Dispute Resolution Hotline

September 22, 2014

UK SUPREME COURT RULES ON SECRET COMMISSION CASE

- Secret commission accepted by an agent is held on trust for his principal;
- Benefit acquired by an agent arising out of his fiduciary position, or pursuant to an opportunity which results from his fiduciary position, the general equitable rule is to treat the benefit as having acquired on behalf of his principal, therefore beneficially owned by the principal;
- Agent owes a duty of undivided loyalty to the principal, so principal is entitled to the entire benefit of the agent's acts in the course of his agency, including but not limited to benefits arising out of acceptance of bribe or secret commission.

Recently, the Supreme Court of United Kingdom **("UK Supreme Court")** in *FHR European Ventures LLP and others v. Cedar Capital Partners LLC*[1]*,* has opined on an interesting question of law, whether a bribe or secret commission received by an agent is held by that agent 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 commission. Notably, if the bribe or commission is held on trust, the principal has a proprietary claim to it, or if the principal merely has a claim for equitable compensation, the claim is not proprietary.

The distinction is relevant for two main reasons. First, if the agent becomes insolvent, a proprietary claim would give the principal priority over the agent's unsecured creditors. Secondly, if the principal has a proprietary claim to a bribe or commission, he can trace and follow it in equity.

FACTS

On 22 December 2004, FHR European Ventures LLP **("FHR")** purchased the issued share capital of Monte Carlo Grand Hotel SAM **("Monte Carlo")**. Cedar Capital Partners LLC **("Cedar")** provided consultancy services to the hotel industry, and it had acted as the FHR's agent in negotiating the purchase. Prior to the transaction, on 24 September 2004, Cedar had entered into an agreement with Monte Carlo **("the Exclusive Brokerage Agreement")**, which entitled Cedar, to a payment of fee of □10m fee following a successful conclusion of the sale and purchase of the issued share capital of Monte Carlo.

Subsequently, on 7 January 2005, Monte Carlo paid Cedar □10m. Thereafter, on 23 November 2009, FHR began proceedings for recovery of the sum of □10m from Cedar. Simon J delivered the judgment and (i) ordered a declaration of liability for breach of fiduciary duty on the part of Cedar for having failed to obtain FHR`s consent in respect of the □10m arrangement; and (ii) ordered Cedar to pay such sum to FHR; but importantly (iii) *refused to grant FHR a proprietary remedy in respect of the monies.*

FHR appealed to the Court of Appeal against the refusal to grant FHR a proprietary remedy and the appeal was allowed. Accordingly, the Court of Appeal made an order which included a declaration that Cedar received the □10m fee on constructive trust for FHR absolutely.

Cedar subsequently appealed to the UK Supreme Court, on the limited aspect, of whether FHR had a proprietary remedy in respect of the monies claimed.

ISSUE

The dispute was regarding the applicability of the rule of equity when the benefit is a bribe or secret commission obtained by an agent, in breach of his fiduciary duty to his principal. Therefore, the question was whether the Court of Appeal correctly held that the FHR is entitled to the proprietary remedy in respect of the □10m received by Cedar from Monte Carlo?

CONTENTIONS

Appellant:

It was argued that the equitable rule should not apply to a bribe or secret commission paid to an agent, because it is not a benefit which can be said to be the property of the principal. Reference was made to the scholarly writings of Professor Sir Roy Goode and Professor Sarah Worthington. Relying on their writings it was argued that no proprietary interest arises where an agent obtains a benefit in breach of his duty unless the benefit either (i) flows from an asset which was (a) beneficially owned by the principal, or (b) intended for the principal, or (ii) was derived from an activity of the agent which, if he chose to undertake it, he was under an equitable duty to undertake for the principal.

Respondent:

Research Papers

Littler International Guide (India) 2024
November 08, 2024

Unmasking Deepfakes
October 25, 2024

Are we ready for Designer Babies
October 24, 2024

Research Articles

The Bitcoin Effect
November 14, 2024

Acquirers Beware: Indian Merger Control Regime Revamped!
September 15, 2024

Navigating the Boom: Rise of M&A in Healthcare
August 23, 2024

Audio

Digital Lending - Part 1 - What's New with NBFC P2Ps
November 19, 2024

Renewable Roadmap: Budget 2024 and Beyond - Part I
August 26, 2024

Renewable Roadmap: Budget 2024 and Beyond - Part II
August 26, 2024

NDA Connect

Connect with us at events, conferences and seminars.

NDA Hotline

Click here to view Hotline archives.

Video

"Investment return is not enough" Nishith Desai with Nikunj Dalmia (ET Now) at FII8 event in Riyadh
October 31, 2024

Analysing SEBI's Consultation Paper on Simplification of registration for FPIs
September 26, 2024

It was argued that equitable rule applies to bribes or secret commissions received by an agent, because, where an agent receives a benefit, which is, or results from, a breach of the fiduciary duty owed to his principal, the agent holds the benefit on trust for the principal. Reference was made to scholarly writing of Lord Millet who has suggested that on the grounds of practicality, policy and principle, a principal should be beneficially entitled to a bribe or secret commission received by his agent. Notably, he based his conclusion on the proposition that equity will not permit the agent to rely on his own breach of fiduciary duty to justify retaining the benefit on the ground that it was bribe or secret commission, and will assume that he acted in accordance with his duty, so that the benefit must be the principal`s.

JUDGMENT

The UK Supreme Court after considering series of precedents and scholarly writings, unanimously dismissed the appeal filed by Cedar against the judgment of the Court of Appeal. Lord Neuberger observed that in circumstances where an agent acquires a benefit arising out of his fiduciary position, the general equitable rule would be to treat him as having acquired the benefit on behalf of his principal, and therefore the same would mean to be beneficially owned by the principal.[2]

Firstly, UK Supreme Court observed that the dispute in this case is the extent to which the equitable rule applies, where the benefit is a bribe or secret commission obtained by an agent in breach of his fiduciary duty to his principal. UK Supreme Court opined that while it is not possible, as a matter of pure legal authority, to identify any plain right or wrong answer to the issue of the extent of the applicability of the equitable rule, considerations of practicality and principle support the case that a bribe or secret commission accepted by an agent is held on trust for his principal.[3]

Secondly, the UK Supreme Court held that the agent owes a duty of undivided loyalty to the principal, unless the latter has given his consent to some less demanding standard of duty. The principal is thus entitled to the entire benefit of the agent's acts in the course of his agency.[4]

Thirdly, UK Supreme Court further held that an agent owes a fiduciary duty to his principal because he is "*someone who has undertaken to act for or on behalf of [his principal] in a particular matter in circumstances which give rise to a relationship of trust and confidence"*.[5]

Fourthly, UK Supreme Court held that Respondent’s formulation of the equitable rule has merits of simplicity in so far as any benefit acquired by an agent as a result of his agency and in breach of his fiduciary duty is held on trust for the principal, while on the other hand, the Appellant`s position is more likely to result in uncertainty – and therefore while affirming Respondent’s position carved an exception to the scholarly writings which stipulates exclusion of bribe or commission from the equitable rule. Fifthly, according to UK Supreme Court, the notion that the equitable rule should not apply to a bribe or secret commission received by an agent because it could not have been received by, or on behalf of, the principal is unattractive. The whole reason that the agent should not have accepted the bribe or commission is that it puts him in conflict with his duty to his principal. Accordingly, FHR’s proprietary claim to Cedar’s Brokerage Fee was allowed.[6]

ANALYSIS

This is a landmark decision of great practical importance. Notably, it clarifies whether or not a proprietary remedy was available where there had been an unlawful misuse of a business by an agent for obtaining a bribe or a secret commission.

The key take away from the judgment are as follows: first, assuming that the agent becomes insolvent, the principal will have a proprietary claim which will give the principal priority over the agent’s unsecured creditors (on the contrary a right only to an equitable compensation claim would have ranked the principal equally with other unsecured creditors); and secondly, a proprietary claim gives the principal the right to trace the bribe or commission and follow it in equity, which is otherwise not available to a principal with a claim for equitable compensation.

This ruling could be relied on by Indian Courts if a similar question of law is in consideration before High Courts or Supreme Court of India. The reasoning of the UK Supreme Court appears to be correct in so far as it binds the agent in terms of broad fiduciary principles. This ruling will assist in bringing more clarity to the principal-agent relationship.

– Alipak Banerjee, Payel Chatterjee & Vivek Kathpalia
You can direct your queries or comments to the authors

[1] [2014] UKSC 45
[2] Paragraph 7
[3] Paragraph 32
[4] Paragraph 33
[5] Paragraph 5
[6] Paragraph 37

DISCLAIMER

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

This Hotline provides general information existing at the time of preparation. The Hotline is intended as a news update and Nishith Desai Associates neither assumes nor accepts any responsibility for any loss arising to any person acting or refraining from acting as a result of any material contained in this Hotline. It is recommended that professional advice be taken based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your name. Since India has no anti-spamming law, we refer to the US directive, which states that a mail cannot be considered Spam if it contains the sender's contact information, which this mail does. In case this mail doesn't concern you, please unsubscribe from mailing list.

Scope of judicial interference and inquiry in an application for appointment of arbitrator under the (Indian) Arbitration and Conciliation Act, 1996
September 22, 2024