Neutral Citation Number: [2011] EWCA Civ 347

Case No: A3/2010/1776 & 1778

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
The Hon Mr Justice Lewison
Claim No HC07C03030

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 29/03/2011

Before :

THE MASTER OF THE ROLLS

LORD JUSTICE RICHARDS
and
LORD JUSTICE HUGHES

- -

Between :

Sinclair Investments (UK) Ltd	**Appellant**
- and -	
(1) Versailles Trade Finance Limited (in administrative receivership)	
(2) Versailles Group Plc (in administrative receivership)	**Respondents and Cross-appellants**
(3) National Westminster Bank Plc	
(4) Anthony V Lomas	
(5) Robert Birchall	
(6) Royal bank of Scotland Plc	

Robert Miles QC and **Richard Hill** (instructed by **Liam Hemmings, Sinclair Investments (UK) Ltd**) for the **Appellant**
Matthew Collings QC (instructed by **Denton Wilde Sapte LLP**) for the **Respondents**

Hearing dates : 14th, 15th and 16th February 2011

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Approved Judgment

The Master of the Rolls:

1. This is an appeal and a cross-appeal against a decision of Lewison J, who held that the appellant, Sinclair Investments (UK) Limited ("Sinclair"), was not entitled to assert a proprietary interest in the proceeds of sale of some shares in Versailles Group PLC ("VGP"), but was entitled to assert a proprietary interest in funds originally held by Versailles Trade Finance Limited ("VTFL"), albeit to a more limited extent than Sinclair had claimed.

2. The proprietary claims arise out of the insolvency of the Versailles Group, whose business the Judge described as "little but a fraudulent scam" and "a classic Ponzi scheme". The claims give rise to (i) an issue as to the circumstances in which a proprietary interest arises, (ii) an issue as to what constitutes sufficient notice to defeat a person's claim that he is a purchaser for value without notice in good faith, and (iii) a number of other issues relating to tracing claims.

The background

The facts in outline

3. I take the relevant facts largely from the judgment below at [2010] EWHC 1614 (Ch), paras 3-19, where Lewison J set out the background, which was more fully described by Rimer J in an earlier case, *Sinclair Investment Holdings SA v Versailles Trade Finance Ltd* [2007] EWHC 915 (Ch), paras 7-72.

4. VGP's principal shareholder was Mr Carl Cushnie (or, more accurately, a company which it is agreed is to be treated as his *alter ego*, and so I shall simplify matters by ignoring it). VTFL was VGP's wholly owned principal trading subsidiary, and, at least ostensibly, its business was a modified form of factoring. This business required money, and funds came from two principal sources, wealthy individuals, known as "traders", and loans made by banks.

5. The traders provided the money to a company, which was not part of the Versailles Group, called Trading Partners Ltd ("TPL"), which was controlled by Mr Cushnie and his associate Mr Clough, and of which they were both directors. From March 1996, TPL solicited funds from traders, who, having been promised high returns, supplied funds to TPL under a form of written agreement ("the traders' agreement").

6. Clause 1 of the traders' agreement provided that the funds would be used to "purchase goods of merchantable quality and goods which have been agreed for sale". In so far as the trader's funds were not so used, clause 2 stipulated that they would be "deposited by [TPL] in trust for [the trader] in a … bank account …". Clause 5 required TPL to account to the trader "for the sale and purchase of all goods and the profit thereon on a quarterly basis", and to "pay the net profit to [the traders] together with quarterly reports". Clause 7 of the traders' agreement provided for repayment "of the monies paid hereunder and accrued interest" on "not less than three months notice in writing" by the trader. It also stated that TPL purchased any goods as the trader's agent.

7. TPL and VTFL entered into a written management agreement ("the management agreement") on 4 July 1996. Under this agreement, VTFL was appointed to "take

[exclusive] responsibility for the management and administration of the business activities of [TPL]". To that end, VTFL was given "complete discretion to enter into [any] contracts … in the ordinary course of [TPL's] business subject to the restrictions and limitations contained in this agreement … ." It was further provided that VTFL would "make all purchases and sales of goods in the name of [TPL] or as [it] shall direct." There were also clauses imposing duties of skill and care on VTFL. VTFL was required to maintain any bank accounts opened for the purpose of TPL's business in the name of TPL. VTFL's remuneration was to be "a sum equal to 95% [subsequently increased to 99.5%] of [TPL's] audited profit".

8. The funds advanced by traders to TPL were duly passed to VTFL, but they were not used for the purchase of goods or in genuine factoring transactions. Instead, the funds were (i) used to pay purported profits to traders, initially at a rate of around 16% per annum, (ii) stolen by Mr Clough, or (iii) circulated round a number of other companies also controlled by Mr Cushnie and/or Mr Clough. The purpose of this circulation of funds, referred to as "cross-firing", was to inflate VTFL's apparent turnover and to mask the absence of any genuine business.

9. The scale of the cross-firing was enormous, amounting in all to about £500m-worth. In his earlier judgment, Rimer J explained that there was only one legitimate trade and that made a loss. He concluded that, as none of the traders' advances to TPL was ever used in any factoring transactions, all their advances remained held by TPL on trust for them, and that the management agreement entitled VTFL to transact business in TPL's name, and did not entitle VTFL to use TPL's funds for its own purposes.

10. The money advanced by three banks ("the banks"), National Westminster Bank Plc ("NatWest"), Royal Bank of Scotland plc ("RBS") and Barclays Bank PLC ("Barclays"), was also used in the cross-firing. The banks took fixed and floating charges over VTFL's assets (which consisted principally of its book debts). For present purposes, it is unnecessary to distinguish between the banks.

11. Importantly for present purposes, it is common ground that, while neither VTFL nor Mr Cushnie owed the banks any fiduciary duties, Mr Cushnie did owe fiduciary duties to both VTFL and TPL.

12. As a result of the fraud, which was perpetrated by Mr Cushnie with Mr Clough's help, VTFL reported an uninterrupted increase in turnover and profit each year up to and including 1999. In 1995, a combination of some of Mr Cushnie's shares and some newly issued shares in VGP were offered to the public, and the company was listed on AIM. It was subsequently listed on the London Stock Exchange. VGP's share price steadily increased.

13. As described by Rimer J at [2007] EWHC 915 (Ch), para 23:

> "VTFL's turnover was inflated in the following manner: (i) the accounts showed money paid to and received from other companies controlled and managed by Mr Cushnie and Mr Clough (the so-called cross-firing companies) as if they were genuine trading payments and receipts, which they were not; and (ii) the nominal ledger contained entries which purported to be sales, purchases and trading receipts and payments which were not justified by any actual trading. The main cross-firing companies were

> [effectively controlled by Mr Cushnie]. In broad terms, it worked as follows. VTFL had a Customer Service Division, which was a genuine trade generating funds. VTFL was financed by bank loans. It also received finance …. from March 1996, from TPL; [which was] financed by the traders. The money so received by VTFL was then revolved around the cross-firing companies. … [B]etween June 1993 and October 1999 hundreds of millions of pounds were transferred both ways between VTFL and various cross-firing companies. VTFL's receipts were disguised in its cash books to make them appear as genuine sales to genuine customers, so falsely inflating its turnover."

For many years the fraud was well concealed. Banks, investors, VTFL's auditors and the financial press were all taken in.

14. On 17 August 1999, Mr Cushie (through an *alter ego* company, whose existence I shall disregard as it is irrelevant for present purposes) bought a house in Kensington, London ("the Kensington property"), with the help of an advance from RBS of £9.975m, which was secured on the property.

15. On 9 November 1999, Mr Cushnie sold some 13.9 million shares in VGP ("the Shares"), representing about 5% of his total holding, for £28.69m. The proceeds of this sale were distributed to various parties in about February 2000. These payments included the following: £9.19m to the Versailles group, £1m to Mr Clough, £1.75m to traders, £2.25m loan repayment to NatWest, and £11.47m to RBS, of which £1.49m was an overdraft repayment and £9.98m was repayment of the loan secured on the Kensington property.

16. On 5 May 1999, the DTI had begun an investigation into VGP's affairs under section 447 of the Companies Act 1985. On 30 November 1999, Baker Tilley were commissioned to provide a report under section 2.11 of the London Stock Exchange Yellow Book. On 8 December 1999, share dealing in VGP, whose market capitalisation was then £632m, was suspended. In early January 2000, the banks appointed PwC to investigate and review VGP's affairs. On 18 January 2000 the SFO announced an investigation into the Versailles Group. On 14 January 2000 PwC produced an initial report; and on 20 January they reported that the position was far worse than they had realised. On the same day the banks appointed certain PwC partners, including Mr Lomas, as joint administrative receivers of VGP and VTFL ("the administrative receivers"). PwC produced their final report on 31 January. Some traders had been repaid in full before the collapse of VGP in January 2000, but the remainder had sums totalling approximately £22.6m invested. The banks were owed a total of £70.5m. In February 2000, NatWest received a payment of £2.25m from Mr Cushnie to pay off a loan he had raised to buy a villa near St Tropez.

17. In July 2000, TPL was ordered to be wound up in the BVI, and, shortly thereafter, joint liquidators ("the liquidators") were appointed; one of them was Mr Akers of Grant Thornton. He met Mr Greaves, who worked for the administrative receivers, on 18 August, and explained that the liquidators were "interested in a tracing process that leads to ultimate cash", but that their "problem is that our money probably went into PwC's black hole". Further meetings took place between the administrative receivers and the liquidators, and their respective representatives over the next two years or more.

18. From some time in 2000 the administrative receivers were in negotiation with Mr Cushnie, and in January 2001, they made a distribution to the banks from the moey they received from him. On 26 February 2001, they entered into a settlement agreement with Mr Cushnie. This purported to settle claims that VGP and VTFL had against him, namely (i) a claim by VGP for some £2.7 million for repayment of dividends paid on the false basis that VGP had distributable profits enabling the dividends to be paid; and (ii) a claim by VTFL for breach of his duties as a director. Neither dishonesty nor a proprietary claim was alleged in the settlement agreement. The administrative receivers entered into subsequent settlement agreements with Mr Cushnie in 2002 and 2005.

19. Under the settlement agreement of 26 February 2001, VTFL and VGP acquired charges over the Kensington property, and, on 5 December 2001 receivers appointed under the Law of Property Act 1925 sold the property for £8.64m. The net proceeds of some £8.4m were paid to the administrative receivers, who, after the payment of tax, currently hold £5.2 million.

20. Meanwhile monies were being distributed to the banks by the administrative receivers from VTFL's funds. They were paid the following amounts on the following dates: £2.25m and £313,000 in February 2000, just under £4m in January 2001, £4,750,000 in September 2001, £500,000 in November 2001, £2,497,000 in August 2004, and £500,000 in January 2005.

21. Mr Cushnie and Mr Clough were charged with criminal offences, all involving conspiracy to defraud. Mr Clough pleaded guilty to three counts, and Mr Cushnie was charged with two counts, to which he pleaded not guilty. After a four month trial before Jackson J, at which Mr Clough gave evidence and Mr Cushnie did not, the jury found Mr Cushnie guilty on one of the counts, namely that, between March 1992 and January 2000, he, together with Mr Clough and a Ms Jones, conspired to defraud the traders by dishonestly (a) representing that their moneys would be used for the purpose of trading transactions by or on behalf of TPL and (b) transferring those moneys between bank accounts held by TPL and bank accounts held by VTFL for the purposes of falsely inflating their turnover and assets.

22. On 8 June 2004, Mr Cushnie and Mr Clough were each sentenced to a prison sentence of six years (reduced on appeal in Mr Clough's case to five years). They were also disqualified from being directors of companies under the Company Directors Disqualification Act 1986 for 15 and 10 years respectively. On 29 June 2005, Jackson J made confiscation and compensation orders against Mr Cushnie under section 71 of the Criminal Justice Act 1988 and section 130 of the Powers of Criminal Courts (Sentencing) Act 2000.

23. Sinclair was one of the traders who paid money to TPL, and, following its unsuccessful action before Rimer J, it took an assignment of all the claims of TPL and of the traders. Like the Judge, I shall treat Sinclair's claims as being brought by TPL.

The claims in these proceedings

24. TPL asserts two proprietary claims. The first is to the proceeds of sale (after payment of tax) of the Shares, which, it contends, Mr Cushnie held on constructive trust for TPL, and it says that the claim is good against the banks and against VTFL. This first

proprietary claim is therefore targeted initially at Mr Cushnie and his breach of fiduciary duties as a director of TPL, and effectively seeks to undermine the benefit to the defendants of the settlement agreement referred to in para 18 above.

25. The key steps in TPL's argument on this first claim, essentially as summarised by Lewison J, are as follows:

i) Mr Cushnie owed TPL fiduciary duties, including a duty not to make secret or unauthorised profits and not to apply traders' funds in breach of the terms of the agreements with the traders.

ii) Mr Cushnie breached those duties by misusing, or permitting the misuse of, the monies entrusted to TPL ("the TPL Trust monies") in the cross-firing fraud.

iii) This misuse of the TPL Trust monies was calculated to, and did, increase the share price of VGP above its true value, which was at all times nil.

iv) Mr Cushnie realised the value of this increase on 9 November 1999 by selling the Shares for £28.69m.

v) The £28.69m was an unauthorised gain made by Mr Cushnie in the course of his fiduciary relationship with TPL, a gain he was only able to make through the misuse of the TPL Trust monies.

vi) Accordingly, the moment it was made, the £28.69m was held by Mr Cushnie on constructive trust for the benefit of TPL.

vii) TPL is therefore entitled in equity to claim the traceable proceeds of the gain, and this entitlement is a proprietary right, good against anyone except a purchaser for value without notice.

viii) As VTFL was a defaulting fiduciary for TPL, neither it nor its holding company VGP can have a competing proprietary claim. Nor can the banks, who are merely creditors of VTFL.

26. It is common ground that Mr Cushnie realised much (if not all) of the gain he made in selling the Shares as a result of his breaches of fiduciary duty. Mr Miles QC (who appeared with Mr Hill for Sinclair) argued that TPL accordingly has a proprietary interest in – effectively beneficial ownership of – the proceeds of sale of the Shares, which it is entitled to assert against the defendants, namely VGP, VGTL, the administrative receivers and the banks.

27. For the defendants, Mr Collings QC, while accepting that Mr Cushnie was liable to account to TPL for at least that part of the gain attributable to the misuse of TPL's monies, contended that this liability to account is a personal liability only, and thus TPL's claim is an unsecured personal claim against Mr Cushnie. On this basis, as Mr Cushnie has not been the subject of any relevant insolvency proceedings, he was free to deal with unsecured claims as he pleased, and, as the proceeds of sale of the Shares

were distributed in satisfaction of his liabilities, TPL has no right to upset that distribution.

28. It is common ground that if, contrary to Mr Collings's submissions, TPL can establish a proprietary right to the proceeds of sale of the Shares, it is entitled in principle to trace those proceeds into the Kensington property. However, any proprietary right that TPL would otherwise have in the sale proceeds of the Shares would plainly be no more than an equitable right, and could therefore be defeated if the proceeds have passed to a *bona fide* purchaser without notice. Mr Collings said that the banks are entitled to rely on that defence, whereas, for TPL, Mr Miles contended that they are not.

29. So far as TPL's first claim is concerned, there are thus two questions. The first question is whether TPL has a proprietary interest in the proceeds of sale of the Shares. If it does, then the second question is whether the banks and VTFL are entitled to rely on the defence of *bona fide* purchaser for value without notice.

30. TPL's second proprietary claim is in relation to the monies which passed from it to VTFL and were mixed with VTFL's own monies. So far as this second claim is concerned it is therefore initially targeted against VTFL, on the basis that it had fiduciary duties to TPL in respect of the funds entrusted to it under the management agreement, and it thus seeks effectively to undermine the benefit to the banks of the payments referred to in para 20 above. Mr Miles contended that TPL is entitled to what remains of the mixed fund and that it is entitled to trace that fund into the hands of the banks. Mr Collings argued that there is no such proprietary right, primarily because of the inextricability of TPL's funds and the funds of VTFL. There are also two further points in relation to this tracing claim.

31. After considering the legal principles applicable to both these claims, I propose to consider three main issues. The first and second main issues relate to the first claim, the third main issue relates to the second claim. The first main issue is whether TPL has a proprietary interest in the proceeds of sale of the Shares. The second main issue is whether that claim can be traced into the monies paid to the banks as described in para 18 above. The third main issue is the extent to which TPL can trace into the monies paid as described in para 20 above a proprietary claim to the monies held in the name of VTFL, which raises a number of disparate questions relating to the right to trace.

The applicable legal principles

32. TPL's first proprietary claim is based on the proposition that, in his capacity as a director of TPL, Mr Cushnie misused the funds provided by traders, that this amounted to a breach of trust and that the proprietary interest which TPL had in the funds can be traced through to the proceeds of sale of the Shares. As for TPL's second proprietary claim, it rests on the proposition that it is entitled to trace or follow its monies into an account held by VTFL in circumstances where those monies were mixed with monies owned by VTFL, all of which monies were involved in the cross-firing fraud.

33. In that connection, Lewison J helpfully set out some "uncontroversial propositions" at [2010] EWHC 1614, paras 23 to 30, from which much of what is in the next few paragraphs is derived.

The duties of trustees and others in fiduciary positions

34. Although company directors are not strictly speaking trustees, they are in a closely analogous position because of the fiduciary duties which they owe to the company: *Bairstow v Queens Moat Houses plc* [2001] 2 BCLC 531, 548. In particular they are treated as trustees as respects the assets of the company which come into their hands or under their control: per Nourse LJ in *Re Duckwari plc* (No 2) [1999] Ch 253, 262. Similarly, a person entrusted with another person's money for a specific purpose has fiduciary duties to the other person in respect of the use to which those monies are put.

35. The distinguishing obligation of a fiduciary is the obligation of loyalty, which has several features: (i) a fiduciary must act in good faith; (ii) he must not make an unauthorised profit out of his trust; (iii) he must not place himself in a position where his duty and his interest may conflict; (iv) he may not act for his own benefit or the benefit of a third person without the informed consent of his principal: per Millett LJ in *Bristol and West Building Society v Mothew* [1998] Ch 1, 18.

36. In accordance with feature (i), it is a breach of fiduciary duty for directors of a company to exercise their powers of management and control otherwise than in good faith and in a way which they believe is in the best interests of the company: *Item Software (UK) Ltd v Fassihi* [2005] ICR 450. In accordance with features (ii) and (iii), if a director of a company makes an unauthorised profit by the use of his position as a director, he is liable to account for that profit to the company, whether or not he acted in good faith: *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134, 144.

Proprietary claims

37. Whether a proprietary interest exists or not is a matter of property law, and is not a matter of discretion: see *Foskett v McKeown* [2001] 1 AC 102, 109 per Lord Browne-Wilkinson, It follows that the courts of England and Wales do not recognise a remedial constructive trust as opposed to an institutional constructive trust.

38. *Foskett* [2001] 1 AC 102, 127-130 also establishes that, where a person has such a proprietary interest, he may enforce it by (a) following the asset unless and until the asset passes into the hands of a *bona fide* purchaser for value without notice, and also (b) tracing the value of his proprietary interest into identifiable substitutes for the original asset, unless the substitute has been provided by a *bona fide* purchaser for value without notice.

39. As Lord Millett explained in *Foskett* [2001] 1 AC 102, 127, "[f]ollowing is the process of following the same asset as it moves from hand to hand" whereas "[t]racing is the process of identifying a new asset as the substitute for the old." He went on to explain that, at least in principle, "[w]here one asset is exchanged for another, a claimant can elect whether to follow the original … or to trace the value". In individual cases, for a variety of different reasons (sometimes practical sometimes

principled) one or other course, or, if he is unlucky, both courses, may not be open to a claimant.

Personal claims against fiduciaries

40. If a trustee commits a breach of trust, the beneficiary's remedy against him is a personal one. The basic rule, as stated by Lord Browne-Wilkinson in *Target Holdings Ltd v. Redferns* [1996] AC 421, 434 is:

> "that a trustee in breach of trust must restore or pay to the trust estate either the assets which have been lost to the estate by reason of the breach or compensation for such loss. Courts of Equity did not award damages but, acting *in personam*, ordered the defaulting trustee to restore the trust estate. If specific restitution of the trust property is not possible, then the liability of the trustee is to pay sufficient compensation to the trust estate to put it back to what it would have been had the breach not been committed."

41. To much the same effect, Lord Millett said this in *Foskett v McKeown* [2001] 1 AC 102, 130:

> "A beneficiary's claim against a trustee for breach of trust is a personal claim. It does not entitle him to priority over the trustee's general creditors unless he can trace the trust property into its product and establish a proprietary interest in the proceeds."

42. In *Chan v. Zacharia* (1984) 154 CLR 178, 198 (cited with approval in *Don King Productions Inc v. Warren* [2000] Ch 291) Deane J said this:

> "Stated comprehensively in terms of the liability to account, the principle of equity is that a person who is under a fiduciary obligation must account to the person to whom the obligation is owed for any benefit or gain (i) which has been obtained or received in circumstances where a conflict or significant possibility of conflict existed between his fiduciary duty and his personal interest in the pursuit or possible receipt of such a benefit or gain or (ii) which was obtained or received by use or by reason of his fiduciary position or of opportunity or knowledge resulting from it. Any such benefit or gain is held by the fiduciary as constructive trustee…".

Claims based on constructive trust

43. As Lewison J said at [2010] EWHC 1614 (Ch), para 30, the phrase "held by the fiduciary as constructive trustee" has caused much trouble, and it has led to considerable confusion. It was commented on by Millett LJ in *Paragon Finance plc v*

DB Thakerar & Co [1999] 1 All ER 400, 408, in a passage in which he identified two classes, the first of which he described as follows:

> "A constructive trust arises by operation of law whenever the circumstances are such that it would be unconscionable for the owner of property … to assert his own beneficial interest in the property and deny the beneficial interest of another. In th[is] class of case, … the constructive trustee really is a trustee. … In these cases the plaintiff does not impugn the transaction by which the defendant obtained control of the property. He alleges that the circumstances in which the defendant obtained control make it unconscionable for him thereafter to assert a beneficial interest in the property.
>
> The second class of case is different. It arises when the defendant is implicated in a fraud. Equity has always given relief against fraud by making any person sufficiently implicated in the fraud accountable in equity. In such a case he is traditionally though I think unfortunately described as a constructive trustee and said to be 'liable to account as constructive trustee'. Such a person is not in fact a trustee at all, even though he may be liable to account as if he were. He never assumes the position of a trustee, and if he receives the trust property at all it is adversely to the plaintiff by an unlawful transaction which is impugned by the plaintiff. In such a case the expressions 'constructive trust' and 'constructive trustee' are misleading, for there is no trust and usually no possibility of a proprietary remedy; they are 'nothing more than a formula for equitable relief': *Selangor United Rubber Estates Ltd v Cradock (No 3)* [1968] 1 WLR 1555 at 1582 per Ungoed-Thomas J."

44. In *Dubai Aluminium Co Ltd v Salaam* [2003] 2 AC 366, 404 Lord Millett returned to the point, saying that, in the second class of case which he had identified, "the expressions 'constructive trust' and 'constructive trustee' create a trap", that they are "nothing more than a formula for equitable relief", and that "we should now discard the words 'accountable as constructive trustee' in this context and substitute the words 'accountable in equity'."

Equitable compensation

45. As this suggested reformulation implies, the traditional way in which a non-proprietary claim is assessed in equity is through the medium of an equitable account, which in turn leads to equitable compensation. The right to an account is dependent on the existence of a fiduciary relationship, so that it can be sought, for instance, by a principal against his agent, or even by a claimant in a passing off claim.

46. The right to equitable compensation through an equitable account will often produce the same answer, in terms of the ultimate value to the claimant, as a proprietary interest, but it has the disadvantage of being a personal claim, so it would rank *pari passu* with the defaulting fiduciary's other unsecured creditors' claims, in the event of his bankruptcy. Mr Miles argued that it also has the disadvantage of preventing the claimant from benefitting fully from a following or tracing claim. Thus, if the defaulting fiduciary invests the money he has misappropriated, and for which he

would be liable to account, in an asset which appreciates, a claimant with a proprietary claim can trace into that asset and recover its full value because he can effectively claim to own the asset beneficially, whereas, if he is limited to a personal claim, he cannot.

47. Some support for that contention may be found in observations in *Target* [1996] AC 421, where Lord Browne-Wilkinson said:

> "Equitable compensation for breach of trust is designed to achieve exactly what the word compensation suggests: to make good a loss in fact suffered by the beneficiaries and which, using hindsight and common sense, can be seen to have been caused by the breach."

However, although it is subject to limiting principles, equitable compensation is a more flexible concept than common law damages. Kirby J in the High Court of Australia put it this way in *Maguire v Makaronis (1997)* 188 CLR 449, 496:

> "[Equitable] remedies will be fashioned according to the exigencies of the particular case so as to do what is 'practically just' as between the parties. The fiduciary must not be 'robbed'; nor must the beneficiary be unjustly enriched."

First main issue: TPL's proprietary claim to the sale proceeds of the Shares

Introductory

48. In a nutshell, the issue between the parties is whether, as it contends, TPL has a proprietary interest in the proceeds of sale of the Shares, or whether, as the defendants argue, TPL has a right to an equitable account to the proceeds of sale. The difference is vital, because, if TPL is correct, it was the beneficial owner of those proceeds, and its beneficial ownership would override, subject to the question of notice, the payments made to the banks in so far as they were made out of the proceeds of sale. On the other hand, if the defendants' case is right, Mr Cushnie's duty is to account to TPL for the proceeds of sale, which is a personal remedy, which would not override the payments already made to the banks.

The proprietary claim to the proceeds of sale of the Shares: the arguments

49. TPL's proprietary claim relies on the fact that Mr Cushnie was able to sell the Shares in VGP for a substantial sum because he dishonestly misused funds in respect of which he owed TPL fiduciary duties, in order to inflate the apparent turnover and profits of VGP's wholly owned trading subsidiary, thereby increasing (or, in truth, creating) VGP's market value.

50. The proprietary claim is thus neither to the funds in respect of which Mr Cushnie owed the relevant fiduciary duties to TPL, nor to any asset, or proceeds of any asset, purchased with those funds; nor is the claim to the proceeds of any right or opportunity which belonged to TPL. Further, Mr Cushnie did not acquire the Shares with funds beneficially owned by TPL, or with money derived from those funds; indeed, he did not even acquire those shares as an indirect consequence of his misuse of those funds.

51. Having said that, there was undoubtedly a close commercial causal connection between Mr Cushnie's misuse of the funds in respect of which he owed fiduciary duties to TPL, and the money which he made on the sale of the Shares. Accordingly, on the basis that the misuse of the funds by Mr Cushnie in breach of his fiduciary duty was intended to, and did, enable him to make a profit, there is some common sense attraction in the notion that the profit should be beneficially owned by those to whom he owed the duty.

52. However, there is obvious force in the contention that the mere fact that the breach of duty enabled Mr Cushnie to make a profit should not, of itself, be enough to give TPL a proprietary interest in that profit. Why, it may be asked, should the fact that a fiduciary is able to make a profit as a result of the breach of his duties to a beneficiary, without more, give the beneficiary a proprietary interest in the profit? After all, a proprietary claim is based on property law, and it is not entirely easy to see conceptually how the proprietary rights of the beneficiary in the misused funds should follow into the profit made on the sale of the Shares.

53. On this argument, the fact that the breach of fiduciary duty owed to the beneficiary resulted in the profit should not necessarily mean that the profit is treated as the property of the beneficiary. Mr Miles argued, however, that this was the only way of ensuring that those with fiduciary duties were dissuaded from breaching their duties. At least on the basis of the argument we have heard, I do not regard the point as open and shut: it is possible that the assessment of equitable compensation is sufficiently flexible to extend to such a profit (a point touched on again at para 90 below). If, however, equitable compensation cannot extend to include such profits, then Mr Miles's point is correct, and I accept that it has some real force. If it is not correct, it undermines the main policy reason supporting TPL's proprietary claim: it does not matter to the defaulting fiduciary if he is stripped of his profits because they are beneficially owned by the beneficiary, or because he has to account for those profits to the beneficiary.

54. But the difference very much matters to the other creditors of the defaulting fiduciary, if he is insolvent. A person with a proprietary claim to assets held in the name of an insolvent person is better off than a secured creditor, and all such assets are unavailable to other creditors. That is not to suggest that there is anything commercially objectionable about proprietary claims, whose existence is well established and appropriate, but it is, I think, a reason for not extending the reach of such claims beyond what is established by authority and accords with principle.

55. Both the judgment below and the arguments before us focussed on cases where the courts have had to consider whether, where an agent or employee accepts a bribe or secret commission or the like, his principal or employer beneficially owns the bribe. As in the present case, the money in such cases was received by a fiduciary, and, although its receipt derived from his fiduciary position and was a plain breach of his fiduciary duties, it was not money which was part of the assets subject to his duties, or derived from such assets.

56. I am prepared to accept for present purposes that, if a claimant beneficially owns a bribe received by a fiduciary, it follows that TPL's proprietary claim to the proceeds of sale of the Shares must succeed. Nonetheless, it is worth pointing out that a fiduciary who accepts a bribe receives it directly because of his fiduciary function -

e.g. as the principal's agent, in order to induce him to place a contract for the principal with the bribe payer. Not only did Mr Cushnie not acquire the Shares with, or as a result of, his breach of duty as director of TPL, but the profit which he made on the Shares was as a shareholder in VTFL (indirectly through VGP) not as a director of TPL. Having pointed out that distinction, I can well see that, for practical, as well as principled, reasons, the proceeds of sale of the Shares, as an unauthorised secret profit, should be treated for present purposes in the same way as a bribe.

The proprietary claim to the proceeds of sale of the Shares: the cases up to 1993

57. In the famous, if rather unsatisfactorily reported, decision of King LC in *Keech v Sandford* (1726) Sel Cas t King 61, the only issue which appears to have been argued was whether, as the landlord had refused to renew a lease held on trust, the normal rule, that a trustee, who renews a lease held on trust, holds the renewed lease on trust, applied. If the normal rule applied, as was held to be the case, there does not seem to have been any dispute as to the consequences: the judgment is short and unreasoned, and there is no report of the argument. Both parties may have been happy for the lease to be treated as held on trust, if the claim succeeded in principle as it did.

58. Quite apart from this, it is possible to regard *Keech* Sel Cas t King 61 as an example of a trustee acquiring an asset through seizing for his own benefit an opportunity which was effectively owned by the trust. As explained by Hicks, in *The Remedial Principle in* Keech v Sandford *reconsidered* (2010) 69 Camb LJ 285, 295 to 298, the opportunity to renew a tenancy, although not strictly a legal right, was effectively recognised as such by the courts in the 18th century. Thus, King LC himself in *Addis v Clement* (1728) 2 P Wms 456, 459 referred to a church lease as being "always renewable" and therefore possible to regard as "a perpetual estate". Viewed in this way, *Keech* Sel Cas t King 61 can be said to be an orthodox, if rather strict, application of the principle that where a trustee takes advantage of an opportunity, which is really owned by the beneficiary, he holds the consequent proceeds for the beneficiary (as in *In re Cape Breton Company* (1885) 29 Ch D 795).

59. Next, there is a first instance decision of Stuart V-C, *Sugden v Crossland* (1856) 2 Sm & G 192, whose reasoning proceeded on the basis that there was no "distinction between a profit which a trustee takes out of a trust and a profit such as a bribe which a trustee receives from a third party", to quote Lord Templeman in *Attorney-General for Hong Kong v Reid* [1994] 1 AC 324. However, *Sugden* 2 Sm & G 192 was a first instance decision, and the same result would have obtained on the basis of equitable accounting, which does not appear to have been raised as an argument, and there was no question of the defendant being insolvent.

60. The next case in time is a decision of the House of Lords, *Tyrrell v Bank of London* (1862) 10 HL Cas 26. There was disagreement between Mr Miles and Mr Collings as to whether the reasoning of Lord Westbury LC and Lord Cranworth is inconsistent with the notion that a bribe received by an agent would be beneficially owned by his principal. However, there is no doubt that part of the reasoning of Lord Chelmsford, at 10 HL Cas 26, 59-60, is inconsistent with that notion, as he discussed and specifically rejected the contention that a solicitor, who receives a bribe to induce his client to purchase land, holds the bribe on trust for his client.

61. The view of all three members of the committee in *Tyrrell* (1862) 10 HL Cas 26 was that a solicitor, who bought a piece of land (which he knew that his client was interested in acquiring), (i) held that part of the land which his client then purchased on trust for his client (so that his client beneficially owned the profit which the solicitor made on that part), but (ii) did not hold the remainder of the land on trust for his client. In *Reid* [1994] 1 AC 324, 333, Lord Templeman seems to have thought that his conclusion that a bribe accepted by an agent was beneficially owned by his principal was inconsistent only with Lord Chelmsford's view. I find it hard to see how it is not also inconsistent with the view of all three members of the committee in *Tyrrell v* 10 HL Cas 26 on point (ii).

62. Although it is a decision of the House of Lords, *Tyrrell* 10 HL Cas 26 was not cited below, and it was not in the forefront of Mr Collings's argument before us, although he did rely on it. Its lack of prominence may be attributable to the rather uninformative headnote coupled with the density of the judgments. Whatever the reason, it does not seem to have been referred to in many of the subsequent relevant cases, or in many of the articles which discuss the cases on bribes in this field (referred to in para 81 below).

63. In *Re Caerphilly Colliery Company (Pearson's case)* LR 5 Ch D 336 the promoters of a company agreed to sell a colliery to the company for a substantial profit, and the price was payable partly in cash and partly in shares in the purchasing company. Some of the shares were given to Pearson, a director of the company, who was instrumental in ensuring that the contract was completed. Sir George Jessel MR said at LR 5 Ch D 336, 340, that:

> "[Pearson] cannot in the fiduciary position he occupied, retain for himself any benefit or advantage that he obtained under such circumstances. He must be deemed to have obtained it under circumstances which made him liable, at the option of the *cestuis que trust*, to account either for the value at the time of the present he was receiving, or to account for the thing itself and its proceeds if it had increased in value."

James LJ (in a judgment which I suspect betrays the court's view of the underlying merits of the case) and Baggallay JA agreed – see at LR 5 Ch D 336, 342.

64. In that case, again, there appears to have been no issue as to whether the claim against Pearson was based on a proprietary interest or a duty to account in equity, and, as there was no suggestion that Pearson was in danger of bankruptcy, it is not clear that either party had an interest in raising that issue. I also note that *Tyrrell* 10 HL Cas 26 does not appear to have been cited. Further, as pointed out by Lewison J at [2010] EWHC 1614, para 36, given that the shares had been issued as part of the payment by the company for the acquisition of the colliery, *Pearson's case* LR 5 Ch D 336 "was a case in which the property that was subject to the trust had originally been the beneficiary's property".

65. In *Metropolitan Bank v. Heiron* (1880) 5 Ex D 319, a director of a company who had received a bribe was being sued by the company, and he successfully ran a limitation defence on the ground that the company could not treat the bribe "as the money of the

company": per Brett and Cotton LJJ at 5 Ex D 319, 324 and 325. James LJ said at 5 Ex D 319, 323:

> "The ground of this suit is concealed fraud. If a man receives money by way of a bribe for misconduct against a company or *cestui que trust*, or any person or body towards whom he stands in a fiduciary position, he is liable to have that money taken from him by his principal or *cestui que trust*. But it must be borne in mind that that liability is a debt only differing from ordinary debts in the fact that it is merely equitable, and in dealing with equitable debts of such a nature Courts of Equity have always followed by analogy the provisions of the Statute of Limitations … ."

66. *Lister & Co v Stubbs* (1890) LR 45 Ch D 1 is to the same effect. In that case, an employee received a bribe from one of his employer's suppliers. He retained part of in cash, and invested the remainder. The Court of Appeal (Cotton, Lindley and Bowen LJJ) unanimously held that the bribe could not be considered to be the property of the employers. Lindley LJ said at LR 45 Ch D 1, 15:

> "Then comes the question, as between [employer] and [employee], whether [the employee] can keep the money he has received without accounting for it? Obviously not. I apprehend that he is liable to account for it the moment that he gets it. It is an obligation to pay and account to [the employer] … . But 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."

The last three sentences indicate that Lindley LJ thought that equitable compensation would not have extended to enabling the employer to claim the full value of the profits made on the business or asset purchased by the employee with the bribe, which, as Mr Miles said, rather undermines Mr Collings's suggestion that equitable accounting would enable a fiduciary to be held accountable for any profit he made on an asset which he acquired with a bribe.

67. In neither *Heiron* 5 Ex D 319 nor *Lister* LR 45 Ch D 1 was *Pearson's case* LR 5 Ch D 336 cited. However, in the next case which it is appropriate to mention, *In re North Australian Territory Company (Archer's case)* [1892] 1 Ch 322, it was. *Archer's case* [1892] 1 Ch 322 concerned a secret commission paid to a director. Lindley LJ specifically addressed cases in which it had been said that bribes or commissions paid to a director "belonged" to the company, describing the expression as "ambiguous", and made it clear that he adhered to the view he had taken in *Lister* 45 Ch D 1 – see at

[1892] 1 Ch 322, 338. He said that "[i]n one sense" the commission "may be said to be the company's money", but only "in the sense that the company are entitled to get it." He then said that "in the event of the [director's] bankruptcy, [the company could not] withdraw the money from his assets instead of ranking as creditors against his estate."

68. These observations in *Archer's case* [1892] 1 Ch 322 can fairly be said to highlight the need for caution when citing cases such as *Sugden* 2 Sm & G 192 and *Pearson's case* LR 5 Ch D 336 to support the proposition that the claimant has a proprietary interest in the commission or bribe received by the fiduciary. This point is further bolstered by the fact that Bowen LJ was "of the same opinion" as Lindley LJ – at [1892] 1 Ch 322, 339, and Fry LJ (who considered *Pearson's case* LR 5 Ch D 336 in a little detail at [1892] 1 Ch 322, 343) not only was "of the same opinion", but "express[ed] his entire concurrence with everything that ha[d] been said by" Lindley and Bowen LJJ – [1892] 1 Ch 322, 342, 344.

69. The approach in *Heiron* 5 Ex D 319 and *Lister* LR 45 Ch D 1 was followed by the Court of Appeal in the civil case of *Powell & Thomas v Evans Jones & Co* [1905] 1 KB 11, and in the criminal case, *Attorney-General's Reference (No 1 of 1985)* [1986] 1 QB 491. Further, *Lister* 45 Ch D 1 was referred to without any suggestion that it was wrong by Lord Wright in *Regal (Hastings) Ltd v Gulliver* [1942] 2 AC 134.

70. The well known case of *Boardman v Phipps* [1967] 2 AC 46 was relied on by TPL. On analysis, it takes matters no further. The precise nature of the remedy was not at issue in the Court of Appeal or the House of Lords, as the argument centred on the question of liability – see [1965] Ch 992, 1007G and [1967] 2 AC 46, 61F. Lewison J's analysis of *Boardman* [1967] 2 AC 46 at [2010] EWHC 1614 (Ch), paras 41-47 suggests that it is unclear whether the remedy granted at first instance was proprietary or personal, and I agree with his view that "it seems … to be clear that the question was never argued, and apparently did not matter".

71. While both *Heiron* 5 Ex D 319 and *Lister* 45 Ch D 1 were followed and applied in at least three subsequent decisions of this court, they were disapproved by the Privy Council in *Reid* [1994] 1 AC 324. In that case, a public prosecutor employed by the Hong Kong administration had received bribes for not pursuing accused persons. Lord Templeman, who gave the opinion of the Board, said this:

> "When a bribe is offered and accepted in money or in kind, the money or property constituting the bribe belongs in law to the recipient. Money paid to the false fiduciary belongs to him. The legal estate in freehold property conveyed to the false fiduciary by way of bribe vests in him. Equity, however, which acts *in personam*, insists that it is unconscionable for a fiduciary to obtain and retain a benefit in breach of duty. The provider of a bribe cannot recover it because he committed a criminal offence when he paid the bribe. The false fiduciary who received the bribe in breach of duty must pay and account for the bribe to the person to whom that duty was owed. In the present case, as soon as the first respondent received a bribe in breach of the duties he owed to the Government of Hong Kong, he became a debtor in equity to the Crown for the amount of that bribe. So much is admitted. But if the bribe consists of property which

> increases in value or if a cash bribe is invested advantageously, the false fiduciary will receive a benefit from his breach of duty unless he is accountable not only for the original amount or value of the bribe but also for the increased value of the property representing the bribe."

The proprietary claim to the proceeds of sale of the Shares: principle and precedent

72. Lewison J followed the approach of the Court of Appeal in *Heiron* 5 Ex D 319 and *Lister* 45 Ch D 1, and accordingly held that TPL had no proprietary interest in the proceeds of sale of the Shares. For TPL, Mr Miles contends that this was wrong and that we should follow the decision of the Privy Council in *Reid* [1994] 1 AC 324.

73. I would reject that contention. We should not follow the Privy Council decision in *Reid* [1994] 1 AC 324 in preference to decisions of this court, unless there are domestic authorities which show that the decisions of this court were *per incuriam*, or at least of doubtful reliability. Save where there are powerful reasons to the contrary, the Court of Appeal should follow its own previous decisions, and in this instance there are five such previous decisions. It is true that there is a powerful subsequent decision of the Privy Council which goes the other way, but that of itself is not enough to justify departing from the earlier decisions of this court: see *Re Spectrum Plus Ltd (in liquidation)* [2004] EWCA Civ 670, [2004] Ch 37, para 56 per Lord Phillips of Worth Matravers MR and [2005] UKHL 41, [2005] 2 AC 680, para 153 per Lord Walker of Gestingthorpe.

74. I do not suggest that it would always be wrong for this court to refuse to follow a decision of the Privy Council in preference to one of its own previous decisions, but it the general rule is that we follow our previous decisions, leaving it to the Supreme Court to overrule those decisions if it is appropriate to do so. Two recent cases where this court preferred to follow a decision of the Privy Council rather than an earlier domestic decision which would normally be regarded as binding (in each case a decision of the House of Lords) are *R v James (Leslie)* [2006] EWCA Crim 14, [2006] 1 All ER 759 and *Abou-Rahmah v Abacha* [2006] EWCA Civ 1492, [2007] 1 Lloyd's Rep 115. In each case, the decision was justified, based as it was on the proposition that it was a foregone conclusion that, if the case had gone to the House of Lords, they would have followed the Privy Council decision.

75. In the present instance, Mr Miles invited us to take the view that it was a foregone conclusion that the Supreme Court would follow the Privy Council in *Reid* [1994] 1 AC 324 rather than the Court of Appeal in *Heiron* 5 Ex D 319 and *Lister* 45 Ch D 1, and therefore to follow the Privy Council approach rather than that of this court.

76. Although it is possible that the Supreme Court would follow *Reid* [1994] 1 AC 324 rather than *Heiron* 5 Ex D 319 and *Lister* 45 Ch D 1, I am far from satisfied that they would do so. In any event it does not seem to me right to follow *Reid* [1994] 1 AC 324.

77. First, there are five decisions of this court (*Heiron* 5 Ex D 319 *Lister* 45 Ch D 1, *Archer's case* [1892] 1 Ch 322, *Powell* [1905] 1 KB 11, and, *A-G's Reference* [1986]

1 QB 491) spread over 95 years, all of which have reached the same conclusion on the point, and there is the reasoning of the House of Lords in *Tyrrell* 10 HL Cas 26. Although it may be true that the reasoning in *Pearson's case* LR 5 Ch D 336, which was not cited to the courts in *Heiron* 5 Ex D 319 and *Lister* 45 Ch D 1, is inconsistent with those cases, I am not persuaded that the point has any force: (i) the point does not appear to have been argued in *Pearson's case* LR 5 Ch D 336, (ii) *Tyrrell* 10 HL Cas 26 was not cited in *Pearson's case* LR 5 Ch D 336, (iii) *Pearson's case* LR 5 Ch D 336 and *Lister* 45 Ch D 1 were both cited in *Archer's case* [1892] 1 Ch 322, and the latter authority was preferred, and (iv) in subsequent cases, this court followed *Lister* 45 Ch D 1.

78. Secondly, much of the reasoning of Lord Templeman in *Reid* [1994] 1 AC 324 seems to me to beg the question, or to assume what it asserts (although I suppose that the same can be said about the views expressed in *Heiron* 5 Ex D 319 and *Lister* 45 Ch D 1). Thus, before setting out to explain his reasoning, Lord Templeman asserts at [1994] 1 AC 324, 331B that a bribe paid to a "false fiduciary vests in … the person to whom the duty is owed". But that is the very issue he then purports to decide.

79. Thirdly, the concern which Lord Templeman expressed at the end of the passage I have quoted in para 71 above might well be met by ordering an equitable account: there was apparently no argument before the Privy Council to that effect.

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

81. Fifthly, not only has there been much academic commentary since *Reid* [1994] 1 AC 324 which supports the approach in *Heiron* 5 Ex D 319 and *Lister* 45 Ch D 1, but, at least from what I have seen, there is significantly more support for the approach for those cases in scholarly articles than there is for *Reid* [1994] 1 AC 324. It is true that Lord Millett (*Bribes and Secret Commissions* [1993] RLR 7 and subsequently, e.g. in Degeling and Edelman, *Equity and Commercial Law*, 2005, pp.312-319) strongly agrees with *Reid* [1994] 1 AC 324. However, the reasoning in *Lister* 45 Ch D 1 is supported by Professor Birks *Introduction to the Law of Restitution,* second edition, pp. 386-9), Professor Goode (*Ownership and obligation in commercial transactions* (1997) LQR 433 and other works, including in Cornish on *Restitution – Past, Present and Future*, 1998, Chapter 5), Professor Virgo in *The Principles of the Law of Restitution*, (second edition, pp. 519-524), and Professor Burrows in *The Law of Restitution* (second edition, p 500) and Tettenborn in *The Law of Restitution in England and Ireland* (second edition, pp 231-3) as well as by other closely reasoned articles such as those by Watts on *Bribes and Constructive Trusts* (1994) 110 LQR. 178, Crilley in *A Case of Proprietary Overkill* [1994] RLR 57, and McCormack in *The Remedial Constructive Trust and Commercial Transactions* (1996) Company

Lawyer 3. (While it may be seeking to undermine some of the arguments which support *Reid* [1994] 1 AC 324, Hicks in (2010) 69 Camb LJ 285, is, I think, ultimately neutral).

82. As for the text books, the majority appear to accept *Reid* [1994] 1 AC 324 as correct – see e.g Goff and Jones in *The Law of Restitution* (sixth edition, para 33-025) Underhill & Hayton on *The Law Relating to Trusts and Trustees* (18th edition, paras 27.29-30), *Lewin on Trusts* (18th edition, p. 589) and *Snell* (31st edition paras 7-141-2). However, on the whole, these books do not devote much analysis to the point at issue, whereas the most recent edition of *Bowstead & Reynolds* (19th edition, paras 6-040 to 6-043) gives the topic close consideration and the editor clearly has significant doubts about the soundness of *Reid* [1994] 1 AC 324.

83. Sixthly, it seems to me that Lord Templeman may have given insufficient weight to the potentially unfair consequences to the interests of other creditors, if his conclusion was right. His dismissal of their concerns on the basis that they should be in no better position than the defaulting fiduciary at [1994] 1 AC 324, 331F-H stands in rather stark contrast with what was said in *Lister* 45 Ch D 1, 15, and in *Archer's case* [1892] 1 Ch 322, 338, as well as, more recently, in *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669, 716E. In that case, Lord Browne-Wilkinson disapproved extending the reach of resulting trust as it could produce "most unjust results", namely "conferring on the plaintiff a right to recover property from, or at the expense of [for example] the lender whose debt is secured by a floating charge and all other parties who have purchased an equitable interest only …".

84. Seventhly, there are some relevant domestic decisions subsequent to *Reid* [1994] 1 AC 324. In *Daraydan Holdings Ltd v Solland International Ltd* [2005] Ch. 119, para 86, Lawrence Collins J (after referring at [2005] Ch 119, para 81 to some other post-*Reid* [1994] AC 324 first instance decisions which seemed to have gone in different ways) preferred to follow *Reid* [1994] 1 AC 324, but (i) that was before the guidance given in *Spectrum Plus* [2004] Ch 37, [2005] 2 AC 680, referred to in para 73 above, (ii) as Lawrence Collins J pointed out at [2005] Ch. 119, paras 87-88, on the facts of that case, the decision was not inconsistent with the reasoning in *Lister* 45 Ch D 1, and (iii) it was a first instance judgment, and neither *Tyrrell* 10 HL Cas 26 nor *Archer's case* [1892] 1 Ch 322 was cited to him.

85. Perhaps of more direct relevance for present purposes are two recent decisions, both of this court, where the reasoning in *Lister* 45 Ch D 1 was followed, namely *Gwembe Valley Development Co Ltd v Koshy (No 3)* [2004] 1 BCLC 131 and *Halton International Inc v Guernroy* [2006] EWCA Civ 801.

86. In *Gwembe* [2004] 1 BCLC 131, a director had made secret profits in breach of his fiduciary duty to the company. As in *Heiron* 5 Ex D 319 and *Paragon* [1999] 1 All ER 400, the issue was whether the director was entitled to rely on a defence of limitation. The Court of Appeal applied the two-fold categorisation expounded by Millett LJ in *Paragon* [1999] 1 All ER 400, 409, and held that he fell within the second class, as the director's "personal liability to account to [the company] for profits made by him from his fiduciary position as a director is not dependent on establishing that he has received any money or other property belonging to [the company] as a result of the misapplication of [its] assets" - [2004] 1 BCLC 131, para 118. In the following paragraph, the court distinguished an earlier decision, *JJ*

Harrison (Properties) Ltd v Harrison [2002] 1 BCLC 162, where a proprietary claim was upheld, on the ground that, in the earlier case, the director had transferred to himself assets which were the property of the company.

87. In *Halton* [2006] EWCA Civ 801, para 18, Carnwath LJ said that "[t]he difference between [*Harrison* [2002] 1 BCLC 162 and *Gwembe* [2004] 1 BCLC 131], in short, was that while in the former the director had a pre-existing 'trustee-like responsibility' in relation to the particular property which was the subject of the action, in the latter he did not." It is interesting to note that Carnwath LJ said this at [2006] EWCA Civ 801, para 25:

> "*Keech v Sandford* might arguably be brought within [Millett LJ's] class 1 [in *Paragon* [1999] 1 All ER 400, 409], but, if so, only because of the special nature of the property involved. As was explained in *Biss v Biss* [1903] 2 Ch 40, 56 … , the renewal is treated as 'an accretion to or graft upon the original term arising out of the goodwill or quasi-tenant right annexed thereto'. It provides no analogy for a similar link between the voting rights and the new shares in the present case."

Conclusion on the proprietary claim to the proceeds of sale of the Shares

88. In my view, Lewison J was right to reject TPL's proprietary claim to the proceeds of sale of the Shares. It is true that the decisions in *Reid* [1994] 1 AC 324, *Sugden* 2 Sm & G 192 and (at least arguably) *Pearson's case* LR 5 Ch D 336 go the other way. However, there is a consistent line of reasoned decisions of this court (two of which were decided within the last ten years) stretching back into the late 19th century, and one decision of the House of Lords 150 years ago, which appear to establish that a beneficiary of a fiduciary's duties cannot claim a proprietary interest, but is entitled to an equitable account, in respect of any money or asset acquired by a fiduciary in breach of his duties to the beneficiary, unless 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.

89. For the reasons I have given, 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. However, those cases also establish that, in such a case, a claimant does have a personal claim in equity to the funds. There is no case which appears to support the notion that such a personal claim entitles the claimant to claim the value of the asset (if it is greater than the amount of the funds together with interest), and there are judicial indications which tend to militate against that notion.

90. Mr Miles suggested (with Lord Millett's extrajudicial support) that, essentially as a matter of equitable policy, a fiduciary should not be allowed to profit from his breach of duties, even to the extent of retaining any profit from such an asset after compensating a claimant in full. If that is indeed correct (as Mr Collings appeared to accept), then it seems to me that this should be dealt with by extending, or adjusting, the rules relating to equitable compensation rather than those relating to proprietary interests. Such a course, as I see it, would do less violence to the law as consistently laid down (where it has been specifically addressed) in a number of domestic cases of high authority, whereas it would involve little interference with established authority relating to equitable compensation. In addition, the law relating to proprietary interests, being within the law of property, is inherently rather less flexible than the law relating to equitable compensation. Furthermore, extending the law relating to equitable compensation in such a case would interfere far less with the legitimate interests of other creditors than extending the law relating to proprietary interests.

91. (It may even be that tracing can be invoked to support such a personal claim. I find it a little hard to see how that could work, save where the tracing exercise is being pursued in respect of a defendant's proprietary interest by a claimant with a personal claim against the defendant. In *Foskett* [2001] 1 AC 102, 128, after explaining that "[t]racing is thus neither a claim nor a remedy", Lord Millett said that "[t]he successful completion of a tracing exercise may be a preliminary to a personal claim … or a proprietary one, to the enforcement of a legal right … or an equitable one." Lord Steyn said much the same thing at [2001] 1 AC 102, 113.)

92. In these circumstances, I cannot improve on Lewison J's conclusion on this part of the case at [2010] EWHC 1614 (Ch), para 81:

> "The fiduciary duty relied on in the present case is a duty owed by Mr Cushnie to TPL. The unauthorised profit is a profit realised by Mr Cushnie on the sale of shares in VGP. … Mr Cushnie acquired those shares before TPL was even incorporated. But at any rate his initial acquisition of the shares could not, in my judgment, have amounted to an acquisition of property that belonged in any sense to TPL. Before his sale of those shares he did not owe trustee-like duties in relation to that specific property. It follows, in my judgment, that the claim by TPL to the profit realised by Mr Cushnie on a sale of those shares is a claim based on the transaction which gave rise to those profits, and the circumstances in which it was made. It is, therefore, a case which falls into [Millett LJ's] second class; and gives rise to a personal remedy only. Since the claim gives rise to a personal remedy only, it is not open to TPL to trace those profits into the proceeds of sale of the Kensington property and to assert a proprietary claim to those proceeds. The settlement of personal claims between VTFL and Mr Cushnie cannot be undone by TPL in reliance on a personal claim. That settlement could only be undone by a trustee in bankruptcy or liquidator."

Second main issue: Following any proprietary claim to the Share sale proceeds

Introductory

93. Given my conclusion that TPL has no proprietary claim to the proceeds of sale of the Shares, it is strictly unnecessary to deal with the question whether the banks and VTFL were *bona fide* purchasers for value without notice. However, it is right to address the issue, as it has been fully argued, and it will anyway be necessary to consider the question of notice in connection with the third main issue. Accordingly, this section of my judgment proceeds on the basis that, contrary to the conclusion just expressed, TPL has a proprietary claim to the proceeds of sale of the Shares.

94. The question is whether TPL's attempt to follow certain payments to the banks from those proceeds of sale can be defeated by the banks on the ground that they were *bona fide* purchasers for value without notice. There is no suggestion that the banks did not act *bona fide* (save to the extent that that question overlaps with the question of notice). There is no dispute that they were "purchasers" for value, in the sense that the money they received was used in partial discharge of Mr Cushnie's secured liabilities to them. Accordingly, the sole issue is whether the banks had notice of the proprietary claim at the time they received the relevant payment. As to that, it is common ground that the burden of proof is on the banks - see *Re Nisbet and Potts' Contract* [1906] 1 Ch 386.

95. So far as concerns this, the first of TPL's two proprietary claims, namely that based on Mr Cushnie's breach of fiduciary duties, against the proceeds of sale of the Shares, it is agreed that there are three relevant dates so far as payments to the banks are concerned. They are (i) the date of the payment to NatWest referred to at the end of para 16 above, February 2000, (ii) the date of the second payment, January 2001, referred to in para 18 above, and (iii) in respect of any subsequent payment, the date of the settlement agreement described in paras 18 and 19 above, 26 February 2001. As for VTFL, the relevant date is also 26 February 2001, as that was the date of the settlement agreement, under which Mr Cushnie also agreed to make the payment of £2.7m to it.

96. Lewison J held that, as at each of these dates, neither the banks nor VTFL had notice of TPL's proprietary claim to the monies involved.

The concept of notice

97. Leaving the money paid to VTFL on one side, the issue is simply whether on the facts known to the banks at the time at which they received the payments in question they had notice of TPL's proprietary right to the money so paid.

98. In *Barclays Bank Plc v O'Brien* [1994] 1 AC 180, 195 Lord Browne-Wilkinson explained:

> "The doctrine of notice lies at the heart of equity. Given that there are two innocent parties, each enjoying rights, the earlier right prevails against the later right if the acquirer of the later right knows of the earlier right (actual notice) or would have discovered it had he taken proper steps (constructive notice). In particular, if the party asserting that he takes free of the earlier rights of another knows of certain facts which put him on inquiry as to the possible existence of the rights of

> that other and he fails to make such inquiry or take such other steps as are reasonable to verify whether such earlier right does or does not exist, he will have constructive notice of the earlier right and take subject to it."

99. In *Macmillan Inc v Bishopsgate Trust plc (No 3)* [1995] 1 WLR 978, 1014, Millett J, albeit in an addendum to his judgment, touched on the question of the nature of constructive notice in these terms:

> "[The plaintiff] attempted to establish constructive notice on the part of each of the defendants by a meticulous and detailed examination of every document, letter, record or minute to see whether it threw any light on the true ownership of the [relevant] shares which a careful reader — with instant recall of the whole of the contents of his files — ought to have detected. That is not the proper approach. Account officers are not detectives. Unless and until they are alerted to the possibility of wrongdoing, they proceed, and are entitled to proceed, on the assumption that they are dealing with honest men. In order to establish constructive notice it is necessary to prove that the facts known to the defendant made it imperative for him to seek an explanation, because in the absence of an explanation it was obvious that the transaction was probably improper."

100. In the present case, as at the three dates identified in para 95 above, TPL's case is that the banks ought to have appreciated that the transfers of money effected on, or as at, those dates was "probably improper" on the ground that the money was beneficially owned by TPL, or at least that the banks ought to have made enquiries before accepting the money. It is accepted by both TPL and the defendants that the issue is to be determined by asking what the banks actually knew, and what further enquiries, if any, a reasonable person, with the knowledge and experience of the banks, would have made, and, in the light of that, whether it was, or should have been, obvious to the banks that the transaction was probably improper.

101. The information available to the banks, through the administrative receivers, as to what had really been going on in the Versailles Group started to come through from December 1999. The incremental increase in the available information then built up over the next three years, as a result of forensic accounting investigations, meetings and discussions, especially with representatives of those who had been defrauded, such as Mr Akers on behalf of TPL, and legal, accounting and financial reports and advice. The ultimate, and difficult, task for the Judge was to decide at what point the level of information was such that the banks had notice of TPL's proprietary claim. At some point, an item of factual information, a (possibly informal) notification of a claim, or a piece of advice, when taken together with the facts, notifications and advice already available would have changed the banks' position from not having notice to having such notice. That point had to be decided, of course, on the basis of the evidence available to the Judge, and his assessment of what a reasonable and honest person in the position of the banks, with all their experience and available sources of advice, should have known, done, and appreciated, as well as what they actually knew, did, and appreciated.

Notice: is it right to impute the legal consequences of known facts?

102. An issue between the parties was whether the banks should be treated as appreciating the legal consequences of the facts which they knew or ought to be treated as knowing, even if they did not in fact appreciate those consequences.

103. Mr Miles contended that the banks should be assumed to have appreciated the legal consequences of the facts which they knew. He drew support for this contention from dicta of Buckley and Goff LJJ in relation to a constructive trust claim in *Belmont Finance Corporation v Williams Furniture Ltd (No 2)* [1980] 1 All ER 393, 405f and 412e respectively. Those passages do not specifically spell out the conclusion for which Mr Miles contends. However, while neither of the judgments appears directly to address the issue, they do seem to support his contention in the light of the fact that, at [1980] 1 All ER 393, 404g-h, Buckley LJ held that, in connection with the parallel conspiracy claim, it did not assist the defendants that they did not believe that the transactions in question broke the law, and that "ignorance of the law will not excuse them". It is also unclear whether it was argued or conceded in that case that the constructive trust claim required knowledge of the legal consequences.

104. In my view, despite what was apparently assumed in *Belmont Finance* [1980] 1 All ER 393, it seems to me that it is not possible to be as categorical as Mr Miles suggests. Just as in some cases but not in others, a defendant ought to make further enquiries as to the facts, so in some cases but not in others, it may be that a defendant should be taken to know the law. In my opinion, once a person knows certain facts, he should only be treated as appreciating the legal consequences if he actually knew of those consequences, or if, in all the circumstances, he ought reasonably have appreciated those consequences.

105. That conclusion seems to be consistent with the principles referred to in paras 98 and 99 above, although the cases referred to there were concerned with facts and factual inferences rather than legal consequences. The conclusion also appears consistent with what was said, in *Carl Zeiss Stiftung v Herbert Smith & Co* [1969] 2 Ch 276, 290, where Danckwerts LJ said this:

> "In my view, knowledge of a claim being made against the solicitor's client by the other party is not sufficient to amount to notice of a trust or notice of misapplication of the moneys. In the present case, which involves unsolved questions of fact, and difficult questions of German and English law, I have no doubt that knowledge of the plaintiffs' claim is not notice of the trusts alleged by the plaintiffs."

Sachs LJ took the same view, and at [1969] 2 Ch 276, 290 described "the duty to inquire" as "vary[ing] according to the facts", and that, in that case, when it came to the law, the defendants "were under no duty … in such a complex matter either to make enquiries or to attempt to assess the result."

106. It is true that, like *Belmont* [1980] 1 All ER 393, *Carl Zeiss* [1969] 2 Ch 276 was not a notice case. It is also true that different standards may be appropriate for assessing what constitutes knowledge or notice in knowing receipt, constructive trust, and notice cases (see per Sir Robert Megarry V-C in *In re Montagu's Settlement Trusts* [1987] Ch 264 and *Bank of Credit and Commerce International (Overseas) Ltd v Akindele* [2001] Ch 437). However, all such cases ultimately involve the question

whether a recipient of money to which another person has a proprietary claim can properly retain the money, in the face of a claim by the other person, given what the recipient knew or ought to have appreciated at the time he received the money.

107. Even if different standards are appropriate to those different equitable claims (as to which I express no view), it would be surprising if a wholly different approach was taken when assessing whether the recipient of the money should be assumed to appreciate the legal consequences of the facts he knows or ought to know. It seems to me that the question whether one attributes to the recipient of the money knowledge of the legal consequences of the facts that he knows should be determined by reference to the same standard as is applicable to the facts. Thus, in the present case, the proper approach to the issue should be as laid down in the passages cited in paras 98-100 above.

108. Accordingly, I agree with the Judge that it is not right automatically to impute to the banks knowledge of the legal consequences of the facts which they knew or ought to have known. I also agree with him that the reasoning in *Carl Zeiss* [1969] 2 Ch 276 supports the proposition that notice of a claim is not the same as notice of a right. In every case, one has to identify the facts known to the person alleged to have notice, and then consider the question by reference to the guidance given in the passages quoted in paras 98 and 99 above, whose effect is, I believe, accurately summarised in para 100 above.

Notice: the approach to be adopted in this case

109. In this case, it appears to me that the question which the Judge had to determine was whether, on the facts known to the banks as at the three dates identified in para 95 above, a reasonable person with their attributes (i.e. those of a responsible large bank, with the benefit of highly experienced insolvency practitioners as their appointed administrative receivers) should either have appreciated that a proprietary claim probably existed or should have made enquiries or sought advice, which would have revealed the probable existence of such a claim.

110. When considering this question, Mr Collings relied on what was said by Lord Herschell LC in *Thomson v Clydesdale Bank* [1893] AC 282, 287:

> "It cannot, I think, be questioned that under ordinary circumstances a person, be he banker or other, who takes money from his debtor in discharge of a debt is not bound to inquire into the manner in which the person so paying the debt acquired the money with which he pays it. However that money may have been acquired by the person making the payment, the person taking that payment is entitled to retain it in discharge of the debt which is due to him."

111. It is fair to say that this observation accords with Millett J's observations cited in para 99 above. However, in this case the transactions which TPL seeks to impugn were not merely effected under the shadow of an apparent insolvency, but there actually was an inquiry under way, as described in paras 16 and 17 above and it had become clear that something very wrong indeed had been going on. By each of the three dates in question, it had become clear, as a result of PwC's investigations, that there had been

what the Judge described as "a massive defalcation", that there had been "misappropriated funds", and that "TPL were … the victims of the fraud and had lost substantial funds" – see at [2010] EWHC 1614 (Ch), para 114. By 20 January 2000, PwC had decided that Mr Clough was probably responsible, and a freezing order was obtained against him by the administrative receivers six days later. By contrast, although PwC reported that Mr Cushnie "may not have been the perpetrator", they certainly did not exonerate him. Indeed, they described his sale of the Shares as "superbly timed" and referred to an unexplained payment he made of £1m to Mr Clough.

112. Accordingly, it seems to me that the most that can be made by the defendants in this case of Lord Herschell's statement, is that it is important that the courts do not interpret or develop the law of notice in such a way as to interfere unacceptably with ordinary and honest commerce. I would accept that this is an important factor to bear in mind even when parties are entering into transactions knowing that they are doing so in the shadow of insolvency and fraud. However, that is as far as the point goes in this case.

Notice so far as the banks are concerned

113. Lewison J looked at the contemporaneous documentary evidence, including notes of meetings attended by the administrative receivers and the liquidators and/or their representatives, and heard oral evidence from a number of those parties, in particular Mr Greaves, who was the individual most closely involved with matters on behalf of the administrative receivers (and the banks). The Judge carefully and fully assessed the evidence in relation to each of the three transactions under consideration, and concluded that the banks and the administrative receivers were *bona fide* purchasers for value without notice – [2010] EWHC 1614 (Ch), paras 102-139. Unsurprisingly, there is no doubt that the Judge asked himself the right basic question, namely whether, as at all or any of the three relevant dates, early February 2000, January 2001, and 26 February 2001, the banks or administrative receivers had actual or constructive notice of the fact that the proceeds of sale of the Shares in Mr Cushnie's hands were subject to a proprietary interest in favour of TPL.

114. In the end, it seems to me that there were two factors which persuaded the Judge to reach this conclusion, the first of which justified his conclusion in relation to the first and second of the three dates, and the second of which justified his conclusion in relation to all three dates.

115. First, although there was plenty of evidence to support the contention that TPL had a claim in relation to the monies that it had paid over to VTFL, it never occurred to the administrative receivers or the banks that TPL had a proprietary claim in respect of those monies. The Judge thought that, at least until the middle of February 2001, it would not be right to attribute to the administrative receivers or the banks the (assumed, for present purposes) legal consequence of a proprietary claim as a result of the facts they knew at that time.

116. The Judge's rejection of the contention that the administrative receivers knew or ought to have appreciated the fact that TPL had a proprietary claim is strongly reinforced by the fact that the existence of such a claim had not been raised on behalf of TPL itself at any meeting or in any correspondence with the liquidators, until 14

February 2001, when Mr Akers asserted a proprietary claim which would "trump the banks". Indeed, it seems clear that, at that time, the possibility of such a claim had not occurred to the liquidators until much before that date.

117. The second factor which weighed with the Judge was that there was simply insufficient evidence, even by the end of February 2001, to suggest that Mr Cushnie had been responsible for any wrongdoing, let alone what the nature and timing of his wrongdoing might have been. Now that one knows that the Versailles Group's business was nothing but a fraud from the inception, and that Mr Cushnie was one of the two main architects of the fraud, it is easy to fall into the trap of thinking that this must have been obvious to anyone in the position of the administrative receivers and the banks as soon as VGP share dealing was suspended and the administrative receivers were appointed.

118. TPL's submissions on both points which caused the Judge to reject its case on notice involved concentrating attention on isolated statements in some documents which, with wisdom of hindsight, could be said to suggest that there was good reason before mid-February 2001 to think that TPL had a proprietary claim, and good reason to conclude before the end of February 2001, that Mr Cushnie had been fraudulent in his management of the Versailles Group.

119. Thus, Mr Miles relied on the fact that, a few months after Mr Cushnie's sale of the Shares, his brokers, Tether and Greenwood, resigned as stockbrokers to VGP, saying that they were "horrified" to discover that he had sold the Shares at the time that he knew that there was a DTI investigation into the company. That may well have cast doubt on Mr Cushnie's straightforwardness, or even on his honesty, at least in relation to selling a 5% interest in VGP. However, at least in the absence of other compelling evidence, it does not begin to justify the conclusion that the banks thereby had notice of the fact that anyone had a proprietary interest in the proceeds of sale of the Shares.

120. Mr Miles also relied on the fact that, in January 2000, the banks had clear evidence of the cross-firing. However, that does not mean that they should have been appreciated that TPL therefore had a proprietary claim, and, anyway, there was nothing to show that Mr Cushnie was responsible for it. In retrospect it may seem surprising that it took so long for the penny to drop, but it is clear that, in late 2000, at least some of the traders, who obviously appreciated by then that things had gone badly wrong, regarded Mr Cushnie as an ally, who was to be trusted. Similarly, Mr Lomas produced a detailed report for the banks on 24 November 2000, which did not even imply that Mr Cushie was implicated in any wrongdoing. The matter was further complicated by the fact that VTFL had been subject to a separate substantial fraud.

121. It is also true that, as mentioned above, at a meeting in mid-February 2001 attended by Mr Lomas and Mr Akers among others, there was reference to a proprietary claim, but it does not appear to have been one against Mr Cushnie, it did not refer to the proceeds of sale of the Shares, and it appears to have been based on some questionable notion that a liquidator would have had to be appointed to pursue it.

122. Accordingly, I am of the view that Lewison J was at the very least entitled to decide that, even if TPL had a proprietary claim to the proceeds of sale of the Shares, the banks took free of that claim in respect of the payments made to them by Mr Cushnie out of those proceeds, up to the end of February 2001.

Can VTFL claim to be a bona fide *purchaser without notice?*

123. The next question is whether the Judge was right to reach the same conclusion in relation to any payment to VTFL. TPL's case was, as it is before us, that, when in February 2001 VTFL received the money from Mr Cushnie, it could not, as a party to the fraud practised on TPL over the years leading up to 2000, claim to have had no notice of TPL's proprietary claim to the money it received from Mr Cushnie, based as the claim is on that very fraud.

124. In a passage at [2010] EWHC 1614, para 140 which contains his reasoning in compressed terms, Lewison J rejected that argument for two reasons. The first reason was that VTFL was as much a victim of the fraud as TPL. The second reason was that, at the time when it received the money in February 2001, those running VTFL, and hence VTFL itself, were as unaware of the possibility of the proprietary claim as were the banks, especially bearing in mind the fact that it depended on the sale of shares in VGP.

125. In my opinion, Lewison J was right to hold that, because the administrative receivers represented the controlling minds of VTFL at the time that the money in question was paid to VTFL, and they did not have notice of TPL's proprietary claim at that time, VTFL was a bona fide purchaser for value without notice. The issue is whether VTFL had notice of the claim, and, at least on the face of it, that turns on what was in the minds and memories of those persons controlling VTFL. Accordingly, unless it can be said that, as a matter of principle or policy, VTFL should be treated as knowing or remembering something which none of those controlling and managing it knew or remembered at the relevant time, its contention that it received the money in question without notice seems to me to be correct.

126. At first sight, there is a powerful argument to support a contrary conclusion, as Mr Miles contended. From the point of view of TPL and the traders, one can see how it can be said that VTFL was a party to the fraud together with Mr Cushnie and Mr Clough, however much it may also be true that, from the point of view of VTFL itself, it was a victim of Mr Cushnie and Mr Clough. However, it seems to me that this point does not assist TPL on the question whether, at a later point in time, when it was under different management, VTFL had notice of the fraud, when it received money.

127. If, and to the extent that, TPL has a claim, whether proprietary or personal, against VTFL because of the fraud perpetrated by Mr Cushnie through VTFL, it can bring that claim in the appropriate way; such a claim would be based on the past actions and knowledge of VTFL. However, the factual basis for that claim would be different from the facts impinging on the question whether money subsequently paid to VTFL was, as a matter of fact, received by it with notice of the fraud. As the Judge said, the Court of Appeal in *El Ajou v Dollar Land Holdings plc* [1994] 2 All ER 685, 697 accepted that a company can, in effect, lose its memory. I think that there is a valid congruence between the position of an individual, who has genuinely forgotten and that of a company whose management has changed.

128. Again, this conclusion is supported by considering the commercial consequence. If VTFL were solvent, it would not matter whether it received the payment with or without notice: any proprietary claim could be traced into the payment (although, if it had been used to purchase an asset which appreciated substantially, TPL could well

be better off if it succeeded on the notice issue). However, if, as is the case, VTFL is insolvent, it would seem somewhat unfair on its other creditors if VTFL could not claim to be a *bona fide* purchaser for value without notice, because it was treated as having had notice because of what it did or knew in the past under previous directors, all of whom have ceased to be involved with the company.

Third main issue: TPL's proprietary claim to the monies held by VTFL

Introductory

129. As explained in paras 24-30 above, over and above its first proprietary claim, TPL raises a second, and separate, proprietary claim, which, Mr Miles contended, entitles it to follow the monies paid to the banks. This claim is based on the contention that VTFL owed TPL fiduciary duties in respect of the monies which TPL entrusted to it under the management agreement. Accordingly, even though TPL may have failed in respect of its first proprietary claim, based on Mr Cushnie's breach of duty, it maintained its second claim, which is said to extend to all the payments made, and referred to in para 20 above.

130. There are two main points in relation to this second claim, namely whether there is a proprietary interest as TPL alleges, and, if so, whether the banks can defeat that claim on the ground of having been *bona fide* purchasers without notice. In principle, these are exactly the same two arguments as are raised by the first two main issues on TPL's first claim. However, the disputes in relation to TPL's second claim are very different from those raised by its first claim.

131. Lewison J upheld this second claim, albeit only to an extent. He held that it could be enforced against the payments out of monies held by VTFL ("the mixed fund") made to the banks (as summarised in para 20 above) in and after September 2001, but not in respect of the payments made in February 2000 and January 2001, on the basis that the banks had notice of TPL's proprietary interest in the mixed fund in July 2001. The Judge also made findings as to the extent of the claim.

132. So far as the question of a proprietary interest is concerned, Mr Collings for the defendants realistically conceded that, unlike on the first claim, TPL had a proprietary interest in the funds it entrusted to VTFL under the management agreement. However, he had a point, based on the inextricable mixing of monies, which he contended defeated this second claim. He also had a point on the extent of the monies to which the claim could extend. If the second claim was good, Mr Miles for TPL raised an argument that the Judge underestimated its extent.

133. As to the question of notice, Mr Miles for TPL contended that the banks had notice of TPL's proprietary interest in the mixed fund before January 2001, whereas Mr Collings for the defendants contended that the banks were not on notice of TPL's proprietary claim in respect of the mixed fund until after September 2001.

134. So there are four issues in relation to the second claim, and (fortunately) they can be dealt with a little more shortly. It is convenient to deal first with Mr Collings's point that tracing is not open to TPL, secondly to turn to the arguments on notice, then to discuss Mr Collings's corporation tax point, and finally to consider Mr Miles's challenge to the Judge's view of the extent of TPL's claim to the mixed fund.

Is the proprietary claim defeated by the inextricable mixing of monies?

135. Mr Collings contention in this connection is that the cross-firing led to the monies beneficially owned by TPL and by VTFL being so inextricably mixed together that it was impossible for TPL to mount a proprietary claim in respect of any of the money in VTFL's name. As the Judge put it at [2010] EWHC 1614 (Ch), para 145: "All the witnesses agreed that it is not possible to trace any of TPL's money through VTFL. VTFL was variously described as a 'black hole' or a 'maelstrom'."

136. The argument that this means that tracing or following is impermissible is said by Mr Collings to be supported by observations in various well-known cases concerned with tracing. I do not think that anything said in *Re Hallett's Estate* 13 Ch D 696, 719, in *Re Diplock* [1948] Ch 465, 521, or in *Bishopsgate Investment Management Ltd (in liquidation) v Homan* [1995] Ch 211, 220 and 223 is of assistance on this issue. In the first of those cases, Sir George Jessel MR was explaining that there could be no tracing into an overdrawn account; in *Diplock*, Lord Greene MR was dealing with the principles of tracing in general terms; the issue discussed by Dillon and Leggatt LJJ in *Bishopsgate*[1995] Ch 211 was the same as that being considered by Sir George Jessel in *Hallett* 13 Ch D 696, 719.

137. However, I accept that Mr Collings gets somewhat more assistance from what Lord Ellenborough LC in *Taylor v Plumer* (1815) 3 M&S 562, where he said that the right to trace ceases when there is no means of ascertaining whether the source of particular funds is money beneficially owned by the claimant, and gave as an example where the money is "mixed and confounded in a general mass with the same description." Accordingly, contended Mr Collings, in view of the conclusion reached by Lewison J that payments into VTFL's accounts fell into a "maelstrom" or "black hole", it must follow that, even if TPL would otherwise have the ability to trace into such accounts, they cannot claim such a remedy.

138. I reject this argument. I do not doubt the general principle, reiterated by Lord Millett in *Foskett* [2001] 1 AC 102, 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. Unless constrained by authority, I should therefore be very reluctant to accede to the defendants' case on this point. In fact, it seems to me that authority actually supports my view.

139. In *Cook v Addison* (1869) LR 7 Eq 466, 470 Stuart V-C said this:

> "It is a well-established doctrine in this court, that if a trustee or agent mixes and confuses the property which he holds in a fiduciary character with his own property, so as that they cannot be separated with perfect accuracy, he is liable for the whole."

Ungoed-Thomas J considered and applied this principle in *Re Tilley's Will Trusts* [1967] Ch 1179, saying this:

> "The words in that passage 'so as that they cannot be separated with perfect accuracy' are an essential part of the Vice-Chancellor's proposition, and indeed of the principle of *Lupton v. White*. If a trustee mixes trust assets with his own, the onus is on the trustee to distinguish the separate assets, and to the extent that he fails to do so they belong to the trust."

140. *Lupton v White* (1808) 15 Ves 442 was referred to with approval by Lord Millett in the section of his opinion dealing with the rules of tracing in *Foskett* [2001] 1 AC 102. Mr Collings's submission seems to me to be contrary to the whole thrust of that section of Lord Millett's opinion. But it goes further than that. Lord Millett specifically quoted with approval the observation of Page Wood V-C in *Frith v Cartland* (1865) 2 H&M 417, 418, to this effect:

> "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."

141. It seems to me to follow from this that both principle and authority establish that, as Lewison J concluded, once it is shown that money held on trust for TPL was paid into a "maelstrom" account, the administrative receivers, representing VTFL for this purpose, bear the burden of showing that money in that account is not that of TPL. Both legal principle and fairness to other creditors of the defaulting fiduciary suggest that the extent of that burden should not be other than the normal civil standard of proof, namely the balance of probabilities. So, if, after considering the evidence, the court concludes that it is more probable than not that a particular sum of money held in the name of in VTFL is not attributable to any of the funds held by VTFL on trust for TPL or its identifiable substitute, then the court should refuse any tracing remedy in respect of such money.

The finding that the banks were first on notice in July 2001

142. I have discussed the principles relating to the question of notice in paras 97-112 above in relation to TPL's proprietary interest in the proceeds of sale of the Shares, and they are equally applicable in relation to its proprietary interest in the mixed fund. The analysis of the factual position in relation to notice of the former interest in paras 113-122 above also has some relevance to notice of the latter interest.

143. TPL argued that the banks had notice of its proprietary interest in the proceeds of sale of the Shares later than they had notice of its proprietary interest in the mixed fund. This was because the former contention faced the problem of establishing that the banks had notice of the claim in respect of money made by Mr Cushnie as shareholder in VGP as a result of his wrongly getting VTFL to misuse TFL's money in cross-firing (see para 117 above), whereas the latter contention had no such problem and was simply raised in respect of money paid by TPL to VTFL and then misused by VTFL in cross-firing.

144. I accept that TPL had a powerful case below for saying that, by January 2001 the banks had sufficient notice of TPL's proprietary interest in the mixed fund. As the Judge said at [2010] EWHC 1614 (Ch), para 159, by the end of November 2000, Mr Greaves, acting for the administrative receivers, recognised that VTFL had misapplied TPL's money and that TPL would have the basis of a claim against VTFL, Mr Akers had told Mr Greaves in August 2000 that TPL was interested in a tracing process, and Mr Lomas had specifically reported to the banks on the cross-firing and the mixing of money.

145. However, as the Judge found at [2010] EWHC 1610 (Ch), para 139, up to February 2001, Mr Greaves only contemplated the possibility that TPL had a personal unsecured claim. Further, what Mr Akers was talking about in August 2000 was the possibility of tracing TPL's money "where the money actually flowed beyond VTFL" - see at [2010] EWHC 1610 (Ch) para 128. There was no mention of any claim to ownership or partial ownership of a mixed fund. The Judge concluded that, by the end of January 2001, it had not occurred to the banks or the administrative receivers, including Mr Greaves, that TPL even had an arguable proprietary claim in the mixed fund. As the Judge put it, having heard oral evidence from Mr Greaves, at [2010] EWHC 1610 (Ch), para 160;

> "He knew that the banks had mortgage debentures over the book debts; and he accounted to the banks for his recoveries. Whether those recoveries might be impressed with a trust in favour of TPL did not enter his mind. Had he thought that the debts did not belong to VTFL or that they were not covered by the banks' charges, he would not have accounted to them in the way that he did. He appreciated that there were mixed monies, but that was as far as it went."

146. Accordingly, as the Judge put it in the next paragraph of the judgment, "[t]he [administrative] receivers plainly knew that TPL had a claim against VTFL, but they regarded it as an unsecured personal claim". He therefore concluded that they did not have notice of the proprietary interest in the mixed fund. In my view, that was a conclusion which he was entitled to reach as a matter of law. If it had been correct, as a matter of course, to attribute to the banks knowledge of the legal consequences of facts which were or ought to have been known to them, then the Judge's conclusion almost certainly could not stand. But, as explained above, I do not consider that it is the law. The Judge plainly considered that, no doubt in part because it did not even appear to have occurred to Mr Akers that TPL may well have a proprietary interest until February 2001, the banks and administrative receivers acted in good faith and reasonably in not appreciating that they should seek legal advice as to whether, TPL had, or might have, a proprietary interest in the mixed fund. So I reject TPL's contention that the Judge was wrong in not finding that the banks had notice of TPL's proprietary interest in the mixed fund earlier than July 2001.

147. I would also reject the argument for the defendants on this topic is that there was insufficient evidence to found a contention that the banks or administrative receivers had notice of TPL's interest in the mixed fund even as late as September 2001. The Judge's conclusion primarily rested on two statements communicated by Mr Akers to the administrative receivers. First, as mentioned in para 116 above, on 14 February 2001, Mr Akers asserted to Mr Greaves that TPL had a proprietary claim which, he said, would "trump the banks". Mr Collings suggested that Mr Akers was referring to

a somewhat different proprietary claim, but, even that is right, it does not mean that the reference should not have put the administrative receivers on notice of the correct proprietary interest, particularly when taken with other facts. Secondly, in a witness statement dated 4 July 2001, Mr Akers said he needed VTFL's cashbook to see if "TPL has a right to any of these assets", and that "the funds held by the [administrative receivers] may be subject to interests which I represent".

148. In my judgment, it was plainly open to Lewison J to conclude that the banks had sufficient notice by 10 July 2001, allowing for a few days of appreciation of matters, after the administrative receivers' receipt of Mr Akers's witness statement. As a result of those two communications, the point had come, in the Judge's view, when a person in the banks' position, and with their attributes, were sufficiently on notice of TPL's proprietary claim in the mixed fund, so that, for instance, they should have formally instructed solicitors about that possibility. Particularly bearing in mind the oral evidence available to the Judge, that is plainly not a finding with which we could interfere.

The repayments of corporation tax

149. Because VTFL had been ostensibly carrying on business and making profits, it paid tax. In particular, it had paid corporation tax on its reported profits and VAT in respect of some of its reported turnover. When the fraud was discovered, it made claims to the tax authorities for what amounted to repayments of that tax, which it now transpired should not have been paid. This duly led to recoveries of sums from the tax authorities.

150. The Judge held that TPL's proprietary claim could be traced into these recoveries of overpaid tax – see [2010] EWHC 1614 (Ch), paras 152-3. Mr Collings contended that this was wrong in relation to the repayments of corporation tax, but accepted that it was right so far as the repayments of VAT are concerned. This is because he said that the repayment of corporation tax, unlike the repayment of VAT, was, as it were, a fresh receipt, insufficiently linked to the corporation tax paid out of VTFL's bank account.

151. Repayment of overpaid VAT is dealt with in section 80 of the Value Added Tax Act 1994. Section 80(1) provides that, where a person pays an amount "by way of VAT" which was not in fact due as such, the authorities "shall be liable to repay the amount due to him." Accordingly, as Mr Collings accepted, when a person pays VAT, the payment carries with it a right to repayment in so far as it includes an overpayment, and it must follow that if the VAT payment was out of monies against which a third party has a proprietary claim, that claim can, absent special reason to the contrary, be traced into the repaid amount.

152. However, the equivalent corporation tax provisions are differently expressed. Section 10(3) of the Income and Corporation Taxes Act 1988 provides that, if after payment of corporation tax, "the company has grounds for believing that, by reason of a change in the circumstances of the case since the tax was paid, the amount paid exceeds the company's probable liability" the company must file a notice of claim with reasons. In this case, the discovery of the fraudulent nature of VTFL's activities was accepted by the authorities as a relevant "change in the circumstances", and

accordingly they acceded to the section 10(3) notice of claim on behalf of VTFL, and repaid the corporation tax which had, as it transpired, been overpaid.

153. There is, it was argued by Mr Collings, a clear hiatus between the payment of the corporation tax out of VTFL's bank account and the receipt of any sum by VTFL paid pursuant to a section 10(3) notice of claim. Accordingly, ran the argument, a proprietary claim which could attach the money before it was paid as tax cannot be traced into any sum paid pursuant to a section 10(3) notice of claim.

154. I have no hesitation in rejecting that argument, which ultimately involved Mr Collings having to accept that, in the event of overpayment of tax, section 10(3) of the 1988 Act gave no more than a *spes*, or hope, of repayment, whereas section 80(1) of the 1994 Act gave a right to repayment. In my view, in relation to corporation tax, that is simply wrong. Where a company pays corporation tax, the payment carries with it a contingent right in the company to make a section 10(3) claim, and that must carry with it a right to expect such a claim to be treated lawfully by the authorities, and, in particular, to be acceded to if, and to the extent that, it is justified in fact and law.

The extent of TPL's claim

155. Given that the banks were on notice of proprietary claims before 26 September 2001, the final issue is whether the Judge was right in his conclusion that, given that TPL was entitled to trace into money received by the banks on and after 26 September 2001, it was limited to a loss in the region of £10.1m. At [2010] EWHC 1614, para 165, the Judge held that, to the extent that TPL or the traders had received payments from or on behalf of VTFL, while it was trading or subsequently, those payments should be treated as return of capital. Thus, the fictitious returns enjoyed by the traders through TPL as a result of VTFL's apparent profits up to 1999, and the £1.75m received in about February 2000 from the proceeds of sale of the Shares, were, in the Judge's view, to be debited against the capital paid by the traders.

156. On behalf of TPL, it was contended that the payments ought to be treated as interest on the capital paid by TPL. The argument was not really discussed in the judgment below, and it was dealt with in just a few sentences in the written and oral arguments before us.

157. If TPL is entitled to compound interest in respect of any capital payments made to VTFL, it may well be that the resolution of this issue is not of great significance to the parties, but that was not a point explored in argument, and it is therefore right to proceed on the basis that the issue at least might be important.

158. The Judge at [2010] EWHC 1614, para 165 referred to the payments actually made to the traders before 2000 as "purported payments of interest", and this analysis was adopted by Mr Miles. That does not appear to me to be correct. The traders' agreement as described in para 6 above (and more fully set out at [2010] EWHC 1614 (Ch), para 5) envisages the trader's share of the profits being paid quarterly, and any interest being paid only when the trader withdrew his money (see clauses 5 and 7). The payments before 2000 were thus purportedly based on VTFL's profits, as there was an obligation on TPL to account to the traders for such profits quarterly. (I would be very surprised if this did not also reflect the apparent reality: although we were not taken to any evidence on the point, at least the great majority of the payments made to

traders must have been said or assumed to be based on the profits made by the factoring business.)

159. If, as was in fact the case, there were no such profits, then, as I see it, there was no obligation to make any periodic payments, and therefore it seems to me to follow that any payments actually made should be treated as repayments of capital. Further, as a melancholy matter of fact, the payments were repayments of capital, in the sense that it was the capital of VTFL or TPL, mostly in the form of new traders' funds (a classical Ponzi scheme, as the Judge said), which was being used to fund the payments.

160. As for the payment of £1.75m to the traders in about February 2000, I see no reason to treat it differently. On the very limited facts we have been shown, it seems to me that, on the evidence, the Judge was, to put it at its lowest, entitled to infer that the payment was intended to be a partial repayment of capital. Further, under the traders' agreement, they still had no right to be paid interest, as they had not withdrawn from their agreements (or at least there was no evidence that they had done so).

Conclusion

161. For these reasons, I would dismiss both the appeal and the cross-appeal.

Lord Justice Richards:

162. I agree.

Lord Justice Hughes:

163. I also agree.