it. Mr Reid was acting Director of Public Prosecutions in Hong Kong. In breach of his fiduciary duty to the Crown he received substantial bribes in consideration of which he obstructed the prosecution of certain criminals. The Crown was able to trace the bribe monies through to three freehold properties in New Zealand, and to assert a restitutionary claim to them under a constructive trust. Lord Templeman held: 'Equity considers as done that which ought to be done. As soon as the bribe was received, whether in cash or in kind, the false fiduciary held the bribe on a constructive trust for the person injured.' But in what sense did the constructive trust in this case operate to vindicate the Crown's pre-existing proprietary entitlement to the bribe? The Crown was surely no more entitled to the bribe prior to its receipt by Reid than was he himself.

This area of law has been transformed by the decision of the Court of Appeal in *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd (In Administration)* [2011] EWCA Civ 347. The facts were that the Claimant company asserted a proprietary interest in sums that one of its directors, Mr C, had received from selling shares in another company (VGP) on the ground that the apparent value of VGP had been artificially inflated. The Claimant alleged that the proceeds of sale of the shares represented an unauthorised gain made by

Mr C in breach of fiduciary duties owed to the Claimant, and through the misuse of the Claimant's money, and should be recovered under a constructive trust.

The claim was rejected. It was held that the decision of the Privy Council in A-G for Hong Kong v Reid [1994] 1 All ER 1 does not alter the long line of English decisions that establishes that the beneficiary of a fiduciary's duties cannot claim a proprietary interest, but is only entitled to an equitable account.

In *Sinclair v Versailles*, Lord Neuberger MR held that: '… there is a real case for saying that the decision in Reid [1994] 1 AC 324 is unsound. In cases where a fiduciary takes for himself an asset which, if he chose to take, he was under a duty to take for the beneficiary, it is easy to see why the asset should be treated as the property of the beneficiary. However, a bribe paid to a fiduciary could not possibly be said to be an asset which the fiduciary was under a duty to take for the beneficiary. There can thus be said to be a fundamental distinction between (i) a fiduciary enriching himself by depriving a Claimant of an asset and (ii) a fiduciary enriching himself by doing a wrong to the Claimant. Having said that, I can see a real policy reason in its favour (if equitable accounting is not available), but the fact that it may not accord with principle is obviously a good reason for not following it in preference to decisions of this court'. [para. 80]

An exception (where a constructive trust may still be imposed on a bribe or other wrongful gain in the fiduciary's control) applies where the asset or money wrongfully gained was or had been beneficially the property of the beneficiary or the trustee. [Note: it was on this basis that a constructive trust was imposed on the facts of *Daraydan Holdings Ltd v Solland Interiors Ltd* [2004] EWHC 622]

Another interesting case is *Boardman* v *Phipps* [1967] 2 AC 46. There, Boardman (the solicitor to the trust) wrote to the beneficiaries outlining his plans to take a personal interest in the company, thus giving them an opportunity to raise any objections they might have to his so doing. No objectors having come forward, Boardman proceeded with the take-over. In the event the take-over was very successful and the value of all the shares in the company increased in value. The present action was brought by Phipps, a beneficiary under the trust, for an account of profits made by Boardman in his fiduciary capacity. The

trial judge found as a fact that Phipps had not been fully informed by Boardman as to the precise nature of his plans. A bare majority of their Lordships (Viscount Dilhorne and Lord Upjohn dissenting) held that Boardman had placed himself in a fiduciary position in relation to the trust and would therefore be accountable for the profits that he had made on information obtained in his fiduciary capacity. There was only a slight suggestion in their Lordships' speeches that the inside information had itself been property of the trust. In fact, Boardman was held to be a constructive trustee, not to vindicate the beneficiary's pre-existing rights in property held by Boardman (he had not held any such property), but 'by reason of the fiduciary *position* in which [he] stood' (emphasis added).

Professor Birks has suggested ((1988) LMCLQ 128) that the use of constructive trust language was inappropriate to the facts of this case. For Birks, *Boardman* v *Phipps* was a case which should have been disposed of as a straightforward personal claim against the principal, and that in essence, despite the occasional unconvincing reference to constructive trusteeship, this is how the case *was* disposed of. It is true that the House of Lords made no order requiring that the defendants should transfer the shares to the plaintiff. Against this Professor Andrew Burrows points out that a declaration that the defendant held the shares on constructive trust *was* made at first instance, and (that judgment having been upheld) 'it must follow that the plaintiffs would have been entitled to proprietary remedies, affording priority, had the defendants been insolvent' (*The Law of Restitution* (1993), p. 413). The decision in *Sinclair v Versailles* does not resolve the debate in *Boardman v Phipps*, partly because it was in the very different context of bribery and partly because it was decided in a lower court.

It is suggested that the right approach would be for the courts to find a constructive trust in favour of the principal where the unauthorized profits were made through the use of the principal's property in the hands of the fiduciary, but in other cases to allow the creditors to prove their claims ahead of any windfall to the principal in the guise of a constructive trust.