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CASE COMMENTARY

THE PURSUIT OF PROPRIETARY REMEDIES FOR BREACH OF FIDUCIARY DUTY

Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd (in Administration)
Court of Appeal [2011] EWCA Civ 347

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INTRODUCTION

There is an old adage that if an opportunity looks too good to be true, then it almost certainly is. Despite this, the law reports are filled with examples of people seeking redress for the fallout from "get rich quick" schemes that have gone wrong. One type of scam, exemplified by the fraudulent investment scheme run by Bernard Madoff from the United States and which collapsed in 2008, is known as a "Ponzi[1] scheme".[2] The wrongdoer in such a scheme invites "investments" promising a high rate of return. The funds subscribed are not in fact invested (or if they are, they are invested in vehicles which produce a lower rate of return than that promised). Instead, the money from new subscribers is used to pay the rewards to earlier subscribers. In due course the scheme is bound to collapse, because there will be a point at which the new funds coming in are insufficient to make the payments to existing subscribers, and the bubble of new investment can continue only for as long as there is confidence on the part of subscribers, encouraging fresh deposits. When the scheme begins to unravel, it falls apart very quickly, since the assets held by the wrongdoer are inevitably inadequate to reimburse all of the subscribers in full. In the ensuing insolvent liquidation, subscribers stand to recover only a small fraction of their subscription as unsecured creditors unless they can demonstrate that they have a proprietary interest in some of

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[1] Named after Charles Ponzi who ran a fraudulent investment scheme of this kind in the United States in the early 20th century.

[2] Another significant example is the Stanford International Bank, run by Sir Robert Stanford in Antigua. See *Re Stanford International Bank Ltd* [2010] EWCA Civ 137.

the remaining assets. *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* is a case involving what the judge at first instance called a "classic Ponzi scheme".

THE FACTS

Carl Cushnie was (through a company he controlled) the major shareholder in Versailles Group plc (VGP). This company in turn had a trading subsidiary, Versailles Trade Finance Ltd (VTFL) whose business was ostensibly a modified form of factoring. In order to supposedly finance this business, investors paid in money through another company, Trading Partners Ltd (TPL) which was not part of the Versailles Group but in respect of which Mr Cushnie was a director. Furthermore, monies had been made available by various banks, in the main by way of secured lending. In fact, the money advanced by TPL to VTFL was not used in genuine trading activities. Instead, part of the funds were used to pay the purported profits to the investors, part was stolen by an associate of Mr Cushnie, and part was circulated (or "cross-fired") through companies within or associated with the Versailles Group to create an illusion that VTFL was trading at a substantial level. The tangled web of deceit deluded investors, banks, auditors, the stock exchange and the financial press into believing that the Versailles Group was a genuine and successful set of companies for some considerable time.[3] Inevitably however the scheme collapsed, and in due course the banks appointed joint administrative receivers.

The principal ways in which Mr Cushnie profited from the fraudulent enterprise were that he received dividends which were paid on the false basis that the Versailles Group was making distributable profits and more substantially, he received £28.69million from a sale of part of his shareholding in VGP. When the administrative receivers were appointed they pursued claims against Mr Cushnie (some of which were settled) and made substantial payments to the banks which had lent to VTFL.

The claimants, Sinclair Investments, had invested through TPL and had also taken an assignment of TPL's claims. They asserted two proprietary claims against the money received by the banks from the administrative receivers. The first was in respect of the proceeds of sale of the shares in VGP, which they claimed were held on constructive trust for TPL and the

[3] In much the same way that Bernard Madoff's Ponzi scheme, masked by a large volume of stock trading, escaped detection for at least a decade and possibly for as long as 30 years. The ability of fraudulent schemes of such magnitude as these escaping detection, and indeed, often receiving plaudits from the financial services industry and some financial journalists, raises serious issues about the effectiveness of industry regulation.

second was in relation to the monies which had passed from TPL to VTFL and were mixed with VTFL's own monies.

THE CLAIM TO THE FUNDS PAID TO VTFL

The second of the proprietary claims was the less controversial. It was agreed that the claimants had a proprietary interest in the funds paid to VTFL. The funds originally received by TPL were held on trust (there was an express term of the contract with the subscribing investors to this effect), and the investors therefore retained a beneficial interest in those funds when they were paid to VTFL which received them subject to fiduciary duties contained in its management agreement with TPL. What was disputed was whether the claimants had the right to assert this claim against the banks since it was argued that it was impossible to trace any of the money through VTFL which was variously described as a "black hole" or a "maelstrom". The Court of Appeal however upheld the decision of Lewison J at first instance that this was a valid claim. Even though the funds had been inextricably mixed with other money by VTFL, Lord Neuberger MR observed:

> "I do not doubt the general principle, reiterated by Lord Millett in Foskett v McKeown,4 that, if a proprietary claim is to be made good by tracing, there must be a clear link between the claimant's funds and the asset or money into which he seeks to trace. However, I do not see why this should mean that a proprietary claim is lost simply because the defaulting fiduciary, while still holding much of the money, has acted particularly dishonestly or cunningly by creating a maelstrom. Where he has mixed the funds held on trust with his own funds, the onus should be on the fiduciary to establish that part, and what part, of the mixed fund is his property."[5]

The Court concluded that both principle and authority supported that proposition, referring in particular to the fact that Lord Millett had specifically quoted with approval the observations of Page Wood V-C in *Frith v Cartland*[6] that "If a man mixes trust funds with his own, the whole will be treated as trust property, except so far as he may be able to distinguish what is his own". TPL was thus able to maintain a claim to any funds which had been paid to VTFL and it was for the administrative receivers to show, on the balance of probabilities, that any funds received by them did not represent funds due to TPL. This claim against VTFL could also be maintained against the banks

[4] [2001] 1 AC 102.
[5] [2011] EWCA Civ 347 at 138.
[6] (1865) 2 H&M 417 at 418.

who received payments from the administrative receivers except to the extent that they could show that they received the funds without notice of the claimants' equitable rights. The banks had received the first distributions in good faith and without such notice, but once they had been informed that the claimants had a proprietary claim they could no longer rely on this defence.

THE CLAIM TO THE PROCEEDS OF SALE OF THE SHARES IN VGP

A more complex issue related to the other proprietary claim made by the claimants. It was agreed that Mr Cushnie owed fiduciary duties to both TPL and VTFL. The claimants relied on the fact that Mr Cushnie was able to sell his shares in VGP at a substantial profit because as a director of TPL and in breach of his fiduciary duty he dishonestly misused TPL's funds in the cross-firing activities in order to inflate the apparent turnover and profits of VTFL, thereby increasing the supposed market value of its holding company VGP. Without the cross-firing it would have been obvious that VGP was in reality worthless. This profit in selling shares at an artificially inflated price, it was argued, was held on constructive trust and allowed the claimants to assert a proprietary claim in the proceeds of sale. This in turn permitted them to trace into the amounts received by the banks insofar as they had notice of the claim.

On the face of it, this argument was supported by the decision of the Privy Council in *Attorney General for Hong Kong v Reid*.[7] This controversial decision[8] held that where a dishonest fiduciary accepted a bribe (in that case a bribe taken for subverting the course of justice), a constructive trust was immediately imposed upon the recipient. This enabled the bribe to be traced into assets which were no longer in the possession or ownership of the fiduciary. The facts in the *Versailles* case were different, and the two situations might have been distinguished: the secret profit claimed in the *Versailles* case was not a bribe, nor the acquisition of a new asset by the dishonest fiduciary. It was, instead, an increase in the value of an asset (albeit otherwise worthless) already held by the fiduciary. The Court was of the view[9] that nonetheless the unauthorised secret profit in the present case should be treated in the same way as a bribe, even though Mr Cushnie had not acquired the shares as a result of his breach and the profit was made as a shareholder and not a director of VTFL (indirectly through VGP). Despite this, the Court of Appeal declined to follow *Reid*.

Lord Neuberger pointed out that as a general rule the Court of Appeal should follow its own previous decisions rather than a decision of the Privy

[7] [1994] 1 AC 324.
[8] See Pearce "Personal and Proprietary Claims Against Bribees" [1994] LMCLQ 189.
[9] [2011] EWCA Civ 347 at 56.

Council, although there might be an exception where it was a foregone conclusion that the Supreme Court would prefer the Privy Council decision.[10] Lord Neuberger did not think that this was a case where the Supreme Court would necessarily prefer the decision of the Privy Council.[11]

In his view, the Court was instead bound by a series of contrary decisions of the Court of Appeal, commencing with the cases of *Metropolitan Bank v Heiron*[12] and *Lister & Co v Stubbs.*[13] In the first of these two cases a director of a company who had taken a bribe raised the defence of limitation in respect of an action brought against him by the company to recover the bribe. The Court of Appeal in that case held that a bribe received by a company director amounted to a debt owed in equity to that company which, by analogy to a legal action to recover a debt, would be subject to the same limitation period as governed by the Statute of Limitations; no proprietary claim (which would not have been subject to the limitation period) was available to the company. In *Lister & Co v Stubbs* an employee took bribes in return for selling his employer's goods at a reduced price. Despite the clear association between the illicit profit made by the employee and the damage suffered by the employer, the Court of Appeal held that the obligation on the employee was simply a personal obligation to account, with no proprietary rights on the employer's part attaching to the bribe or its proceeds. Lord Neuberger referred[14] to the strong statement made by Lindley LJ:

> "…the relation between them is that of debtor and creditor; it is not that of trustee and *cestui que trust*. We are asked to hold that it is – which would involve consequences which, I confess, startle me. One consequence, of course, would be that, if [the employee] were to become bankrupt, this property acquired by him with the [bribe] would be withdrawn from the mass of his creditors and be handed over bodily to [the employer]. Can that be right? Another consequence would be that [the employer] could compel [the employee] to account to them, not only for the money with interest, but for all the profits which he might have made by embarking in trade with it. Can that be right? It appears to me that those consequences shew that there is some flaw in the argument."[15]

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[10] Ibid at 73 to 74.
[11] Ibid at 76.
[12] (1880) 5 Ex D 319.
[13] (1890) 45 Ch D 1.
[14] [2011] EWCA Civ 347 at 66.
[15] (1890) 45 Ch D 1 at15.

Those two cases had been followed in three subsequent decisions (*Archer's Case,*[16] *Powell & Thomas v Evan Jones & Co,*[17] and, *A-G's Reference (no 1 of 1985)*[18]) and were supported by an earlier decision of the House of Lords, *Tyrrell v Bank of London.*[19] The preference for the reasoning in *Lister & Co v Stubbs* was, moreover, supported by two decisions of the Court of Appeal following the *Reid* case, *Gwembe Valley Development Co Ltd v Koshy (No 3),*[20] and *Halton International Inc v Guernroy.*[21,22]

In his view, another reason for not following *Reid* was "that there is a real case for saying that the decision ... is unsound" continuing "There can ... 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."[23] He further pointed out that much of the reasoning in *Reid* was circular;[24] the Privy Council in *Reid* had misapprehended the extent to which *Tyrrell v Bank of London* was inconsistent with its decision,[25] and the decision had been criticised in most academic commentaries.[26] The result desired in the case (to deprive a false fiduciary of any profit) could have been achieved by means of an equitable account.[27] On the merits of the decision, Lord Neuberger expressed his view that Lord Templeman in *Reid* "may have given insufficient weight to the potentially unfair consequences of the decision to other creditors, if his conclusion was right."[28]

COMMENTARY

(1) Fiduciary duties give rise to personal obligations

The duties of a fiduciary are essentially duties of loyalty: to subrogate his or her own interests to those of the principal, and to act with honesty and integrity. Whilst fiduciaries have frequently been confusingly described as

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[16] [1892] 1 Ch 322.
[17] [1905] 1 KB 11.
[18] [1986] 1 QB 491.
[19] (1862) 10 HL Cas 26.
[20] [2004] 1 BCLC 131.
[21] [2006] EWCA Civ 801.
[22] [2011] EWCA Civ 347 at 85.
[23] Ibid, at 80.
[24] Ibid, at 78.
[25] Ibid, at 61.
[26] Ibid, at 81.
[27] Ibid, at 79.
[28] Ibid, at 83.

constructive trustees[29] (the classic example of this ambiguous description being *Boardman v Phipps*[30]), a breach of fiduciary duty is not in essence substantially different from the breach of other duties such as contractual or tortious duties.[31] The enforcement of duties in contract and in tort does not require the imposition of a proprietary remedy, nor does a breach of fiduciary duty, without more. This analysis of breach of fiduciary duty as giving rise to a personal liability only lies at the heart of both *Metropolitan Bank v Heiron* and *Lister & Co v Stubbs.*

(2) When will a proprietary remedy be available?

So when will a proprietary remedy be available against a fiduciary? There are two prime instances, both of which can be explained as examples of a fiduciary depriving a claimant of an asset. The first is where the assets claimed were originally beneficially owned by the claimant or have been acquired directly using funds owned beneficially by the claimant. Lord Neuberger explained the principle (by exclusion) in this way:

> " … previous decisions of this court establish that a claimant cannot claim proprietary ownership of an asset purchased by the defaulting fiduciary with funds which, although they could not have been obtained if he had not enjoyed his fiduciary status, were not beneficially owned by the claimant or derived from opportunities beneficially owned by the claimant."[32]

In the *Versailles* case, there was no real defence to the claim that funds paid to TPL and held by it on an express trust could be traced into the hands of the banks which had received those funds to the extent that the original funds or their product could still be identified. Applying the principle as explained by Lord Neuberger, a proprietary right can additionally be asserted not just where property was from the outset beneficially owned by the claimant, but also where a trustee holds a right or opportunity exercisable on

[29] There is a growing awareness of the desirability of being much clearer in the use of this term: see *FHR European Venture LLP* [2011] EWHC 299 where Simon J, following *Versailles* and *Cadogon (below),* said that he should have described a person who had gained financially through a breach of fiduciary duty as "accountable in equity" rather than as a "constructive trustee". See also *Paragon Finance plc v DB Thakerar & Co* [1999] 1 All ER 400 at 408-409 (Millett LJ).
[30] [1967] 2 AC 46.
[31] See Shearman and Pearce "Exempting a Trustee for Gross Negligence" [2011] Denning LJ 181.
[32] Above n 22, at 89.

behalf of the trust, and chooses to exercise the right or to exploit the opportunity for his or her own benefit. According to Lord Neuberger, this is one of the potential explanations of *Keech v Sandford.*[33]

The second instance where a proprietary remedy can be exercised against a fiduciary is where assets are acquired by an agent acting on behalf of a principal. An agent acquiring property in accordance with the principal's instructions does so on the principal's behalf. As Lord Parker of Waddington said in *Jacobus Marler Estates v Marler*:[34]

> "an agent, whose duty it is to acquire property on behalf of his principal, cannot, without ... consent, acquire it on his own behalf and subsequently resell it to his principal at an enhanced price. In such a case the principal can treat the property as originally acquired for him and the resale as nugatory."

This principle applies only, however, where the agency already exists at the time the agent acquires the property:

> "If it did not then exist the property acquired was, at the outset, the agent's own property for all purposes, and the subsequent constitution of the relationship of principal and agent cannot deprive him of property already his own."

The agency need not have been formally constituted. In *Tyrrell v Bank of London*[35] a solicitor knew that his client was interested in acquiring a piece of land. He bought the land himself. The House of Lords held that the solicitor was to be treated as having acquired the land on behalf of his client, so that he was a trustee of that part of the property in which his client was interested (but not of the remainder).

(3) The agency principle

There can be difficulties in identifying the limits of the two situations described above. Looking first at the limits to the agency principle, there can be little doubt that this applies where there is an expressly created agency. There will be comparatively little difficulty where the express purpose of the agency was for the agent to make the acquisition on behalf of the principal.

[33] (1726) Sel Cas Ch 61. Another, and more satisfactory, explanation of the proprietary nature of the beneficiary's right is that the extension of the lease was essentially a graft, enlarging the beneficiary's existing proprietary interest.

[34] 114 LT 640. See also *A. B. Cook v George S. Deeks* [1916] UKPC 10.

[35] (1862) 10 HL Cas 26.

However, in the *Tyrrell* case the solicitor had not been appointed expressly as an agent for the purpose of acquiring the land concerned. The scope and limits of the agency therefore had to be implied. There may also be cases where it is even less clear that there is an agency at all. Lord Neuberger in *Versailles* described the agency principle in this way:

> "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."[36]

Not everyone might agree with this final conclusion. After all, in many cases the receipt of the bribe will cause a direct financial loss to the beneficiary.[37] However, Lord Neuberger's conclusion is strongly supported by *A-G's Reference (No. 1 of 1985).*[38] In that case a salaried pub manager, in addition to selling his employer's beverages, purchased his own and sold them over the bar, pocketing the proceeds. It was held in a criminal prosecution that the money he received from customers did not belong to his employer, yet it would be hard to think of a case where the case for an implied agency would be stronger. The pub manager was doing what he was employed to do (namely to supply drinks across the bar); the customers would have assumed (if they knew the pub manager's status) that he was selling the employer's drinks and that he was receiving payment on the employer's behalf; and all the legitimate payments he received were taken on the employer's behalf and would have belonged to the employer.

When, therefore, can a duty to acquire property on a principal's behalf be implied? That is not at all clear. It may be, in view of the recent decision in *Crossco No 4 Unlimited v Jolan Ltd*[39] that negotiations for a joint venture may give rise to such a duty. In that case Etherton LJ, expressing a view with which the majority disagreed, suggested that the "*Pallant v Morgan* equity" cases should be seen as based upon the existence and breach of fiduciary duty,[40] in most cases (including in *Pallant v Morgan* itself) because the evidence disclosed that the joint venture arrangement amounted to an agency or partnership.[41] In *Pallant v Morgan*[42] the two parties to the litigation had

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[36] *Versailles* [2011] EWCA Civ 347 at 80.
[37] This point is considered further below.
[38] [1986] QB 491.
[39] [2011] EWCA Civ 1619.
[40] Ibid at 88.
[41] Ibid at 88.

agreed before an auction sale that they would not bid against each other, but that the property would be divided between them if the defendant's agent was the successful bidder. The defendant sought to renege on the understanding after the sale. Harman J held that although the pre-auction agreement was not sufficiently clear to amount to a specifically enforceable contract, the defendant held the property on trust for both parties. The decision has been followed and applied on a number of occasions, most notably in *Banner Homes Group plc v Luff Developments Ltd*,[43] a decision which was endorsed by the House of Lords in *Yeoman's Row Management Ltd v Cobbe*.[44] These cases suggest that the basis for the equity is a common intention constructive trust. The majority of the Court of Appeal in *Crossco v Jordan* (McFarlane LJ and Arden LJ) felt that the Court of Appeal was obliged to adopt this interpretation,[45] but Etherton LJ considered that it could not survive strong indications in *Stack v Dowden*[46] and *Jones v Kernott*[47] that the common intention constructive trust was to "be seen clearly in retrospect as a specific jurisprudential response to the problem of a presumption of resulting trust and the absence of legislation for resolving disputes over property ownership where a married or unmarried couple have purchased property for their joint occupation as a family home."[48] It is open to the Supreme Court to prefer Etherton LJ's view, but even if it does, there is a further question as to whether the fiduciary duty upon which Etherton LJ indicates the remedy should be based is sufficient to create a proprietary constructive trust through the implication of an agency, or whether the breach of fiduciary duty creates only personal rights and remedies.

(4) The proprietary base

It is similarly difficult to be certain where the limits are to the first principle, that a proprietary claim will succeed if there is a proprietary base because the assets being claimed were originally beneficially owned by the claimant, or they are directly derived from assets, a right, or an opportunity, beneficially owned by the claimant. Whilst the core of this principle is clear, the full extent of it is not.

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[42] Named after *Pallant v Morgan* [1953] Ch 43.
[43] [2000] Ch 372.
[44] [2008] UKHL 55.
[45] [2011] EWACA Civ 1619 at 120-122 and 128-130.
[46] [2007] 2 AC 432 at 40-46.
[47] [2011] UKSC 53 at 25, 56, 57, 61 and 78.
[48] [2011] EWCA Civ 1619 at 85.

(5) Opportunities as property

It is uncontroversial to suggest that assets can be followed in their original form, or traced into their exchange product.[49] However, the concept that an opportunity can be beneficially owned is difficult.[50] Not least among the obstacles to accepting that opportunities can be property is the very clearly expressed view of Lord Wilberforce in the House of Lords in *National Provincial Bank v Ainsworth*:[51]

> "Before a right or an interest can be admitted into the category of property, or of a right affecting property, it must be definable, identifiable by third parties, capable in its nature of assumption by third parties and have some degree of permanence or stability."

These are not characteristics naturally associated with opportunities, which will frequently be vague and undefined, and transient in character.

Opportunities can arise from a wide range of circumstances. At one end of the spectrum, it is easiest to conceive of an opportunity "belonging" to someone when it has arisen through the development of a new product or process through investment in research and development, particularly if this leads to intellectual property capable of formal legal protection such as copyright or the grant of a patent. However, if the logic of giving a proprietary remedy to the principal wishing to recover gains made by a fiduciary from the abuse of such an opportunity is that there is proprietary base for these gains, then surely the principal should equally be able to exercise proprietary remedies against anyone else who knowingly breaches the intellectual property rights of the principal by making a personal profit from the use of a patent or copyright material.

Whilst there is no reason in logic or in principle why intangible property cannot be followed or traced,[52] giving a proprietary remedy permitting the direct restoration of stolen or misappropriated intellectual property or the restitution of its direct substitute is a long way from accepting that there can be a proprietary interest in funds generated through the use of ideas protected by intellectual property legislation, and even less so where the opportunity is

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[49] See Pearce "A tracing paper" [1976] 40 Conv (ns) 277.

[50] See Tang Hand Wu "Confidence and the constructive trust" (2003) 23 Legal Studies 135 at 147.

[51] [1965] AC 1175 at1247-8.

[52] See *Armstrong DLW GmbH v Winnington Networks Ltd* [2012] EWHC 10 where Stephen Morris QC, sitting as a deputy High Court Judge, allowed proprietary claims to succeed in respect of misappropriated European Union Allowances (tradeable carbon emission allowances).

not so protected. This may be better demonstrated by an analogy. If I steal watercolours painted by and belonging to the Prince of Wales, I can be compelled to return them, or to give up the proceeds I receive if I sell them. There will be proprietary remedies in both cases because the claim is to the original property or its exchange product. However, if I put the paintings on display and make a charge for people to view them, whilst I am almost certainly accountable for the profits I make (and I certainly will be where I acquired the paintings through the breach of an existing fiduciary duty), the remedy in respect of these profits is personal only since the profits do not represent the original property or its exchange product.[53] It should make no difference where the property is intangible (such as copyright material) rather than tangible (such as the paintings).

The case for arguing that the principal is the beneficial owner of an opportunity is much weaker in most other contexts. Many opportunities arise from the identification of a gap in the market, using information which is publicly available. It is hard to conceive of such opportunities belonging to anyone, even if they are identified by an employee or company director in a fiduciary position, perhaps with a responsibility to identify and exploit such opportunities. The case for giving the principal a proprietary remedy against a fiduciary wrongfully exploiting this kind of opportunity appears to be even weaker than that for giving a proprietary remedy to recover a bribe where it will frequently be the case (as in *Lister v Stubbs*) that the whole purpose of the payment of the bribe was to save at least an equivalent sum in what would otherwise have been paid to the principal.[54] In *Cadogan Petroleum*[55] counsel argued that bribe cases could be treated as examples of opportunities beneficially owned by the claimant since a bribe or secret commission would result in a reduction in the price otherwise payable to the claimant by at least as much as the amount of the bribe. Newey J was correctly not persuaded.[56] Even where the opportunity to make a personal gain arises from a specific approach suggesting a profitable business venture being made to the principal through the fiduciary,[57] the real wrong done to the principal is the disloyalty of the fiduciary rather than the use of an asset which the principal owns.

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[53] The profits so made are not materially different from the profits made by the public house manager in *A-G's Reference (No. 1 of 1985)* [1986] QB 491.

[54] A bribe will not invariably confer a financial advantage, as in *Reid,* where the favour being sought was the perversion of a process.

[55] [2011] EWHC 2286.

[56] Ibid at 30.

[57] Or where the fiduciary acquires information through his position, as in *Boardman v Phipps.*

There are cases (reviewed by Lewison J in *Ultraframe (UK) Ltd v Fielding*)[58] in which maturing business opportunities have been treated as "corporate property" so that directors cannot exploit them for their own benefit even after ceasing to be employed by the company, and if they do will be subject to a "constructive trust". However, it does not follow from the use of the phrase constructive trust that a proprietary liability is imposed, and Lewison J in his careful review expressed the opinion that a company's profits cannot be the subject of tracing or following.[59] Since Lewison J links his review of the cases on corporate opportunities to the inability to trace into profits (which are not assets) it would appear to be his view that notwithstanding suggestions that corporate opportunities can be corporate property, this is merely a convenient description for opportunities in respect of which the company can assert rights, and that it does not follow from this description that there will be a proprietary remedy to recover any profits made by the exploitation of those opportunities, even if there may be a personal obligation to account. In any event, the cases also require review in the light of the criticism made in the *Versailles* case of the attempt in *Reid* to push out the boundaries of proprietary remedies.

(6) Why seek a proprietary remedy?

There are three main occasions when a claimant will seek to pursue a proprietary claim. The most usual is because the fiduciary is insolvent, as a proprietary claim will confer priority over the other creditors. Great care has to be taken in limiting the bounds of proprietary claims within proper limits lest there be an unfair impact upon the creditors.[60] In the *Versailles* case Mr Cushnie's frauds had made him appear extremely wealthy, and many people may have extended credit to him in the belief that his apparent wealth made him a good risk. The effects of the fraud impacted on a wide range of people. Can it convincingly be said that the "investors" in TPL were really any worse impacted than the investors who bought VGP shares at grossly inflated prices? Both were victims of exactly the same dishonest dealings. There is some authority which suggests that the victim of a fraudulent transaction may be able to obtain rescission and thereby restore equitable title to the extent

[58] [2005] EWHC 1638 at 1332-1355.

[59] Ibid at [1470] to 1475.

[60] See Allen "Bribes and Constructive Trusts: A-G of Hong Kong v Reid" (1995) 58 MLR 87 and also Lord Neuberger's criticism of the *Reid* decision in *Versailles* [2011] EWCA Civ 347at 83.

necessary to support an equitable tracing claim.[61] This might have allowed the investors who purchased shares in VGP to establish proprietary claims to the sums which they paid for the shares. Giving these investors a proprietary claim might help to redress the balance in their favour, but it would have the effect of further disadvantaging other creditors unable to establish a proprietary interest. There will therefore in due course need to be an evaluation of this line of authority.

The second reason for making a proprietary claim is to enable the claimant to follow or trace an asset into the hands of a third party recipient of funds. This appears to have been a significant factor in the *Reid* case, where the funds which Reid had obtained through bribes had been "laundered" and invested in properties in New Zealand. In many large scale frauds, funds will have been laundered and dispersed, but creating a proprietary claim is against principle and as Lord Neuberger points out, is capable of having unfair consequences on other creditors.[62]

Finally, a proprietary claim will be sought when an asset acquired using dishonestly or improperly generated funds has increased in value. *Foskett v McKeown* makes it clear that where a beneficiary's funds can be traced into an asset which has increased in value, or otherwise generates assets greater than those used to acquire it, the beneficiary can make a claim to a proportionate share and is not restricted to a charge for a sum equal to the beneficiary's loss. In *Lister & Co v Stubbs* the Court of Appeal viewed with equanimity the possibility of a dishonest fiduciary retaining profits made with the funds improperly acquired (see above). Most observers would be less content for a wrongdoer to be able to benefit in this way. But Lord Neuberger points out[63] that it would be possible for equitable account to be used to deprive a wrongdoer of such gains. Equitable account is a tool of potentially very great flexibility, and provided that there is a debt due, as there very clearly is where a fiduciary has abused his or her position and thereby obtained an authorised profit or payment, there appears to be no reason of principle why equitable account could not be used to quantify both direct and indirect gains made by the fiduciary, although this would undoubtedly require development of the law beyond the limits clearly expressed in *Lister & Co v Stubbs.*

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[61] See *El Ajou v Dollar Land Holdings* [1993] 3 All ER 717 at 734d*; Shalson v Russo* [2003] EWHC 1637 at 120-127*; Re Stanford International Bank Ltd* [2012] EW Misc1 (Central Criminal Court) at 98.

[62] [2011] EWCA Civ 347 at 83.

[63] [2011] EWCA Civ 347 at 46 and 79.

CONCLUSION

The rejection of *Reid* and the outcome in the *Versailles* case is welcome. Although the *Versailles* case has already been applied without criticism at first instance,[64] inevitably a considerable measure of uncertainty will remain until the Supreme Court is able to review the law in this area. The Court of Appeal in *Versailles* could have avoided considering *Reid* and the other bribe cases. The taking of a bribe from a third party by a fiduciary and making a profit from it is very different from the taking of a beneficiary's money and using it in such a way that it ultimately increases the value of assets already owned by the fiduciary. Lord Neuberger himself said that there "was undoubtedly a close commercial causal connection between Mr Cushnie's misuse of the funds in which he owed fiduciary duties to TPL, and the money which he made on the sale of the Shares".[65] But because this was not a case where the claimants were purporting to follow their assets into the profits, the court was prepared to equate it to bribe cases inasmuch as in both instances the receipt of the money by the fiduciary derived from his breach of fiduciary duties. This seems to be casting the net very widely. The refusal to follow *Reid* was not inevitable: the law abounds with instances where a decision of the Privy Council has changed English law. The decision to prefer *Lister & Co v Stubbs,* whilst justified on the detailed reasoning in this case, also reflects a policy decision to limit the scope of proprietary remedies, and endorses the view that the normal remedy for a breach of fiduciary duty is a personal remedy only.

The suggestion – albeit with a number of caveats – that equitable account could be used to deprive a fiduciary of profits made through the investment or other use of misappropriated funds certainly merits further exploration. Lord Neuberger recognised that existing authority does not create a strong basis for such an extension, and indeed *Lister & Co v Stubbs* contains unambiguous remarks which are inconsistent with this use of equitable accounting. Nonetheless, to deprive the fiduciary of profits derived from exploiting the proceeds of his misdeeds, prevents the scandal of a dishonest fiduciary profiting from his wrongdoing, and could be considered to have a prophylactic effect by creating an environment in which false fiduciary will have the worst of both worlds – being obliged to cover any loss which the fiduciary's actions have occasioned, but never being able to retain a profit, even one made indirectly. To do this by way of equitable account is certainly far more satisfactory than engineering a proprietary right to achieve the same result.

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[64] *Cadogan Petroleum plc v Tolley* [2011] EWHC 2286; *Page v Hewetts Solicitors* [2011] EWHC 2449.
[65] At 51.