

## KEY POINTS

- The Supreme Court judgment resolves earlier conflicting case law on the limits of the rule that where an agent acquires a benefit as a result of his fiduciary position, he is treated as having acquired it for the benefit of his principal, so that it is beneficially owned by the principal.
- In finding that a bribe or secret commission received by an agent is held on trust for his principal, the Supreme Court has delivered a highly significant judgment, giving principals greater powers of recovery.
- The judgment serves as a reminder to lenders of the potentially onerous duties assumed by agents, arrangers and security trustees under secured syndicated loan arrangements and of the importance of clearly defining such duties contractually.

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# FHR European Ventures v Cedar Capital: a decision with wider implications for the loan market?

In this article, the authors consider the impact of *FHR European Ventures LLP and others v Cedar Capital Partners LLC* [2014] UKSC 45 in the context of syndicated loan arrangements.

## THE AGREED PRINCIPLES

It is well understood that the relationship between an agent and his principal is one that is based on trust and confidence and may, therefore, give rise to fiduciary duties owed by the agent to his principal. Two further established principles are derived from a fiduciary relationship: (i) an agent must not profit from his trust, nor indeed must he place himself in a position in which his duty and his interest conflict, and (ii) an agent who acts for two principals with potentially conflicting interests without the informed consent of both is in breach of his obligation of undivided loyalty and may be subject to a conflict between his duty to one principal and his duty to the other. These core principles were clearly summarised in the decision of Millett LJ in *Bristol and West Building Society v Mothew* [1998] Ch 1, 18.

A further important and undisputed principle is that where an agent receives a benefit in breach of his fiduciary duty, the agent is obliged to account to the principal for that benefit and must pay, in effect, a sum equal to the benefit by way of equitable compensation. However, case law has demonstrated that there are occasions where an agent who acquires a benefit by virtue of his fiduciary position, (or pursuant to an

opportunity which results from his fiduciary position), is to be treated as having acquired that benefit on behalf of his principal so that it is beneficially owned by the principal (“the Rule”).

The central question which had yet to be resolved was whether this Rule applied to a bribe or secret commission, received by an agent in breach of his fiduciary duty. If it did, then it would be held by the agent on trust for his principal, entitling the principal to a proprietary remedy; if not, the principal would merely have a personal claim for equitable compensation in a sum equal to the bribe or commission’s value. The distinction between a personal claim and a proprietary right derived from the Rule is an important one, both because a principal’s proprietary claim would have priority over the unsecured creditors of the agent on an insolvency and because the principal will be able to trace the benefit represented by the proprietary claim into the hands of third parties if necessary.

Judicial decisions going back to the 19th century have answered this question in different ways with dramatically different results. Enter stage right the unanimous decision of the Supreme Court in *FHR European Ventures LLP and others v Cedar Capital Partners LLC* [2014] UKSC 45 to cut through the previous conflicting

judgments and years of academic debate and resolve this issue once and for all.

## A RESUME OF THE FACTS

In 2004, the claimants together purchased the Monte Carlo Grand Hotel through a vehicle called FHR European Ventures LLP (FHR). Cedar Capital Partners LLC (Cedar) acted as FHR’s agent in negotiating the purchase. The fact that Cedar therefore owed fiduciary duties to FHR was never in dispute. However, unbeknown to FHR, Cedar had entered into an exclusive brokerage agreement with the vendor of the hotel, entitling Cedar to receive a brokerage fee of €10m on the conclusion of the sale and purchase.

In 2009, FHR brought proceedings against Cedar for the €10m brokerage fee. Simon J at first instance found that Cedar had failed to make proper disclosure of the exclusive brokerage agreement to FHR and was therefore in breach of its fiduciary duty for failing to obtain properly informed consent. However, whilst Simon J ordered Cedar to pay the €10m to FHR, he refused to grant a proprietary remedy in respect of the monies.

FHR appealed, solely on the question of whether it was entitled to a proprietary remedy. The Court of Appeal unanimously overturned the decision on the point ([2013] EWCA Civ 17) and held that FHR did have a proprietary claim for the brokerage fee. In doing so, Sir Terence Etherton, Chancellor, highlighted the difficulty their Lordships had encountered in reconciling the prior

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conflicting Court of Appeal judgments which had made “the law more complex and uncertain and dependent on very fine factual distinctions” and invited the Supreme Court to overhaul “this entire area of the law... in order to provide a coherent and logical framework”. Cedar appealed to the Supreme Court.

### THE DEBATE

In order to cut through the arguments before them, the Supreme Court resolved first to attempt to marry up the cases which have addressed the issue and then go on to consider policy and practical arguments before reaching its conclusion.

Their Lordships identified a number of cases over the past 150 years or so where it did not seem to be in dispute that, if the recipient of the benefit had received it in breach of his fiduciary duty to the plaintiff, then he held it on trust for the plaintiff. Indeed, many of those cases contained observations to suggest that the Rule applied to all benefits received by an agent in breach of its fiduciary duty. So far so good. However, their Lordships then faced having to reconcile that line of cases with a House of Lords decision which seemed to go the other way, namely *Tyrell v Bank of London* (1862) 10 HL Cas 26, together with

deciding which was to be preferred. Lord Neuberger concluded that it was not possible “to identify any plainly right or plainly wrong answer to the issue of the extent of the Rule, as a matter of pure legal authority.” Instead, it was consideration of points of principle and practicality which broke the deadlock.

### THE DECISION

It is clear that their Lordships were striving for a simple and neat solution which did not run contrary to general principles. Lord Neuberger stated:

“Clarity and simplicity are highly desirable qualities in the law. Subtle distinctions are sometimes inevitable, but in the present case... there is plainly no right answer, and, accordingly, in the absence of any other good reason, it would seem right to opt for the simple answer.”

Their Lordships were clearly attracted to the neatness of a finding that all unauthorised benefits received by an agent fell within the Rule and that the agent holds the bribe or secret commission on trust for his principal, to which the principal has a proprietary claim.

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subsequent Court of Appeal authorities in *Metropolitan Bank v Heiron* (1880) 5 Ex D 319, *Lister & Co v Stubbs* (1890) 45 Ch D 1 and more recently, *Sinclair Investments Ltd v Versailles Trade Finance Ltd* [2012] Ch 453 where arguments based on a proprietary claim were, for one reason or another, rejected.

In order to assist them, their Lordships turned to the wealth of academic debate surrounding this issue which Pill LJ, in the Court of Appeal in this case, described as having given rise to “passions of a force uncommon in the legal world” – [2014] Ch 1, para 61. Deliberation over the arguments on both sides got them no closer to

Essentially, their Lordships made four key points:

- (1) The Rule was consistent with the principles of the law of agency in that an agent owes a duty of undivided loyalty to his principal and is obliged to deliver up to his principal the entire benefit of his acts, whether or not those acts were authorised, not simply pay him compensation.
- (2) It was an unattractive argument to differentiate between benefits derived from secret profits received whilst acting for a principal and a bribe or secret commission received from a third

party which the principal could never himself have obtained, nor was such an approach consistent with earlier judgments.

- (3) To apply the Rule so that it includes bribes and secret commissions has the advantage of matching up the circumstances when an agent has to account for any benefit received in breach of his fiduciary duty with those in which the principal can claim the beneficial ownership of the benefit. It also avoids a paradoxical situation where a principal whose agent receives a bribe is worse off than one whose agent profits in a less inappropriate manner.
- (4) As a matter of public policy, the law should be particularly stringent towards parties who are paid bribes or secret commissions and this is not outweighed by concerns that unsecured creditors may be prejudiced by this outcome.

Therefore, as a matter of principle and practicality, the simplicity of a broad application of the Rule such that any benefit acquired by an agent as a result of his agency and in breach of his fiduciary duty is held on trust for his principal outweighed the potential for uncertainty caused by seeking to separate out specified circumstances where it did not apply. Their Lordships acknowledged the existence of a significant body of conflicting case law but concluded that it lacked clarity and consistency and that they were not obliged to follow it. Further, they concluded that the law had taken a “wrong turn” in the Court of Appeal decisions in *Heiron* and *Lister* and therefore, they should be overturned, together with any subsequent decisions such as *Sinclair*, at least to the extent that they relied on or followed them. What, then, of the House of Lords decision in *Tyrell*? That, too, was deemed to be inconsistent and was accordingly disapproved.

### THE CONSEQUENCES

The resolution of this issue has important implications for those seeking recompense for the double dealing of their agent. The

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claimant principal is in a much stronger position when seeking to recover the bribe or secret commission. First, he can bring a proprietary claim against the agent, which enables him to trace into the agent's assets, and if necessary, into the assets of third party knowing recipients. He may also apply for a proprietary injunction to freeze the bribe/secret commission and its traceable proceeds.

Secondly, if the agent becomes insolvent, then the principal will have priority over unsecured creditors. In their judgment, their Lordships were briefly troubled by the possibility of potential prejudice to an agent's unsecured creditors, but concluded that this was outweighed by the justice of a principal being allowed to trace the proceeds of the bribe or commission more effectively than the limited entitlement to trace at common law. That said, this decision does not prevent the principal from bringing a personal claim if the outcome is likely to be more lucrative, if, say, the agent has invested the bribe and its value has dramatically decreased.

For a lender acting as arranger, agent and/or security trustee in the context of syndicated loan arrangements, this decision gives pause for thought. In assuming duties in any of those capacities, the lender will certainly owe a duty of care and any agency or trustee function may be expected to give rise to a fiduciary relationship with all the duties and obligations that it entails. However, it is perfectly possible, and indeed market practice, for lenders in such roles to ensure that appropriate contractual wording is in place at the outset to put strict limits on their duties. In particular, lenders in those roles generally require express terms to be included in their finance documents which state that they owe no fiduciary duties and will frequently require an indemnity from the other lenders for any loss suffered or liability incurred in discharging such functions.

Such provisions in fact tend to go even further, purporting to restrict the extent to which the arranger, agent or security trustee might owe a duty of care to other lenders or the borrower at all. Whilst the courts will

scrutinise the relevant terms of the loan agreement to ascertain the extent to which such duties have been expressly excluded when breaches of duty are alleged, they are prepared to uphold such provisions. For example, in *Torre Asset Funding Ltd & Another v The Royal Bank of Scotland Plc* [2013] EWHC 2670 (Ch) concerning a lender acting as agent of the syndicate, the High Court readily concluded that provisions within the transaction documents gave rise to functions which were solely mechanical and administrative and that the agent's responsibility to its syndicate was to be narrowly construed. Likewise, in the context of a lender acting as arranger, in *IFE Fund SA v Goldman Sachs International* [2007] EWCA Civ 811, the Court of Appeal endorsed a decision of the High Court which gave effect to contractual provisions relieving the arranger from any duty to disclose information from the auditors which was provided after distribution of the information memorandum.

The role of security trustee might give rise to greater issues. Notwithstanding any contractual exclusions, as a trustee for the lenders, the existence of a fiduciary relationship might be assumed and be of special significance where, as is frequently the case, the security trustee has potentially conflicting duties as a trustee towards both senior lenders and subordinated, junior lenders. In *Saltri III Ltd v MD Mezzanine SA SICAR & Ors* [2012] EWHC 3025 (Comm) the junior, mezzanine lenders in the syndicate argued just this point. The High Court concluded that a person in the position of a security trustee could be in a fiduciary position insofar as some of its functions were concerned, and not others. The court paid close attention to the contractual provisions delineating the duties of the security trustee set out in the intercreditor agreement and found that the contractual terms were inconsistent with any assumption of fiduciary duties. Therefore, even in these circumstances, the express contractual terms will prevail over any implied assumption of a fiduciary relationship.

Finally, the fee arrangements which typically apply in the context of a secured syndicated loan agreement warrant particular consideration following the *FHR* decision. Such arrangements do include an element of secrecy, since the quantum of fees payable by the borrower to the agent, arranger and/or the security trustee is frequently set out in a fees letter which is seldom disclosed to the syndicate of lenders. However, it would be wrong to characterise such payments (the existence of which are normally disclosed to the lenders and which are made in consideration for the assumption of real responsibilities and functions) as either secret commissions or profit, or as a benefit received in breach of a fiduciary duty, provided that it is clear from the contractual matrix that the lenders are aware that a fee is to be paid by the borrower. The normal, market approach (and one which it would be wise to follow in the light of principles expounded in *FHR*) is to expressly impose the obligation to pay fees in the loan agreement (avoiding any suggestion that the fee constitutes a secret profit) even if the quantum and timing of payment is addressed elsewhere.

The *FHR* decision therefore serves to remind lenders fulfilling the function of agents, arrangers and security trustees of the onerous duties assumed by agents and trustees generally, of their duties to account to their principals and beneficiaries for profits received in breach of fiduciary duties and of the need for carefully-considered wording in the contractual documents governing such relationships, in order to dilute the duties which would otherwise apply. ■

**Further reading**

- FHR European Ventures LLP: the demise of *Sinclair v Versailles* and a welcome return to orthodoxy [2014] 5 CRI 175
- The role of the security trustee: lessons from the *Stabilis* restructuring [2013] 4 JIBFL 201
- Lexis PSL: Restructuring and Insolvency: Recovery of property