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UK SUPREME COURT RULING ASSISTS INNOCENT PARTIES IN RECOVERING BRIBES OR SECRET COMMISSIONS PAID TO THEIR AGENTS

Bribes and secret commissions are "*objectionable as they inevitably tend to undermine trust in the commercial world... [a]ccordingly, 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.*" Lord Neuberger, delivering the judgement of the court.

It has long been understood that principals have a right to recover bribes or secret commissions improperly paid to agents, but there has been uncertainty over whether these sums are held on constructive trust. In *FHR European Ventures LLP and others v Cedar Capital Partners LLC*, the UK Supreme Court finally settled this issue, ruling that such payments are held on constructive trust, thereby making it easier for principals to trace and recover bribes or secret commissions and ranking principals ahead of other creditors on an agent's insolvency.

Background

In late 2004, FHR European Ventures LLP ("FHR") purchased the corporate entity that owned the Monte Carlo Grande Hotel from the vendor, Monte Carlo Grand Hotel Limited ("MCG"). Cedar Capital Partners LLC ("Cedar") acted as FHR's agent in the negotiations. Unbeknownst to FHR, Cedar also had an agreement with MCG, whereby MCG paid €10 million to Cedar upon completion of the sale. After discovering the existence of the €10 million commission paid to Cedar, FHR began proceedings seeking payment of this sum.

At first instance, the High Court[1] ruled that: (i) Cedar had not properly declared the €10 million payment to FHR; (ii) Cedar had breached its fiduciary duties to FHR; (iii) Cedar should pay the sum to FHR; but (iv) the sum was not held in constructive trust for FHR. FHR appealed point (iv), and the Court of Appeal ruled[2] in favour of FHR, that the sum was held in a constructive trust. Cedar appealed this finding to the Supreme Court.

The Supreme Court Judgment

In its unanimous judgment,[3] the Supreme Court began by setting out some uncontroversial, but important, principles: first, an agent owes fiduciary duties to its principal, because the agent has agreed to act in a particular matter which gives rise to a relationship of trust and confidence; second, as a result of this duty, the agent must not "make a profit out of his trust"; and third, a fiduciary that "acts for two principals with potentially conflicting interests without the informed consent of both is in breach of its obligation of undivided loyalty." A further fundamental principle is that an agent, who receives a benefit in breach of his fiduciary duty, must account to the principal for the benefit.

[1] [2011] EWHC 2308 (Ch) and [2011] EWHC 2999 (Ch).
[2] [2013] EWCA Civ 17.
[3] [2014] UKSC 45.

The issue in this case was whether a bribe or secret commission received by an agent is held 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 secret commission.

Cedar argued that whether a benefit improperly obtained by an agent is held on trust for the principal depends on the circumstances. Where the benefit is derived from assets which are or should be the property of the principal, or where the benefit was intended for the principal, the benefit would be the "property" of the principal and therefore held on trust. In contrast, Cedar argued, a bribe or secret commission paid to an agent cannot properly be said to be the property of the principal. Cedar's arguments were supported by some prior caselaw and academic opinion.

The Supreme Court found that the relevant preceding caselaw (which spanned a period of over 200 years) was irreconcilable, and that it was "not possible to identify any plainly right or wrong answer" on this issue. The Supreme Court proceeded to consider arguments based on principle, practicality and public policy, and cited considerations, including the following, in support of its judgment:

- The law would be simpler and more consistent if bribes and secret commissions -- consistent with other benefits derived from the principal's property -- were held on trust;
- Cedar's argument that the bribe it received was not "derived" from FHR's assets and/or was not intended to go to the principal, was unattractive as "there must be a strong possibility that the bribe has disadvantaged the principal" and it was "quite likely" that had MCG not paid the bribe, the purchase price paid to MCG would have been €10 million lower, to FHR's benefit;
- It seemed improper that on payment of a bribe, a principal should be left without a proprietary remedy -- and therefore be disadvantaged -- whereas, a less serious breach of fiduciary duty by an agent could result in a proprietary remedy; and
- Finally, attitudes had changed since the precursor cases were decided, and there had never been greater concern as to the pernicious effects of bribery and corruption, as evidenced by the OECD Convention on Combatting Bribery of Foreign Public Officials in International Transactions 1999, the United Nations Convention against Corruption 2003, and the UK Bribery Act 2010. In this context, the law should be expected to be "particularly stringent" against agents that receive bribes or secret commissions.

The Supreme Court concluded that bribes and secret commissions paid to agents <u>are</u> held on trust for the principal, and in doing so overruled the prior contradictory cases, and finally settled this long-standing controversy.

Practical effects

Agency relationships can arise in a broad variety of circumstances, from professional advisors, who are retained to assist their principal, to directors, who are agents of their companies. This judgment will therefore impact a very wide range of scenarios in which bribes could be paid.

Having a proprietary interest in bribes or secret commissions makes it significantly easier for principals to recover. First, the principal will rank ahead of other creditors should the agent become insolvent. This is an important benefit in fraud cases, where the wrongdoers frequently face insolvency. Second, the principal will be entitled to 'equitable tracing', which can assist when an agent no longer holds the precise cash bribe received. The application of tracing depends upon the facts of each case, but, where available, the claimant can elect to follow the original sum into the hands of a third party, or to trace the value of the sum into the asset that the agent purchased with the bribe. Tracing has its limitations, and cannot be used to recover assets from a bona fide third party that received the asset without notice.

The Supreme Court ruling will increase the likelihood of principals recovering bribes paid to agents in breach of duty, and is a welcome clarification to this important area of law.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our dispute resolution practice group:

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