



Concentrate Questions and Answers Equity and Trusts: Law Q&A Revision and Study Guide (3rd edn)

Rosalind Malcolm

p. 125 9. Constructive Trusts

Rosalind Malcolm, Barrister, Professor of Law, University of Surrey

<https://doi.org/10.1093/he/9780198853213.003.0009>

Published in print: 06 August 2020

Published online: September 2020

Abstract

The Concentrate Questions and Answers series offer the best preparation for tackling exam questions. Each book includes typical questions, bullet-pointed answer plans, suggested answers, and author commentary. This book offers advice on what to expect in exams and how best to prepare. This chapter covers questions on constructive trusts.

Keywords: constructive trusts, resulting trusts, mutual wills, secret trusts, fiduciary liability, fiduciary duty, liability, third party, breach of trust

Are You Ready?

In order to attempt the questions in this chapter you will need to have covered the following topics:

- Definition of constructive trust
- Substantive and remedial constructive trusts
- Accessory and recipient liability
- Fully-secret and half-secret trusts
- Mutual wills

Key Debates

Debate: liability of agents and other third parties who assist in a breach of trust or who receive trust property in breach of trust.

The issue of dishonesty in cases of ‘knowing’ or ‘dishonest’ assistance in a breach of trust keeps cropping up and case after case keeps trying to resolve the matter. *Twinsectra Ltd v Yardley* [2002] 2 AC 164, *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, *Ivey v Genting Casinos UK Ltd (t/a Crockfords Club)* [2017] UKSC 67, and now *Group Seven Ltd v Notable Services LLP* [2019] EWCA Civ 614 have all tackled this vexed question. For an interesting short piece on whether this does conclude the argument, see Dixon (2019) (‘Taking Things Further’).

p. 126

Question 1

English law provides no clear and all embracing definition of a constructive trust. Its boundaries have been left perhaps deliberately vague ...

(Edmund Davies LJ in *Carl Zeiss Stiftung v Herbert Smith & Co. (a firm)* (No. 2) [1969] 2 Ch 276)

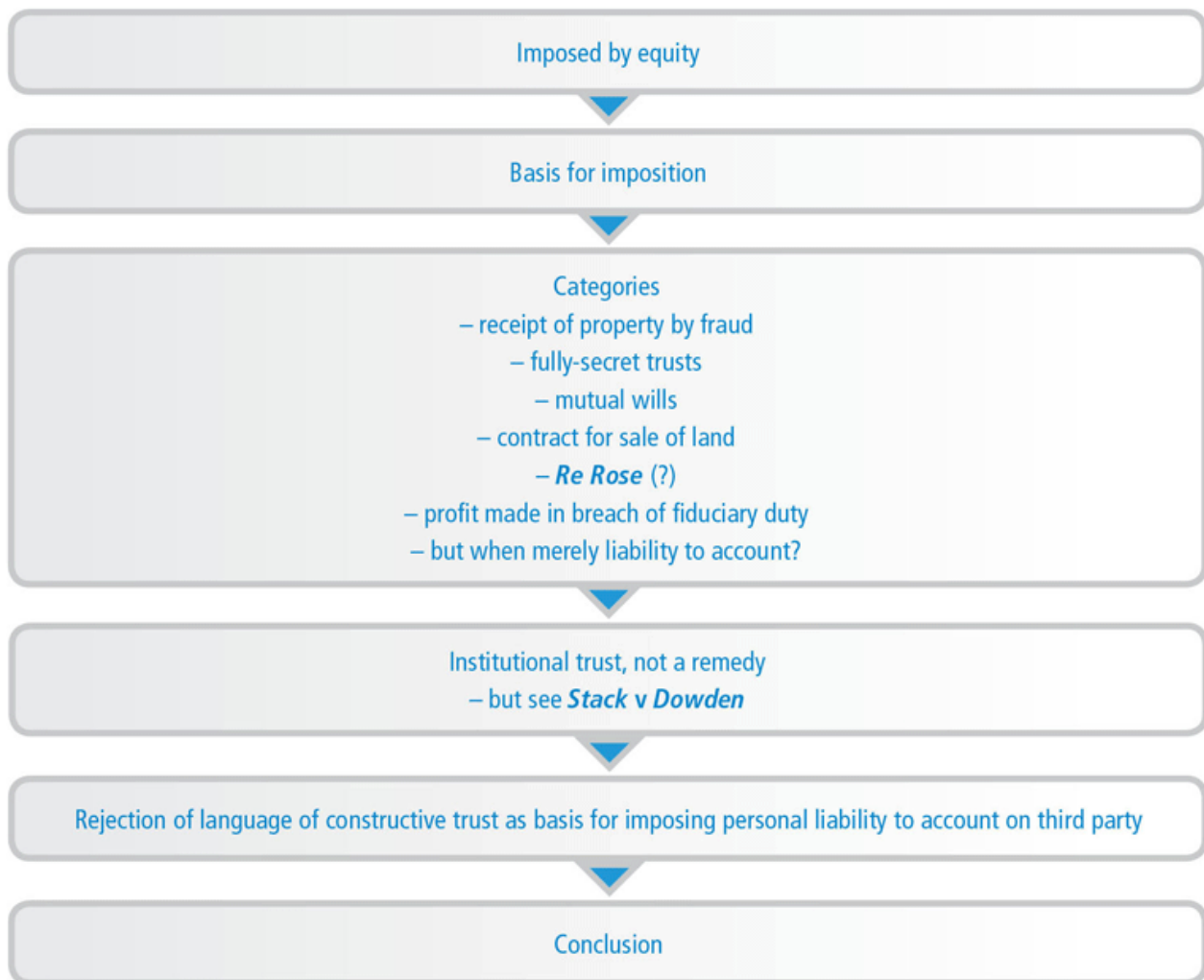
Discuss with reference to decided cases.

Caution!

■ This is a general essay question on the nature of constructive trusts—the sort of question for which you might achieve a pass if you had not actually revised constructive trusts too specifically but had a general overall knowledge of the subject. However, to do well on it, you would need to have a good knowledge of the cases and of recent developments.

■ Remember, however, that no matter how similar two essay questions may be, you should always slant your answer to the particular question asked. The material in this essay answer might well be adapted to similar essays on constructive trusts, such as a discussion of Lord Denning’s statement in *Hussey v Palmer* [1972] 1 WLR 1286, CA, that ‘a constructive trust is one imposed by equity whenever justice and good conscience require it’ but then you would need to get the angle right for the particular essay topic.

Diagram Answer Plan



Suggested Answer

A constructive trust is one imposed by equity on a person in whom the legal title to property is vested.¹ It has the effect of divesting such person of the whole, or part, of the equitable beneficial interest which they then hold as trustee for someone else. The underlying rationale for the imposition of most constructive trusts is the unjust enrichment of the legal owner that would result if he were allowed to retain the whole of the beneficial interest, and a constructive trust usually involves some fraudulent behaviour on the part of the legal owner. This is the application of a very general equitable principle and it is hardly surprising that the circumstances in which the courts have been prepared to

impose a constructive trust are wide and varied. Moreover, it is an ever-evolving area of equity where the courts are constantly redefining and reviewing the principles on which a constructive trust will be imposed in new cases, often applying the maxims of equity to do so.

¹ First paragraph sets the scene by outlining the basics, i.e. imposed by equity and basis in equity.

There are several well-established categories of constructive trusts.² These include where the defendant has obtained property by fraud, and where a third party receives and holds property in breach of a trust or fiduciary obligation with notice of the breach. Other, less certain, classifications are fully-secret trusts (whereas half-secret trusts appear to be express trusts: *Re Baillie (1886) 2 TLR 660*) and mutual wills (if not treated as implied trusts). A specifically enforceable contract for sale (such as a contract for the sale of land) is also considered to give rise to a constructive trust: *Lysaght v Edwards (1876) 2 Ch D 499*. The trust that arises under the doctrine of *Re Rose [1952] Ch 499, CA* has sometimes been treated as constructive (e.g. in *Pennington v Waine [2002] 1 WLR 2075* at p. 2091 (Arden LJ)), but, as such a trust is intended to give effect to the donor's intention, it might be better classified as implied.

² Now introduce the categories of CTs.

p. 128

↵ A constructive trust will also arise where a fiduciary has made an unauthorised profit from his position as fiduciary. In *FHR European Ventures LLP v Cedar Capital Partners LLC [2014] UKSC 45*, the Supreme Court held that the fiduciary held all unauthorised benefits including bribes and secret profits received from a third party on a constructive trust.

In *Hussey v Palmer [1972] 1 WLR 1286, CA*, Lord Denning MR treated a constructive trust as a remedy 'imposed by law whenever justice and good conscience require it'. However, whilst in the USA a constructive trust is a remedy based on unjust enrichment,³ the approach of the English courts has generally been to treat the constructive trust as a substantive institution that arises at the date the defendant receives the property, so that the court, in holding there to be a constructive trust is not imposing the trust, but merely declaring that a trust already exists. The English courts have also been generally wary of treating such a vague concept as 'good conscience' as a basis for a constructive trust. Thus in *Cowcher v Cowcher [1972] 1 WLR 425* at p. 429, Bagnall J stated that rights of property are not to be determined according to what is 'reasonable and fair or just in all the circumstances', but (at p. 430) on 'sure and settled principles', as otherwise 'no lawyer could safely advise on his client's title and every quarrel would lead to a law suit'. Lord Millett was of a similar opinion in *Foskett v McKeown [2001] 1 AC 102* at p. 127.

³ This shows knowledge of the ‘unjust enrichment’ debate and the differing national approaches.

Some individual judges have been prepared to recognise the introduction of the remedial constructive trust,⁴ notably Lord Browne-Wilkinson in *Westdeutsche Landesbank Girocentrale v Islington LBC* [1996] AC 669, at p. 716, and Lord Scott in *Thorner v Major* [2009] 1 WLR 776. Indeed, in *Re Basham* [1986] 1 WLR 1498, a case on proprietary estoppel, the judge satisfied the equity by awarding a constructive trust as a remedy. This is, however, a minority view. English courts are generally concerned that a remedial constructive trust could affect third parties or a bankrupt defendant’s creditors, and have repeatedly stated explicitly that English law does not recognise the remedial constructive trust: *Halifax Building Society v Thomas* [1996] Ch 217, CA; *Re Polly Peck International plc* [1998] 3 All ER 812, CA.

⁴ This develops the unjust enrichment debate.

Some decisions, however, can be more easily explained through the remedial constructive trust. Thus, where the parties have made mutual wills, the imposition of the trust on the death of the first to die seems generally to be treated as remedial in nature, since the court is usually dealing only with whatever property the survivor retains at his own death, as in *Olins v Walters* [2009] Ch 212, CA. The ‘suspensory trust’ mentioned in *Ottaway v Norman* [1972] 1 Ch 698 at p. 713, looks like an attempt to fit into an institutional framework that which might be better explained as a remedial constructive trust. Etherton J, writing extrajudicially, considered that the decision of the House of Lords in *Stack v Dowden* [2007] 2 AC 432, although not expressed to be based on a remedial constructive trust, looks very much like it: [2009] Conv 104. The House of Lords in *Stack* indicated that, in a domestic consumer context, where the legal title to the family home is in joint names but without any declaration of the beneficial interests, there is a strong presumption that the legal owners are also joint tenants in equity. Lady Hale noted, however, a variety of factors that might indicate what the parties intended other than an equitable joint tenancy. The House of Lords in that case seems, as the dissenting judge, Lord Neuberger, indicated, to be moving away from property law into the area of judicial reallocation of property rights—which would be incompatible with the House of Lords’ earlier decisions in *Pettitt v Pettitt* [1970] AC 777 and *Gissing v Gissing* [1971] AC 886. The majority in *Stack* sought to avoid such heresy by placing reliance on the parties’ intentions, but, unconvincingly, they blurred the distinction between an ‘inferred’ and an ‘imputed’ intention. In the Supreme Court in *Jones v Kernott* [2012] 1 AC 776, Lady Hale and Lord Walker, who had been in the majority in *Stack*, not surprisingly adhered to their earlier views. The notion that the size of the beneficial interests might vary after acquisition (as they clearly had in *Kernott*) might nevertheless still be squared with the notion of an institutional constructive trust if the trust could have been

treated as ‘ambulatory’ in character, the size of the parties’ respective beneficial shares varying from the moment that the equitable joint tenant was severed until the date of judgment: *Stack v Dowden*, at para. 62; *Jones v Kernott*, at para. 14.

In the past, the language of constructive trust was often used when imposing personal liability on a third party who either assisted in a breach of trust, or who received trust property in breach of trust. Where equity imposed liability upon such persons, it usually did so by holding them ‘liable to account as constructive trustees’, as for instance in *Barnes v Addy* (1874) LR 9 Ch App 244. The problem with this terminology, however, was that it suggested that the defendant was holding property on trust, whereas a defendant who merely assisted in a breach of trust might never have received any trust property at any stage, and even a defendant who had received trust property might have meanwhile disposed of it. In *Paragon Finance plc v D. B. Thakerar & Co.* [1999] 1 All ER 400, at pp. 408–409, Millett LJ pointed out the different situations involved when using the expressions ‘constructive trust’ and ‘constructive trustee’. ↵ It seems that equity might have attached the appellation ‘constructive trustee’ to a defendant who had never received trust property both because the language of trust came naturally to the Court of Chancery and because of some uncertainty whether a personal action would lie in equity against someone other than a trustee. There was, however, no underlying trust, and the expression was ‘nothing more than a formula for equitable relief’ (*Selangor United Rubber Estates Ltd v Cradock (No. 3)* [1968] 1 WLR 1555, at p. 1582, per Ungood-Thomas J).⁵

⁵ For extra marks you could include here some of the secondary literature—see the ‘Looking for Extra Marks?’ section for details.

In *Dubai Aluminium Co. Ltd v Salaam* [2003] 2 AC 366 at para. 142, Lord Millett said that the reference to the constructive trust in such cases creates a trap; he suggested that the courts should now discard the words ‘accountable as a constructive trustee’ in this context and substitute the words ‘accountable in equity’.

Persons who purport to act as trustees without having been appointed have traditionally been called trustees *de son tort*. Such persons can appropriately be considered to be holding the property on trust, and whilst they have sometimes been called constructive trustees (e.g. in *Mara v Browne* [1896] 1 Ch 199), their liability to the beneficiaries is the same as if they were express trustees. In the *Dubai Aluminium* case, at para. 138, Lord Millett said that it might now be preferable to term such persons *de facto* trustees.

It is clear from the widely differing situations in which a constructive trust has been applied that it is a versatile and flexible weapon of equity, capable of apparently unlimited adaptability to changing social and commercial circumstances. It justifies the statement by Lord Denning MR in *Eves v Eves* [1975] 1 WLR 1338 that 'Equity is not past the age of childbearing'. However, its adaptability necessarily requires that its boundaries should not be too rigidly defined.⁶

⁶ A summarising conclusion referring directly back to the quotation in the question. Make sure you get this link back to show you haven't lost sight of the question in all the discussion.

Looking For Extra Marks?

- There is widespread academic literature on the issue of knowing or dishonest receipt and assistance and you could include here for extra marks an analysis of the arguments presented by R. Chambers, 'The end of knowing receipt' (2016) 2(1) Canadian Journal of Comparative and Contemporary Law 1. This article is wide-ranging and deals with a number of the arguments around this contemporary debate considering whether the situation amounts to a breach of trust, a constructive trust, or unjust enrichment. It introduces much of the earlier literature and would repay careful study on this particular topic. And in that vein, the decision in *Ivey v Genting Casinos* [2017] UKSC 67 might also be another fruitful avenue for inclusion in this answer (especially if coursework).
- You could also deal with the national differences in their judicial approach to the remedial constructive approach, i.e. the difference between the USA's approach and that in the UK as outlined in the answer above.

p. 131

Question 2

Alf is a trustee of the Beta Trust which has a 30 per cent shareholding in Gamma Ltd, a pharmaceutical company developing a new drug to stimulate memory, primarily for students taking examinations. In his position as trustee, Alf learned that tests on the drug were indicative of a successful outcome, and he therefore purchased a 25 per cent shareholding in the company himself. He was subsequently elected as a director of the company and has received considerable sums in director's fees.

Shortly after Alf became a director, the company's lease on its factory premises expired and its landlord wanted to sell the reversion for £100,000. The company could not afford this, so Alf and the company's solicitor, Delta, put up £50,000 each and purchased the reversion themselves jointly. They then granted a new lease to the company at a lower rent than under the previous lease.

The company were also interested in a new drug for improving concentration which had been patented. It was agreed between Alf and Delta that Alf would negotiate to buy the patent and, if successful, would receive for his efforts 1 per cent of the purchase price. He negotiated a purchase for £20,000.

Alf began to have doubts about the company's future and decided to sell his shareholding and retire from the directorship. Having retired as a trustee from the Beta Trust six months previously, he sold his shares in Gamma Ltd to the trust for £5,000 below the market value.

The new drugs which the company were developing have recently failed pharmaceutical tests and the company's shares are now almost worthless.

Alf and Delta have received an offer of £150,000 for the freehold of the factory premises and would like to sell it.

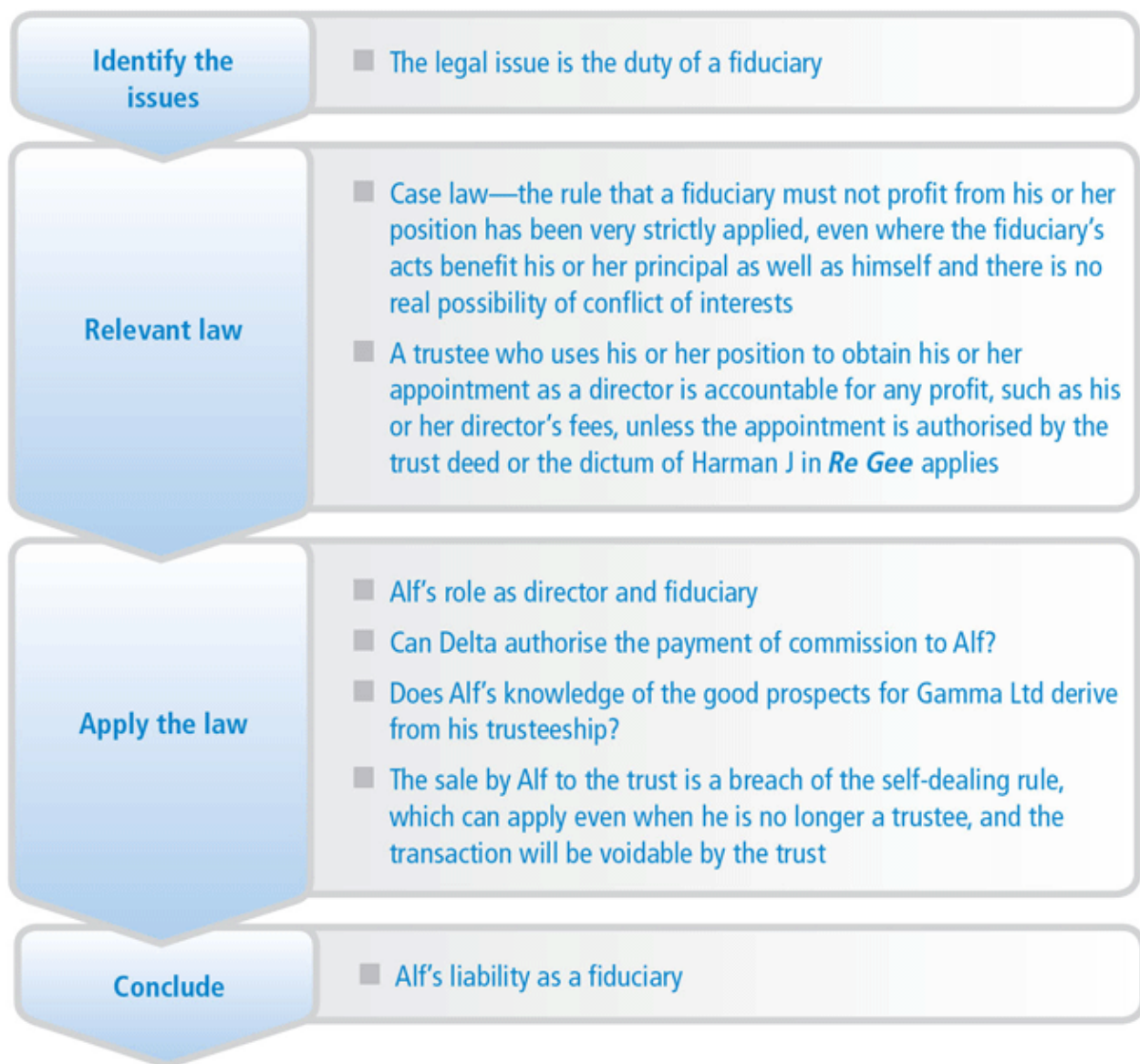
Discuss Alf's liability as a fiduciary in the various circumstances.

Caution!

■ This is a long question involving different fiduciary relationships and different breaches of fiduciary duties. It is the type of question which you should therefore spend some time thinking through, jotting down different points and any relevant cases before embarking on the answer. The risk is, if you do not do this, that you will get to the end and find that there are some points or cases which you have omitted.

■ The question is wide in its scope and requires a fair knowledge of the subject to produce a reasonable answer.

Diagram Answer Plan



p. 132

Suggested Answer

Equity has consistently demonstrated a harsh attitude to the rule that a fiduciary may not benefit from his position.¹ The rule has been applied even where there is no conflict of interest between the fiduciary and the principal and no evidence of an actual consequent injury to the principal. Indeed, in the House of Lords' case of *Boardman v Phipps* [1967] 2 AC 46, the trust, as well as the fiduciary, benefited from the fiduciary's activities, but the strict accountability rule was nevertheless applied.

Even in these circumstances, a fiduciary will still be accountable for a profit derived from his fiduciary relationship. The only modification of this strict approach is the Privy Council case of *Queensland Mines Ltd v Hudson* (1978) 18 ALR 1, which appears to be a decision on the particular merits of the case.

¹ Introduction to the position of fiduciaries and the relevant law.

p. 133

Moreover, a fiduciary relationship is broadly defined and is not restricted to trustee and beneficiary. A director is in a fiduciary position to his company, an agent to his principal, and an employee may also be in a fiduciary relationship to his employer (*Agip (Africa) Ltd v Jackson* [1991] Ch 547, CA) although this depends on the nature of the work and the terms of the employment contract (*Nottingham University v Fischel* [2000] IRLR 471). In *Reading v A-G* [1951] AC 507, it was held that an army officer was in a fiduciary position to the Crown.

A trustee who uses his position to appoint himself as a director of a company is prima facie accountable to the trust for any remuneration he receives as a director: *Re Macadam* [1946] Ch 73. In order to be able to keep his director's fees, Alf would have to show² that his appointment as a director would have been made even if the votes attaching to the trust's shares had been used against him (per Harman J in *Re Gee* [1948] Ch 284). So if Alf can show that he would still have been elected as a director, notwithstanding that the voting rights of the Beta Trust's shares had been used to vote against him, then he will be able to keep his director's fees. Otherwise, he will be prima facie accountable to the Trust for them. He would also be able to retain his director's fees if authorised in the trust instrument: *Re Llewellyn* [1949] Ch 225.

² Application of law to problem starts here.

If the trust property includes a lease, a trustee to whom the lease is renewed (*Keech v Sandford* (1726) Sel Cas Ch 61), or who purchases a reversion on the lease (*Protheroe v Protheroe* [1968] 1 WLR 519, CA), will become a constructive trustee of the lease or reversion for the beneficiaries. In *Protheroe*, a husband and wife were co-owners of a leasehold interest in their matrimonial home. They separated and the husband subsequently purchased the reversion on the lease. It was held that this became trust property in which his wife also had an interest. As a director of Gamma Ltd, Alf is in a fiduciary position to the company and would therefore hold one-half of the reversion on the lease as a constructive trustee for the company. He would similarly be accountable for one-half of any profit made on its sale. It is irrelevant that the company itself could not have purchased the reversion, or that the company itself benefited from the transaction. In *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378, HL, directors purchased shares, which the company could not afford to purchase, in order to enable the company to take a lease of a cinema and subsequently to sell it with other property owned

by the company at a profit. They were nevertheless held accountable for their profits as they had acquired their shares through their fiduciary position. Delta, as the company's solicitor, would also be in a fiduciary position and similarly accountable.

4 In *Guinness plc v Saunders* [1990] 2 AC 663, a director who received an unauthorised fee of 0.2 per cent of the value of a takeover bid was held by the House of Lords to be a constructive trustee of this for the company. Neither was he able to claim payment for his services on a *quantum meruit* as he had created a conflict of interest between himself (in whose interest it was to pay a high price) and the company.³ Assuming that Delta was not authorised to award director's remuneration, the agreement between Delta and Alf would not be binding on the company, and any commission would be a profit derived from Alf's fiduciary position as a director.⁴ He would therefore not be able to claim any such commission. As in *Guinness plc v Saunders*, any such agreement would also create a conflict of interest between Alf and the company in that Alf has an interest in purchasing for a high price and the company in purchasing for a low price. He would similarly not have any claim for work undertaken in this connection on a *quantum meruit*.

³ This exposition of the law introduces the next point of application.

⁴ Application of law to problem.

The case of *Boardman v Phipps* [1967] 2 AC 46, HL, indicates that a trustee or fiduciary who uses information obtained as a result of his fiduciary position to make a profit will be a constructive trustee of that profit for the trust. If Alf's knowledge were the reason for his acquisition of his 25 per cent shareholding and this resulted in profits, he might be accountable for these. If it could be shown that Alf had serious doubts about the company's future when he sold the shares to the Trust, this would amount to a breach of his fiduciary duty and he might be made liable for the subsequent loss to the Trust.

The rule in *Ex parte Lacey* (1802) 6 Ves 625, which is strictly applied, precludes a trustee from purchasing trust property, and this applies even after a trustee has retired: *Wright v Morgan* [1926] AC 788.⁵ A trustee's liability does not necessarily cease on his retirement: he or his estate will remain liable for breaches of trust committed during his trusteeship. The rule in *Ex parte Lacey* applies to any dealing between the trustee in his personal capacity and in his capacity as trustee. In *Bentley v Craven* (1853) 18 Beav 75, it was held that an agent employed to purchase sugar for a company could not sell to the company sugar he had purchased himself, even at the market price, unless his interest was declared and accepted by the company. In that case, Romilly MR said (obiter) that the same principle would apply to other fiduciary relationships, including a dealing by a trustee with a trust. The

transaction necessarily puts the agent in a position of conflict with his principal as to price. Unless there is a full disclosure as to the agent's interest, which is accepted by the principal, the principal may either repudiate the transaction or claim any profit which the agent makes on it. It is quite possible here, therefore, that the Trust ⁵ could repudiate the sale to them and claim back the purchase price. It is irrelevant that it was an advantageous sale to the Trust at the time when it was made.

⁵ This opens the concluding point.

Looking For Extra Marks?

■ Take a look at M. Bryan, 'Boardman v Phipps: Doing Equity Inequitably', in *Landmark Cases in Equity* (C. Mitchell and P. Mitchell, eds), Hart Publishing, 2012, p. 581. This analysis of the case law could be explored for further discussion in the answer for extra marks.

Question 3

A year ago, Grab plc (Grab) appointed Edward its agent for the purpose of acquiring land that could be developed and sold at a profit. The following month, Edward agreed on behalf of Grab the purchase of land from Victoria for £910,000. Victoria secured the sale by agreeing to transfer 1,000 of her shares in Tiger Ltd to Edward upon receipt of the sale proceeds from Grab. On completion of the sale of the land to Grab, Victoria transferred the shares to Edward. At that time the shares were worth £10,000; they have since trebled in value. Edward, who did not disclose to Grab either the agreement he had with Victoria or the share transfer, recently became bankrupt.

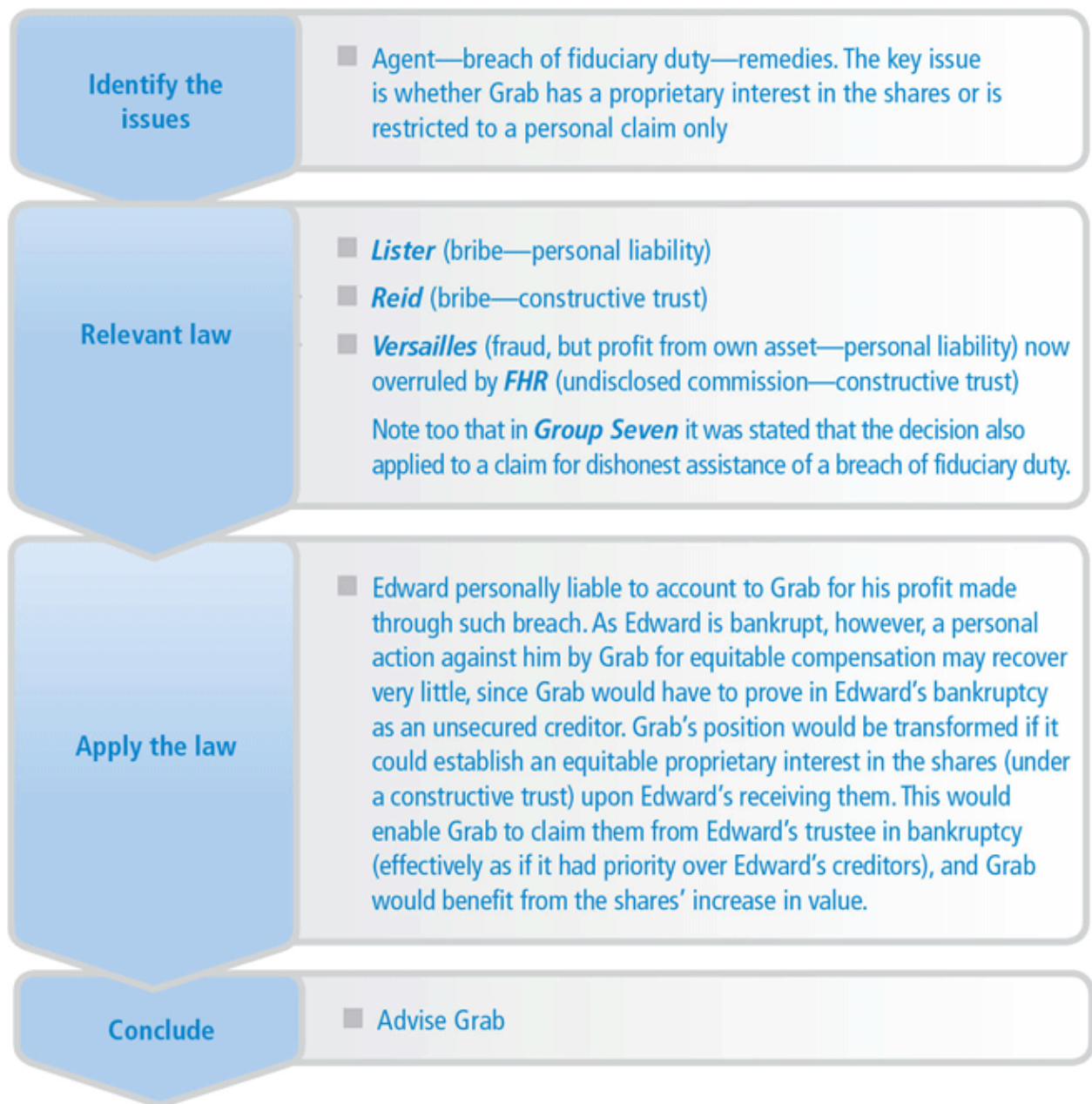
Advise Grab.

Caution!

- Some problems involve many different issues, but this one deals essentially with only one: whether an agent who makes a profit through a breach of fiduciary duty is merely accountable to the principal for the value of the profit or holds the profit on a constructive trust for the principal.
- The answer to the problem needs, first, to address the problem by identifying that issue and by explaining why, on the facts of the problem, a constructive trust has considerable advantages for the claimant.
- Secondly, there should be a discussion of the relevant principal case law. This is where, if you have read and understood the authorities and the extent to which (under our system of judicial precedent) they are binding, you will have a chance to showcase your knowledge. You should analyse the reasoning in the cases, criticising where appropriate, and should explain whether apparently conflicting cases can (or cannot) be reconciled.
- Thirdly, the case law must be applied to the particular facts of the problem. Many students do not give enough attention to this aspect of answering a problem question, yet examiners generally set great store by it. This part of the answer cannot be simply learned in advance, but the technique for dealing with it can be mastered by working through problem questions in tutorials and in past examination papers.
- Fourthly, there should be a conclusion. The conclusion should not repeat what has already been said, but should draw the threads together. The conclusion may be brief: in the suggested answer it is just a few words.
- Note that the suggested answer begins and ends with reference to the problem itself. This is a useful technique, particularly in a single-issue problem such as this, as it helps to ensure that the relevant authorities do not run away with themselves, but are seen to be mustered so as to answer the particular problem set. There are different ways to answer a problem and this is one of them which works in this sort of question.

p. 136

Diagram Answer Plan



Suggested Answer

As Grab's agent, Edward owed fiduciary duties to Grab, which he breached by taking from Victoria a commission (the shares) without disclosing to Grab either his agreement with Victoria or his receipt of the shares.¹ Edward is undoubtedly personally liable to account to Grab for his profit made through

such breach, the measure being the market value of the shares at the time they were transferred to him, i.e. £10,000. As Edward is bankrupt, however, a personal action against him by Grab for equitable compensation may recover very little, since Grab would have to prove in Edward's bankruptcy as an unsecured creditor.

¹ Start with applying the law to the problem. This works here because there is a single issue in the problem so it can be simply stated at the outset.

Grab's position would be transformed if it could establish an equitable proprietary interest in the shares (under a constructive trust) upon Edward's receiving them. This would enable Grab to claim them from Edward's trustee in bankruptcy (effectively as if it had priority over Edward's creditors), and Grab would benefit from the shares' increase in value. The key issue is therefore whether Grab has a proprietary interest in the shares or is restricted to a personal claim only.² The legal position has been subject to much litigation with the recent Supreme Court decision in *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, the latest word on the topic. The case development is lengthy and has been contentious and is set out next.

² Now state the key issue of law.

In *Lister v Stubbs* (1890) 45 ChD 1, the defendant, a purchasing agent, used a bribe he received from a purchaser to buy investments in his own name. His principal, wishing to trace into the investments, tried to stop the defendant from dealing with them. The action failed, the Court of Appeal holding that the relationship between an agent and principal is not that of trustee and beneficiary, but merely one of debtor and creditor.

In *A-G for Hong Kong v Reid* [1994] 1 AC 324, however, the Privy Council declined to follow *Lister v Stubbs*.³ Reid, a senior prosecutor in Hong Kong, had taken bribes for agreeing not to prosecute. The Attorney-General for Hong Kong sought to prevent Reid's disposing of land that he had bought with the bribe. Lord Templeman (at p. 300) referred to bribery as an evil practice that threatens civilised society. He said (at p. 331) that, in accordance with the equitable maxim that 'Equity considers as done that which ought to be done', Reid held the bribe on a constructive trust for his principal from the moment he received it. His Lordship commented (at p. 332) that to permit the fiduciary to retain the benefit of an increase in value in the land would be to permit him to profit from his breach.

³ Continue by laying out the case law.

p. 138

↪ The maxim to which Lord Templeman referred has usually been applied to a contract of sale of land, where the vendor 'ought' to do what it had agreed to do, i.e. transfer the legal estate to a purchaser who has provided valuable consideration and who is able and willing to pay the purchase monies. Lord Templeman's reliance on the maxim in this different context, however, is unhelpful, as what the defendant 'ought' to do depends on whether the principal has an equitable proprietary interest in the bribe or not. If the principal has no such interest, what the defendant 'ought' to do is to account personally for the value of the bribe. Only if the principal has a proprietary interest in the bribe (by means of a constructive trust) can it be said that the defendant 'ought' to transfer the bribe (or its traceable product) to the principal.

Where the agent could not have purchased the investment without using the bribe, the decision in *Reid*, which denies the agent the increase in value of the investment, might still be justified as preventing the agent's being unjustly enriched at the principal's expense. If, however, the agent is bankrupt, the result provides the principal with a windfall at the expense of the agent's general creditors. The court cannot, however, determine whether to impose a constructive trust according to the circumstances that pertain at the date of the hearing, since English law does not recognise the remedial constructive trust in order to remedy unjustified enrichment: *Re Polly Peck (No. 2) [1998] 3 All ER 812, CA*; *Foskett v McKeown [2001] 1 AC 102, HL*.

Reid was not followed by the Court of Appeal in *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd [2012] Ch 453*,⁴ where one Cushnie, the director of a company (TPL), had breached his fiduciary duty to TPL by transferring investors' monies in TPL to another company, Versailles (VTF), in which he had shares. VTF was not trading but was fraudulently paying returns out of the investors' own monies. As a result of the fraud, VTF's share price rose considerably, and Cushnie sold his VTF shares for £29 million. The scheme later collapsed and Cushnie became bankrupt. TPL claimed a proprietary right under a constructive trust to the proceeds of sale of Cushnie's shares, as only this would effectively give it priority over VTF's creditors.

⁴ Here follows a detailed analysis of *Versailles* which is at the heart of the discussion. Although now overruled in *FHR* the academic debate still rages on this point.

p. 139

The Court of Appeal in *Versailles* preferred *Lister v Stubbs*, which it in any event considered to be binding, to the reasoning in *Reid*. Lord Neuberger MR said that TPL had no proprietary interest in Cushnie's profit because it was derived from the increase in value of property (his VTF shares) that he had acquired before TPL took money from investors. Whilst, as Lord Neuberger admitted (at para. 51), 'there was a close commercial causal connection' between Cushnie's ↪ misapplication of the funds and his making a profit on his shares, it was difficult to see (at para. 52) how TPL's proprietary rights in the misused funds could be traced into the profit made on the sale of the shares. He criticised Lord Templeman's reasoning in *Reid* for begging the question of whether a principal has a proprietary

interest in a bribe: para. 78. Lord Neuberger considered (at para. 80) that a bribe taken by a fiduciary could not possibly be said to be an asset that he was under a duty to take for the beneficiary. He also thought (para. 83) that Lord Templeman had taken insufficient account of the potentially unfair consequences of the fiduciary's other creditors.

Lord Neuberger considered that a beneficiary could have a proprietary claim only in two exceptional circumstances, namely, where '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': para. 88. He treated *Keech v Sandford (1726) Sel Cas Ch 61*, as a case in which the trustee had taken advantage of an opportunity that 'was effectively owned by the trust' because the court at that time treated the right to renew a lease as a legal right: para. 58. As Cushnie's profit fell into neither of these exceptional categories, TPL's claim failed.

Lord Millett, the former Lord of Appeal in Ordinary, writing extrajudicially, unequivocally condemned *Versailles*, as being wrong both in law and as a matter of policy in ignoring the prophylactic nature of the no-conflict and no-profit rules, thereby enabling a fiduciary to profit from his breach: P. Millett (2012) 71 CLJ 583. His view is reflected in the rule now established by the Supreme Court in its most recent review of this area:⁵ *FHR European Ventures LLP v Cedar Capital Partners LLC [2014] UKSC 45* where it overruled *Versailles*, and, preferring *Reid*, decided that the defendant fiduciary did hold his commission on a constructive trust for his principal. In this case, a company called Cedar acted for an investor group (the group) in negotiating the purchase price of a hotel that the group wished to buy from a company called Monte Carlo. Ultimately, the group acquired the hotel for €211.50 million, which sum they paid directly to Monte Carlo. Cedar had not told the group, however, that it had received a fee of €10 million from Monte Carlo under an agreement that the latter would pay it such sum within five days of receiving the purchase monies. Cedar had clearly breached its fiduciary duty in entering into such agreement and in receiving the fee without having the group's informed consent. The group ultimately wished to trace into the product of the fee, and so claimed that Cedar had held that fee on a constructive trust for them. The Supreme Court ruled \blacktriangleright that all unauthorised profits including bribes and secret profits received by a fiduciary are held on constructive trust.

⁵ See the second 'Key Debates' at the beginning of this chapter and 'Taking Things Further' at the end.

So, following the decision in *FHR*, Edward will hold the benefit of its fee agreement with Victoria on constructive trust for Grab.⁶

⁶ Regardless of the academic debate about the correctness of the position, at least, thankfully, you can come to a clear conclusion now post the Supreme Court ruling in *FHR*.

Looking For Extra Marks?

■ As demonstrated in the answer, a clear and detailed analysis of the case law leading to the clear ruling by the Supreme Court in *FHR* earns those extra marks. But *FHR* is also not universally welcomed in the academic world. For extra marks you could introduce some of this critique by introducing some secondary material here. For suggestions, see ‘Taking Things Further’.

Question 4

Wynken and Nod are the two partners in a firm of solicitors, Blynken & Co. Wynken acts for the Fishnet Trust. On the instructions of the sole trustee of the Trust, Sleepy, Wynken paid out £30,000 to Chloë, believing her to be a beneficiary under the Trust and properly entitled to be paid this sum. Had Wynken looked at the trust deed in the firm’s strong-room, however, he would have realised that she was neither a beneficiary under the Trust nor a person entitled to any payment. Chloë, who was Sleepy’s daughter, did not realise that the sum was paid to her in breach of trust, and she spent it all on a luxury round-the-world cruise.

- a Consider the liability to the beneficiaries of the Fishnet Trust of (i) Wynken; (ii) Nod; and (iii) Chloë.

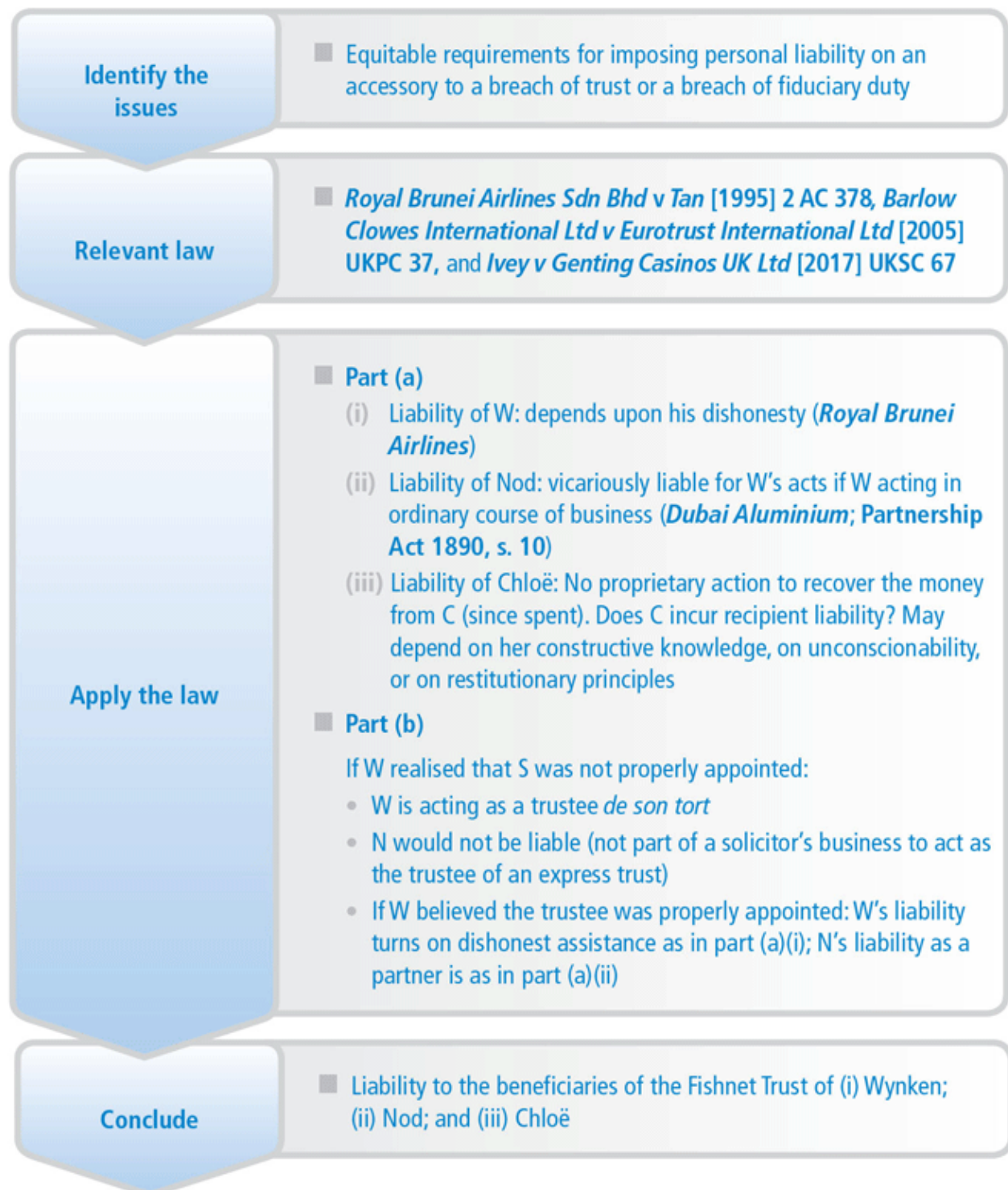
AND

- b Explain whether your answers to (i) and (ii) might differ if it were found that Sleepy’s appointment as trustee had not been properly effected.

Caution!

■ The equitable requirements for imposing personal liability on an accessory to a breach of trust or a breach of fiduciary duty were laid down in *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378, *Barlow Clowes International Ltd v Eurotrust International Ltd* [2005] UKPC 37, and (obiter) *Ivey v Genting Casinos UK Ltd* [2017] UKSC 67. These cases, however, did not involve the personal liability of a person who received property under a breach of trust. The precise requirements of recipient liability are regrettably uncertain; moreover, since liability will depend upon a detailed analysis of the facts you cannot be expected to reach any definite conclusion in this problem question. So what you need to do is to demonstrate a knowledge of the principles involved, and to suggest how they might be applied to the facts of the problem.

Diagram Answer Plan



p. 141

Suggested Answer

Part (a)

(i) Liability of Wynken¹

¹ Go straight into the facts of the problem applying the law to them from the start. Deal with each character separately as required by the question.

p. 142

Wynken would be personally liable to the beneficiaries of the Fishnet Trust if he has dishonestly assisted in a breach of trust in accordance with the principles for accessory liability laid down in *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378, and followed in *Barlow Clowes International Ltd v Eurotrust International Ltd* [2005] 4 UKPC 37, *Ivey v Genting Casinos UK Ltd* [2017] UKSC 67 (obiter), and *Group Seven Ltd v Notable Services LLP and another* [2019] EWCA Civ 614.² Although Sleepy might have been acting dishonestly in seeking to obtain a payment for his daughter, Wynken's liability does not require dishonesty on the part of the trustee: *Brunei*, at p. 392. It must, however, be shown that Wynken was dishonest. In *Group Seven Ltd v Notable Services LLP and another* [2019] EWCA Civ 614, the court stated that, following *Ivey v Genting*, where the discussion on this point was obiter, it is now settled law that the requirement for knowing assistance is dishonesty which is to be determined objectively and there is no room to consider the subjective opinion of the defendant as to whether he believed he was behaving dishonestly under the now discredited second limb of the *R v Ghosh* [1982] QB 1053 test. Whether Wynken is dishonest is therefore a matter of evidence—what he knew about the relevant facts is important but it is then to be determined by the standard of what ordinary decent people would think to be dishonest. Liability is triggered by the defendant's lack of probity which requires a much higher hurdle to be cleared than evidence of negligence. So, merely failing to refer to the trust instrument before making the payment, whilst perhaps amounting to negligence, does not itself indicate dishonesty so as to satisfy the high test for dishonesty required by *Royal Brunei* and *Group Seven* following *Ivey v Genting*.³

² This sets out the law and applies it.

³ Here is the conclusion to this section.

(ii) Nod's liability

Even if Wynken is personally liable for dishonest assistance, his partner, Nod, is not necessarily also liable.⁴ If Nod knew what Wynken was doing and stood by, doing nothing to prevent Wynken from assisting in the breach of trust, the beneficiaries might seek to make Nod also liable for dishonest assistance. It could be argued, however, that merely standing by while Wynken acts does not itself amount to 'assistance'.

⁴ Identifies issue.

The beneficiaries might seek to recover from Nod on the ground that he is liable in equity for his partner's acts. In *Mara v Browne* [1896] 1 Ch 199,⁵ at p. 208, Lord Herschell had stated obiter that 'it is not within the scope of the implied authority of a partner ... [in a solicitor's] business that he should so act as to make himself a constructive trustee, and thereby subject his partners to the same liability'. In *Re Bell's Indenture* [1980] 1 WLR 1217, this dictum was apparently interpreted to mean that, when a partner in a firm of solicitors incurred liability for dishonestly assisting in a breach of trust, his co-partner could not as a matter of law be liable, since such an act was necessarily outside the scope of his implied authority. In *Dubai Aluminium Co. Ltd v Salaam* [2003] 2 AC 366, however, their Lordships disapproved of this interpretation and overruled *Re Bell's Indenture*. Lord Millett suggested that Lord Herschell's dictum referred only to trustees *de son tort*, these being persons who, without being appointed, nevertheless take it upon themselves to act as trustees. Lord Millett said that the expression 'constructive trustee' was best abandoned in the context of liability for dishonest assistance, and that it was more appropriate to refer to the defendant as being merely 'accountable in equity'.

⁵ The relevant cases are now set out.

Under the **Partnership Act 1890, s. 10**,⁶ the firm is liable where a person suffers loss 'by any wrongful act or omission of any partner in the ordinary course of the business of the firm'. In the *Dubai Aluminium* case, the House of Lords held that the phrase 'wrongful act or omission' was not confined to common law torts but included a fault-based equitable wrong such as liability for dishonest assistance in a breach of trust. On this interpretation, Nod's liability as a partner depends on the ordinary principles of partnership law. It is therefore a matter of evidence whether, in paying out money on the instructions of Sleepy in breach of trust, Wynken was acting in the ordinary course of the firm's business. As the act in question was performed by Wynken in his capacity as a solicitor, it would be difficult to argue that it was not also performed in the ordinary course of the firm's business. Assuming this to be the case, if Wynken is liable for dishonest assistance, Nod is vicariously liable.⁷

⁶ And now the statutory reference.

⁷ The conclusion.

(iii) Chloë's liability

As Chloë did not give consideration for the £30,000 paid to her, the beneficiaries could have traced it into her hands (or into its product in her hands) if she still retained it.⁸ As Chloë has spent the money, however, the beneficiaries cannot bring any proprietary action to recover it from her. The beneficiaries will be able to bring a personal action against her to recover the equivalent value, however, if they can establish the ingredients for recipient liability. The initial requirement is met, as Chloë received the money beneficially and as a result of a breach of trust. Unfortunately, the courts have expressed different views about what else is required for recipient liability.⁹

⁸ Introducing the key issue here.

⁹ It is unfortunate as it means that the law is not clear. You just have to express that position and explain what it means.

In *Brunei*, Lord Nicholls said that recipient liability is restitution-based,¹⁰ and his Lordship expressed a similar view in dicta in *Criterion Properties plc v Stratford UK Properties LLC* [2004] 1 WLR 1846, HL. If, therefore, the general principles of restitution were to apply to this type of liability, Chloë would be strictly liable as a beneficial recipient; but, as she has already spent the money, if she is an innocent volunteer she would have the defence of change of position. This analysis met with the approval of Lord Millett in the *Twinsectra* case, but his Lordship recognised that English law had not yet developed in that way. Where property is wrongly distributed under a will, those entitled under it may bring a personal action against the recipients, even if the latter are innocent volunteers: *Re Diplock* [1948] Ch 465, ↵ affirmed *Ministry of Health v Simpson* [1951] AC 251. The action *in personam* resembles what might now be termed a restitutionary claim based on the fact of receipt, and available even against an innocent volunteer. It appears, however, that the *Re Diplock* action *in personam* is limited to claims against recipients of assets wrongly distributed during the course of administration of an estate: *ibid.*, at pp. 265–266 (Lord Simonds). If this limitation still applies today, such action

p. 144

cannot be brought against Chloë, who receives property wrongly distributed under an *inter vivos* trust. The beneficiaries would therefore have to content themselves with a claim based on accessory liability.

¹⁰ Here comes the exposition of the law.

Most authorities hold that liability depends on the recipient's knowledge, but even these are in disagreement about what amounts to knowledge. Some are prepared to accept any of the five categories of knowledge set out in *Baden Delvaux* as sufficient: *Cowan de Groot Properties v Eagle Trust* [1992] 4 All ER 700; *Belmont Finance Corp. v Williams Furniture (No. 2)* [1980] 1 All ER 393, CA. Others require knowledge within the first three categories only: *Re Montagu's Settlement* [1987] Ch 264.

In *Eagle Trust v SBS Securities* [1993] 1 WLR 484, it was held that liability under any of the five heads sufficed where the receipt occurred (as in *Re Montagu*) in a non-commercial transaction. If *Eagle Trust* is applied, then as Chloë was not a commercial recipient, her liability would effectively depend on whether she had constructive notice of the breach of trust. More precisely, her liability would turn on whether she had knowledge within category (iv) of *Baden Delvaux* (knowledge of circumstances that would indicate the facts to an honest and reasonable person), or category (v) (knowledge of circumstances that would put an honest and reasonable person on inquiry).

Other views have, however, been expressed judicially. In *Dubai Aluminium Co. Ltd v Salaam* [2000] 3 WLR 910, the Court of Appeal considered the substantive ingredient for knowing receipt to be dishonesty, not knowledge. In *BCCI (Overseas) Ltd v Akindele* [2001] Ch 437, Nourse LJ said that the test was rather whether the recipient's state of knowledge was such as to make it unconscionable for him to retain the benefit of the receipt.

If the correct test is dishonesty or knowledge within the first three heads of *Baden Delvaux* only (all of which seem to involve some consciousness of wrongdoing), Chloë's lack of awareness of her receipt's being in breach of trust would save her from incurring recipient liability. If, however, the correct test is knowledge within any of the five heads of *Baden Delvaux*, or merely unconscionability, then the question provides insufficient facts for any determination of her liability to be made.¹¹

¹¹ A conclusion to this part—inevitably a tentative one because of the state of the law.

Part (b)

If Sleepy's appointment as trustee had not been properly effected, Wynken could not have been acting as an agent.¹² In *Blythe v Fladgate* [1891] 1 Ch 327, Smith, a partner in a firm of solicitors, continued to deal with trust funds after the death of the sole trustee. He was held liable as an inter-meddler (a trustee *de son tort*), and his co-partners were also held liable on this basis. If in the problem Wynken realised that he was effectively acting as principal, he may be liable as a trustee *de son tort*, in effect as a *de facto* trustee (which latter expression Lord Millett in the *Dubai Aluminium* case thought preferable today). If Wynken were liable as a *de facto* trustee, it would appear that Nod would not be liable, since Lord Millett thought that it was still not within the ordinary scope of a solicitor's practice to act as a trustee of an express trust. These would be the precise circumstances in which Lord Herschell's dictum in *Mara v Browne* would apply.

¹² This raises some different points with accompanying cases.

If, however, Wynken believed that the trustee had been properly appointed, so that he did not realise that he was himself acting as a principal, it would be difficult to characterise him as a *de facto* trustee, since he would not be purporting to act as a trustee. In these circumstances, his liability would depend upon his having dishonestly assisted Sleepy in the breach of trust as considered in (i), and the liability of Nod would be the same as previously considered in (ii).¹³

¹³ A conclusion to this part.

Looking For Extra Marks?

■ You could go much further in discussing the different judicial positions on recipient liability. For an example of how to tackle that, look at the previous answer to question 3. Given the recent flow of case law on the issue of dishonesty, you could include some discussion of these articles: S. Panesar, 'Test of dishonesty revisited' (2019) 210 (Oct) *Trusts and Estates Law & Tax Journal* 14–16 which considers the decision in *Group Seven Ltd v Notable Services LLP, CA*, where the criteria of dishonesty for knowing assistance in breach of trust is discussed, if the alleged accessory had suspicions but they did not amount to blind-eye knowledge; and M. Dixon's editorial, 'Dishonest strangers' [2019] *Conv* 195–198 which also discusses the *Group Seven* decision.

Taking Things Further

■ Bryan, M., 'Boardman v Phipps: Doing Equity Inequitably', in *Landmark Cases in Equity* (C. Mitchell and P. Mitchell, eds), Hart Publishing, 2012, p. 581.

See this chapter for a discussion of breach of fiduciary duty.

■ Chambers, R., 'The end of knowing receipt' (2016) 2(1) *Canadian Journal of Comparative and Contemporary Law* 1.

This article discusses the circumstances surrounding knowing receipt and knowing assistance.

p. 146 ↩ ■ Dixon, M., 'Dishonest strangers' [2019] *Conv* 195–198 (Editorial).

The test for honesty and the relevant case law is considered in this article.

■ Etherton, T., 'Constructive trusts: a new model for equity and unjust enrichment' (2008) 67 *CLJ* 265.

This article covers the issue of whether constructive trusts are remedial or substantive.

■ Panesar, S., 'Test of dishonesty revisited' (2019) 210 (Oct) *Trusts and Estates Law & Tax Journal* 14–16.

*This article discusses **Group Seven Ltd v Notable Services LLP, CA**, on the criteria of dishonesty for knowing assistance in breach of trust, if the alleged accessory had suspicions but they did not amount to blind-eye knowledge.*

■ Salmons, D., 'Claims against third-party recipients of trust property' (2017) 76 *CLJ* 399–429.

This article considers the unjust enrichment argument.

Online Resources

www.oup.com/uk/qanda/ [_<http://www.oup.com/uk/qanda/>](http://www.oup.com/uk/qanda/)

For extra essay and problem questions on this topic and guidance on how to approach them, please visit the online resources.

© Rosalind Malcolm 2020

Related Books

View the Essential Cases in equity & trusts

Related Links

Visit the online resources for this title [<https://oup-arc.com/access/equity-qanda3e>](https://oup-arc.com/access/equity-qanda3e)

Test yourself: Multiple choice questions with instant feedback. <https://learninglink.oup.com/access/content/mcdonald-concentrate8e-student-resources/mcdonald-concentrate8e-diagnostic-test>

Find This Title

In the OUP print catalogue <https://global.oup.com/academic/product/9780198853213>