Staying virtuous

A recent Privy Council case indicates how the court will determine remedies and damages for breach of fiduciary duty. Joseph de Lacey explains

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On 27 March 2017 the Privy Council (PC) gave judgment in *Akita Holdings Ltd v The Honourable Attorney General of The Turks and Caicos Islands* [2017]. The judgment and the decisions of the lower courts provide a useful summary of the principles to be applied when determining:

- the remedies available against a knowing recipient of property acquired at an undervalue from a person acting in breach of their fiduciary duty; and
- the extent of damages available.

The issues raised in this case were dealt with authoritatively in the House of Lords judgment in *Foskett v McKeown* [2000]. Nevertheless, the case provides a worthwhile summary of the development of the law, including an analysis of the distinctions (and the effect of the distinctions) between proprietary and personal remedies and provides a vivid illustration of the importance placed by the courts on the principle that a fiduciary must not, without informed consent, profit from their position. In particular, the case shows the flexibility of the concept of constructive trusts, and how they can be and are used to protect those to whom fiduciary duties are owed.

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Summary of case

Mr Hanchell was a citizen and government minister of Turks and Caicos between 2003 and 2009. At that time a citizen could apply for and be granted a conditional purchase lease (CPL) over Crown land, subject to certain conditions. The conditions being met, the citizen could purchase freehold title at a 50% discount. In 2004, Mr Hanchell identified certain land and was granted a CPL over it. His right to purchase guaranteed by citizenship, the remaining question was price. To set the price, the government agreed to use an out-of-date 1998 valuation, giving the land an open market value of $150,400, therefore granting Mr Hanchell the right to purchase for $75,200.

Mr Hanchell had however recently obtained a valuation of $500,000 but 'little or no effort was made to provide an up to date valuation' to the government.

The development progressed and before acquiring the land, Mr Hanchell transferred that right to purchase to Akita Holdings Ltd (Akita), a company owned by him and his brother. In December 2006 the freehold title was purchased and the development continued, with the assistance of bank loans charged on the property. In November 2008 a further private valuation report for Mr Hanchell valued the property with improvements at $4,250,000. Ostensibly, Mr Hanchell had arranged for the purchase of the land at a significant undervalue. Akita, owned in part by Mr Hanchell, had notice.

As a minister, Mr Hanchell was found by the court to owe a fiduciary duty to the government. By failing to disclose the valuation, and knowingly entering into the transaction at an undervalue, he had profited at the expense of his principal. In doing so, he had potentially breached the key duties of a fiduciary: to act loyally, in good faith, without placing himself in a position of conflict, and without

profiting from his position without informed consent.

An action was brought by the government against Akita.

Judgment at first instance – the Turks and Caicos Supreme Court

A claim was issued against Akita, expressed alternatively for 'unjust enrichment' or 'unconscionable receipt'. The first claim was for $174,800 (the 'underpayment' or difference between the value of the land ($250,000, including the 50% discount) and the price paid ($75,200)). The claim in the alternative was for:

> ... that proportion of the value of the land, including a proportionate share of any benefits made by [Akita] that are attributable to the use of the land.

It was accepted that Mr Hanchell owed the government fiduciary duties. Those duties were breached by failing to disclose the higher valuations:

> Rather than take advantage of that which was on offer, the fiduciary, as opposed to any other member of the general public, is under an obligation to his Principal... to disclose... all relevant facts which may affect the transaction.

The appropriate remedy for the government was to trace the value of the benefit obtained by Akita. It was said that the 'starting point' was to determine the nature of the asset held by the defendant.

The court considered *Foskett* and concluded that the land was a mixed asset: Akita had contributed $75,200 (30.08%) towards the land's value, the government contributing the balance (69.92%). Citing *Foskett*, the court said:

> Where a trustee wrongfully uses trust money to provide part of the cost of acquiring an asset, the beneficiary is entitled at his option either to claim a proportionate share of the asset or to enforce a lien upon it to secure his personal claim against the trustee for the amount of the misapplied money.

Akita therefore held the freehold title on a constructive trust for payment of the value of the benefit to the government and was entitled to:

> ... recover the value of that proportion of the land for which it has not received value... being the value of the unimproved land and the same percentage of the current value of the improved land insofar as the improvements are attributable to the Defendant's use of the land.

Proceedings in the Court of Appeal

A review of *Foskett* suggests that Akita would have great difficulty overturning the judgment. As a beneficiary of a constructive trust, the government was entitled to a proportionate share of any increase in value. This position is endorsed by *Lewin on Trusts* (41-29 to 30) and *Snell's Equity* (31st ed) (28-38).

Grounds of appeal

It was argued that the order that Akita held 69.92% of the land by way of a proprietary remedy on trust for the government was fundamentally flawed. *Foskett* was a case of express trust, not knowing receipt, and in any event there had been no mixing of funds and so the case had been applied incorrectly.

The conventional remedy for a beneficiary against a knowing recipient was to assert a proprietary remedy by avoiding the transaction, or to affirm the transaction and assert a personal claim. The government could and should therefore require the transfer of the land back to it. Akita would be entitled to the sums it had paid out for the purchase and improvement. In support Akita referred in its notice to *Holder v Holder* [1967], a Court of Appeal decision cited by Snell as authority in relation to consent (see paras 28-29) and *Rowley v Ginnever* [1897], a 19th century case which Snell cites as authority for a trustee's right to a lien on a property where they have paid for the costs of improvements to it (see paras 7-124).

In other words, Akita sought to limit the extent of the proprietary remedy available in a manner inconsistent with *Foskett*.

With regard to a personal claim, that would either be an account of profits made or equitable compensation for the loss suffered by the government.

Respondent's notice

The government disagreed, and restated the case as one of knowing receipt. After the elements of knowing receipt had been established (assets held under fiduciary relationship; transfer involved breach of duty; recipient received benefit of transfer; and unconscionable for recipient to retain that benefit), the recipient, Akita, came under an obligation to account to the government for the value of benefits received. If Akita retained the asset, the obligation to account gave rise to a constructive trust over the asset until Akita had accounted to the government for the benefits it received. Lewin (42-09) would agree.

By failing to disclose the valuation, and knowingly entering into the transaction at an undervalue, Mr Hanchell had profited at the expense of his principal.

The following passage, again from *Foskett*, was cited:

> If the traceable proceeds have increased in value and are worth more than the original asset, he [the beneficiary] will assert his beneficial ownership and obtain the profit for himself. There is nothing unfair in this. The trustee cannot be permitted to keep any profit resulting from his misappropriation for himself.

This is the key part. Akita had suggested that the government was entitled to equitable compensation for loss suffered. But as the PC would explain, by reference to *Regal (Hastings) Ltd v Gulliver* [1967], the liability of a fiduciary to account does not depend on the principal being damaged – but on the mere fact that a profit has been made.

The government's case, that it was entitled to a proportion of the value of the improved land, was supported by the analysis by James Barr Ames in 'Following Misappropriated Property into its product' (1906), referred to in *Foskett*, which said that

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if a trustee buys property partly with their own money and partly with trust money, the beneficiary should have the option of taking a proportionate part of the new property *or* a lien upon it, as may be most for their advantage:

> In every case the value formerly inherent in the trust property has become located within the value inherent in the new asset.
>
> If the trust fund is traceable as having furnished in part the money with which a certain investment was made, and the proportion it formed of the whole money so invested is known or ascertainable, the cestui que trust should be allowed to regard the acts of the trustee as done for his benefit, in the same way that he would be allowed to if all the money so invested had been his; that is, he should be entitled in equity to an undivided share of the property which the trust money contributed to purchase – such a proportion of the whole as the trust money bore as the whole money invested.

In Samuel Williston's 'Right to Follow Trust Property When Confused With Other Property' (1888), it was said that:

The logic behind this is, of course, the fundamental principle of fiduciary obligations – the trustee cannot be allowed to make a profit from the use of trust money. If they have, and the property they wrongfully purchased was held subject only to a lien for the amount invested, they would benefit from any appreciation, and thus profit from their breach of duty. The beneficiary was allowed to regard the act of investing as having been done for their benefit and they would be entitled to 'such a proportion of the whole as the trust money bore as the whole money invested'.

Support for the contention of Akita that only a lien or charge was available to a trustee or principal in relation to mixed property came from *Re Hallett's Estate* [1880] but there was

no justification for that rule (see 28-38 of Snell). In the US, the courts had found that there could be 'no excuse for such a rule' (*Primeau v Granfield* [1911] per Learned Hand J). According to *Foskett* and *Ultraframe (UK) Ltd v Fielding* [2007] Akita was a trustee by using funds belonging to the government, which it held as constructive trustee for the government. The government, being the beneficiary of the funds held for it by Akita, had not merely a beneficial interest in the land but also in the development. The property was received as a result of knowing receipt as the trustee had used the trust property to enhance his own property, and so was required to account to the beneficiaries for any profit he had made as a result of the misuse or abuse of the property. 'To hold otherwise would be to defeat the basic duty of a trustee' (para 25, Court of Appeal). The appeal was dismissed.

Appeal to the PC

Akita appealed to the PC. The questions before the PC were as follows:

- May an owner of land transferred at an undervalue in breach of fiduciary duty elect between:
    - following the land and its improvements into the hands of the knowing recipient; and
    - tracing the value of the underpayment into the land and its improvements, where the knowing recipient retains ownership of the land?
- May a claimant who can trace value into land require the knowing recipient to pay by way of profit a proportionate share of the land and improvements?

Submissions of Akita

For Akita, it was said that the only asset that had been transferred was the land, and that the benefit obtained by Akita, the underpayment, could not be traced into the land. Further, any benefit obtained by Akita gave rise to a personal remedy requiring Akita to account for that benefit, but did not make it a trustee of that benefit. The liability to account for a profit made by a knowing recipient was not held on trust and did not give rise to a proprietary remedy. It was also said that it was an invention to suggest that the value of the underpayment was a contribution to the cost of the land's acquisition. Accordingly, the land was not a mixed asset as the government's property had not contributed to the purchase of the new asset (the land). The underpayment merely gave rise to a cause of action. The principles of tracing were therefore not applicable in this case. There was therefore no proprietary base from which the government could trace the land (para 25). Akita was therefore only a remedial accounting party with respect to the underpayment rather than a constructive trustee.

The right to elect between following and tracing could only arise where one asset had been exchanged for another. In this case, the original land remained in the ownership of Akita. The asset remained the same and so it was open to Akita only to follow the underpayment (para 31). Further, the improvement to the land was authorised (by the terms of the CPL) and the principle of tracing value into a mixed asset applied only when there was a wrongful mixture.

Accordingly, it was suggested that if the government was unable to trace the underpayment into the land, it should have followed the land, rescinded the sale and claimed the return of the land, giving counter restitution to Akita for the sum paid (*Holder*). The government had not sought the return of the land, but monetary compensation. This was a personal remedy. And yet it had 'dressed up' its claim for monetary compensation as a proprietary remedy.

Submissions of the government

The government said that what was unconscionably received was the land, not the underpayment. It had always been accepted that, as Akita had made a payment of value, it had a beneficial interest in the land, and so it had not sought to claim the entire interest in the land. Akita should account for any profit that has accrued to it, including the enhancement in the value of the land attributable to inflation and to Akita's use of the land. That conclusion, it was said, would deprive:

> ... Akita of the gain attributable to its wrongful ownership and exploitation of the land.

To accept Akita's argument was to allow it to retain the 'fruits of his wrongdoing'. The government had chosen to elect to recover a proportion of the value of the land by way of an account of profits rather than to seek equitable compensation. It was said that *Foskett* was authority for this ability to make a choice.

As an unconscionable recipient of the land, the government had the same liability as an express trustee, including a liability to account for profits whether or not there had been a loss to the government (*Novoship (UK) Ltd v Nikitin* [2014]).

As to Akita's argument that the government had dressed up a personal claim as a proprietary remedy, it was said that the government was entitled

Akita submitted that the liability to account for a profit made by a knowing recipient was not held on trust and did not give rise to a proprietary remedy.

References

'Following Misappropriated Property into its product', James Barr Ames (1906) 19 Harv L Rev 511

'Right to Follow Trust Property When Confused With Other Property', Samuel Williston (1888) 2 Harv L 28

to require Akita to give up any benefit that it had made as a result of its wrongdoing by, at the government's election, either a proprietary claim or personal remedy. A proprietary claim would require Akita to return the land to the government; the personal remedy was for payment of money, either by an account of profits or by equitable compensation.

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The PC's decision

A brief and precise judgment prepared by Lord Carnwath was handed down on 27 March 2017. The law of knowing receipt was as set out in *Arthur v Attorney General of the Turks & Caicos Islands* [2012], which cited Hoffman LJ in *El Ajou v Dollar Land Holdings Ltd* [1993]:

> ... the plaintiff must show, first, a disposal of his assets in breach of fiduciary duty; secondly the beneficial receipt by the defendant of assets which are traceable as representing the assets of the plaintiff; and thirdly, knowledge on the part of the defendant that the assets he received are traceable to a breach of fiduciary duty.

Plainly, each of those elements was satisfied.

As to liability, the court referred to Longmore LJ, who in *Novoship* described the liability as following from the premise that 'the defendant is held liable to account as if he truly were a trustee to the claimant'. This citation contrasted with the submissions of Akita, as above, that it was only a 'remedial accounting party'. As a trustee therefore, it had to account for profits made following the breach of duty.

The court considered the submissions of Mr Misick QC acting for Akita. It noted that he had contended that the breach of duty related not to the acquisition of the rights under the contract, but merely the price. Accordingly, he said that the fair remedy was to hold Akita liable for the difference in price and no more. This suggested that the measure of damages was the loss suffered by the government. The court disagreed: the liability of a fiduciary did not depend on the principal suffering loss but arose from the mere fact of a profit being made by the fiduciary.

Discussion

It is unsurprising that the PC upheld the lower courts' decisions and allowed the government to claim for a proportion of the increased value of the property. As set out in *Chan v Zacharia* [1984] a fiduciary is required to:

> ... account for any benefit or gain obtained or received by reason of or by use of his fiduciary position or of opportunity or knowledge resulting from it.

The rule is stringent and uncompromising, and for good reason. The essence of the fiduciary relationship is that it creates obligations *of a different character* from those deriving from the contract itself (*Goldcorp Exchange Ltd v Liggett* [1994]). It is in this context that one must consider decisions that can appear overly harsh on the fiduciary. The rule is 'inflexible' (*Bray v Ford* [1896]) and no doubt deliberately so. Where an account is ordered, the court may be lenient and give the fiduciary an allowance for skill and effort employed in obtaining the profit where:

> ... it would be inequitable now for the beneficiaries to step in and take the profit without paying for the skill and labour which has produced it (*Phipps v Boardman* [1964])...

but the power is exercised sparingly out of fear that it may encourage fiduciaries to breach their duties (*Guinness plc v Saunders plc* [1989]).

Akita had complained of the confusion it suggested the court had suffered from in relation to personal and proprietary remedies. Yet the government was entitled to elect, even at a late stage, its remedy (Snell, paras 7-145). It is perhaps this flexibility which best illustrates just how far the courts will go to favour the principal, the beneficiary, in circumstances where a fiduciary is found to have taken advantage of their position. The fiduciary is expected to be virtuous; where they are found wanting, the court will willingly strip them of all profit made, even where that profit is not equivalent to the loss in fact suffered by the trust. It is enough that the profit was made from their position. The case is a salutary lesson in the rigours of the law relating to fiduciaries. It is this rigidity that protects those to whom fiduciary duties are owed. ■

Akita Holdings Ltd v The Honourable Attorney General of The Turks and Caicos Islands
[2017] WTLR 407
Arthur v Attorney General of the Turks & Caicos Islands
[2012] UKPC 30
Bray v Ford
[1896] AC 44
Chan v Zacharia
[1984] HCA 36
El Ajou v Dollar Land Holdings Ltd
[1993] EWCA Civ 4
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[2000] WTLR 667
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[1994] UKPC 3
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[1989] UKHL 2
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(1880) 13 Ch D 696
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[2014] WTLR 1521
Phipps v Boardman
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[1897] 2 Ch 503
Ultraframe (UK) Ltd v Fielding
[2007] WTLR 835