Fiduciary Duties, Secret Profits, and the Illegality Defence: *Crown Prosecution Service* v *Aquila Advisory Ltd* [2021] UKSC 49

Abstract

CPS v *Aquila Advisory Ltd* has provided a welcomed judgment on the application of the illegality defence in the context of secret profits accrued in breach of fiduciary duties. The judgment clarifies the priority to be given to constructive trusts over unauthorised fiduciary profits in the face of CPS confiscation orders, and examines the interrelationship between the rules of attribution and the application of the illegality defence today, namely whether a director's unlawful intention can be attributed to their company to prevent the company, on illegality grounds, from exercising a proprietary interest over the secret profits accrued.

Case Note

The Supreme Court judgment in *Crown Prosecution Service* v *Aquila Advisory Ltd*[1] has provided significant insight and clarification into two core areas of equity and trusts law: secret profits accrued in breach of fiduciary duties and the breadth and application of *Patel* v *Mirza's* reformulated illegality defence.[2]

The judgment not only upholds the precedence to be given to constructive trusts over CPS confiscation orders of secret profits accrued in breach of fiduciary duties, but also provides much welcomed clarity on the remit of *Bilta* v *Nazir's*[3] 'breach of duty' exception to *Patel's* illegality defence by examining whether a director's unlawful obtainment of secret profits can be attributed to the company to whom they owe fiduciary duties where the company stands to profit from the breach:

'in none of the secret profits or bribe cases […] have the courts had to consider whether the fraud of the agent should be attributed to the principal so as to prevent the principal, by

[1] *Crown Prosecution Service* v *Aquila Advisory Ltd* [2021] UKSC 49

[2] *Patel* v *Mirza* [2016] UKSC 42

[3] *Bilta* v *Nazir (No 2)* [2015] UKSC 23

reason of the defence of illegality, from relying on a constructive trust in priority to the claims of unsecured creditors, such as […] the CPS.'[4]

The judgment should accordingly be renowned for its unique examination of the illegality defence and its affirmation of longstanding equitable principles.

Facts

Mr Perrin and Mr Faichney were directors of Vantis Tax Ltd (VTL), a company which consulted on tax matters. Faichney proposed the development of a 'Taxcracker' software to enable VTL's tax advisers to identify high net-worth individuals to approach with their services. VTL accepted the proposal and developed the software under the name of 'Qaria'. The intellectual property (IP) rights of Qaria lay with VTL.

Faichney and Perrin realised the ability for Qaria to be used as part of a tax avoidance scheme by taking advantage of Section 587B of the Income and Corporation Taxes Act 1988, which allows taxpayers to claim tax relief on shares in a quoted trading company which are given to charity.[5] Qaria was used to create 4 separate tax avoidance schemes where share values of quoted trading companies would be inflated through the assignment of Qaria's IP rights to them for a fee. This would allow the shares to then be given to charities for a higher value than they were purchased for which, in turn, allowed taxpayers to receive a higher amount of tax relief. The 4 tax avoidance schemes accrued secret profits of £4.55 million.

Once aware of their actions, Faichney and Perrin were dismissed from VTL, and were convicted for cheating the revenue by dishonestly facilitating and inducing others to submit false claims for tax relief. They were served with a confiscation order under Section 6 of the Proceeds of Crime Act 2002 (POCA) for the £4.55 million accrued. VTL were never tried, charged, or indicted for any offence regarding these matters.

[4] (n 1) [51].[52] (Lord Stephens)

[5] Income and Corporations Taxes Act 1988, s587B

In a claim for their wrongful dismissal, VTL pursued a counter-claim for a declaration that a constructive trust was held over the secret profits given the directors' breach of fiduciary duties and wrongful exploitation of its assets for their own benefit. The CPS intervened and claimed that Faichney and Perrin's fraud should be attributed to VTL to engage the maxim of *ex turpi causa*, namely to render the constructive trust unenforceable on illegality grounds in accordance with *Patel*.[6]

The key question of law to be determined was consequently whether the constructive trust Aquila would otherwise be entitled to enforce against its directors could still be asserted and take priority over a CPS confiscation order, a question determined through an examination of the interrelationship between the illegality defence and attribution.

High Court Decision

The high court provided a three-fold decision when granting the declaration that a constructive trust was imposed over the directors' secret profits in priority to the CPS' confiscation order.[7]

Firstly, Mann J affirmed *FHR's* ruling that any fiduciary who has obtained money by exploiting, or taking advantage of an opportunity that arose from their fiduciary position, is covered by the 'no profit rule', meaning a constructive trust over the profits will be imposed in favour of the fiduciary's principal.[8] Mann J explained that, to find otherwise, would allow fiduciaries to rely on their own wrongdoing to justify the retention of the benefit accrued from their breach of duties, which is in clear contrast to equity's underlying foundations of fairness and justice. The 'proprietary' constructive trust thus takes priority over the CPS' 'personal' confiscation order.

[6] See *Patel* v *Mirza* (n 2) which holds that illegality will be found where allowing a claim would undermine the integrity of the legal system, this being the POCA scheme here

[7] *Faichney* v *Vantis HR Ltd* [2018] EWHC 565

[8] *FHR European Ventures LLP* v *Cedar Capital Partners LLC* [2014] UKSC 45

Mann J's second justification for awarding the declaration surrounded an application of *Bilta's* leading judgment on attribution. Despite the CPS' claims that the directors' dishonest and unlawful intentions should be attributed to the company to prevent them recovering the proceeds on illegality grounds, Mann J found no such attribution since, where a company brings an action against their directors for breach of fiduciary duties, the breach of duty exception against attribution applies.[9] Mann J justifies this application of *Bilta's* exception with reference to the underlying rationale of fiduciary duties; they are designed to protect a company from the directors' wrong-doing so, if a company could be attributed with their directors' dishonest breach of duties, directors could invoke the illegality defence to defeat claims against them, thus negating fiduciary duties.

Accordingly, Mann J called for a principled approach, unaffected by questions of CPS involvement in a case, when determining attribution under *Bilta*. Thus, although the breach of fiduciary duties here occurred in the course of a crime, this was not enough to disapply *Bilta's* exception to attribution; *Bilta's* rules cannot be distorted or denied simply because the proceeds are proceeds of crime to which the CPS has a personal interest, meaning the constructive trust could not be defeated on attribution grounds.

Mann J's final consideration when granting the declaration was the CPS' failure to defeat VTL's constructive trust using the public policy rule in *Patel*.[10] *Patel* provided a trio of considerations to consider when applying the illegality defence: whether the underlying purpose of the prohibition which had been transgressed would be enhanced by the denial of claim; whether there existed any other relevant public policy on which the denial might have an impact; and whether this denial would

[9] (n 3) [89]

[10] ***Patel*** created a more generalised approach to the enforceability of the illegality defence in contrast to *Tinsley* v *Milligan's* [1994] 1 AC 340 'reliance test', where one could not rely on their own illegality to assert their claim or right

be a proportionate response to illegality. The test accordingly concerns questions of whether upholding a transaction 'tainted' by illegality would be harmful to the integrity of the legal system.[11]

Mann J provided welcomed clarification on the remit of *Patel's* public policy consideration, holding that POCA is not operational through public policy, but its own provisions meaning, if the CPS sought to overrule the company's proprietary interest to the proceeds, they would need to bring a claim against them under POCA; equitable rights will stand unless POCA requires otherwise.[12] POCA is consequently not a public policy consideration for the purposes of *Patel's* illegality defence today.

Court of Appeal

Unhappy with Mann J's decision, the CPS brought an appeal stating that Aquila should have their proprietary interest in the secret profits barred on the principles of attribution and illegality under *Bilta* and *Patel*. This claim was dismissed on three further grounds.[13]

Firstly, Patten LJ affirmed *FHR's* leading judgment on unauthorised benefits by a fiduciary. As explained, the basic principle of agency is that a principal has a proprietary interest in any property acquired by its agents for their own benefit, and the right to recover these profits even if they were accrued by unlawful conduct;[14] the profits will be held for the company regardless of the circumstances in which they were obtained to prevent directors from retaining the unauthorised profits and thereby benefitting from their wrong-doing. The CPS were consequently bound by the automatic proprietary consequence of Faichney and Perrin's breach of fiduciary duties, meaning their confiscation order would not trump Aquila's proprietary rights to the proceeds.

The second consideration surrounded the remit of *Bilta's* attribution rules. As explained, in accordance with *Bilta*, even if a company were involved in their directors' fraud or illegality,

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[11] As interpreted in *Stoffel and Co* v *Grondona* [2020] UKSC 42

[12] *R* (*Best)* v *Chief Land Registrar* [2015] EWCA Civ 17 applied

[13] *Crown Prosecution Service* v *Aquila Advisory Ltd* [2019] EWCA Civ 588

[14] (n 8) [33]

attribution cannot be used to defeat their claim for the directors' breach of fiduciary duties; the breach of duty exception to attribution would instead apply to protect the company's proprietary interest in the unauthorised profits.[15] The significance of this understanding is that, even if criminal conduct is attributed to a company, this alone is insufficient to override the company's constructive trust deriving from the directors' breach of duties, meaning the CPS has no better claim to the proceeds and their only remedy was to invoke a confiscation order against Aquila directly. Patten LJ consequently provided much needed clarity on the use of the illegality defence by directors in breach of their fiduciary duties; to attribute their actions to their principal would allow directors to assert title in the proceeds gained, thereby undermining established rules on constructive trusts.

Patten LJ concluded his dismissal of the CPS' claim by explaining the meaning of 'public policy' under *Patel's* illegality defence. Patten LJ noted that attribution and agency were not specifically raised in *Patel* as an issue of public policy, and its judgment provided no guidance to suggest that *Bilta's* attribution rules, and the rules of agency in *FHR*, needed to be reconsidered in light of the new illegality defence. Patten LJ further clarified that *Patel* did not hold that making a confiscation order should alter, or influence, an outcome ordinarily dictated by common law principles, such as those on constructive trusts arising over proceeds accrued through a breach of fiduciary duties, meaning priority should be given to the proprietary interest, even in the face of a confiscation order; this priority is not affected by *Patel* and is not a public policy concern.

The CPS' appeal was accordingly dismissed to avoid significant consequences on well-established rules on fiduciaries and their liability when duties are breached.

The Significance of the Supreme Court Decision

In addressing the CPS' final appeal, the Supreme Court handed down a judgment of significance for, not only its explanation of the remit and application of *Patel's* illegality defence and its interrelationship with attribution in the context of secret profits and the breach of directors'

[15] (n 3) [89]

fiduciary duties, but also for its clarification of the continued priority for equitable interests over CPS confiscation orders.

Ground One: An Analysis of the Illegality Defence and Attribution

The first ground of appeal concerned attributing the directors' fraudulent intentions to Aquila since they stood to profit from these actions by obtaining a proprietary interest over proceeds of crime, a recovery the CPS deemed as undermining POCA's integrity, and thus falling within the remit of *Patel's* illegality defence to bar the company from exercising the constructive trust. The Supreme Court disagreed and instead reiterated the breadth of *Bilta's* 'breach of duty' exception to attribution; **attribution will not be found where a company brings a claim against their directors for breach of duty, even where the company has stood to profit from the directors' actions**. Its remit is thus not limited to instances of loss, but profit too, meaning the exception would apply to Aquila, giving them a proprietary interest over the secret profits in priority to the CPS' confiscation order; to hold otherwise was deemed 'misconceived'.[16] *Patel*'s principles of illegality were accordingly not applied in the absence of attribution.

In justifying this dismissal of ground one, Lord Stephens undertook a dual analysis of the interrelationship between attribution and illegality from the perspective of: allowing directors to retain the benefit of their illegal acts; and preventing the company from exercising its proprietary right over the secret profits obtained, rights entrenched in the common law.

Firstly, Lord Stephens agreed with Patten LJ's judgment that attributing the directors' dishonest intention to Aquila would have the unintended consequence of allowing them to retain the secret profits obtained in breach of their fiduciary duties, which cannot be correct.[17] Lord Stephens explained that the relevant rule to apply instead is whether a duty was owed to the company and, if so, under the breach of duty exception, the company cannot be identified with its officers, meaning it

[16] (n 1) [71] (Lord Stephens)

[17] ibid [74]; Lord Stephens agreed with the judgment of Patten LJ in (n 13) [19]

cannot be attributed with their actions.[18] To create an exception to this element of *Bilta's* ruling by applying attribution where the directors' actions also benefitted, or intended to benefit the company, would result in fiduciary duties being negated, the consequential liability for their breach using constructive trusts being undermined and,[19] as Lord Stephens rightly notes, would move far beyond the simplicity that must be afforded to determinations of liability for fiduciaries obtaining secret profits;[20] directors would no longer be stripped of their profits and guarding against temptation to act in one's own self-interest would be negated.[21]

As this would undermine longstanding precedence on liability for breaching fiduciary duties,[22] Lord Stephens clarification of the application of *Bilta's* rules on attribution when establishing an illegality defence, and affirmation that ***Patel's*** **illegality rules have no impact on** ***Bilta's*** **breach of duty exception to attribution,** is much welcomed.

Secondly, Lord Stephens further explained that *Bilta's* breach of duty exception would continue to apply following *Patel* to uphold established rules on constructive trusts. As explained and affirmed, attribution cannot be used to make a finding of illegality in order to set aside a constructive trust which a company would ordinarily be entitled to when a fiduciary obtains an unauthorised profit, with this being the paradigm case for exception.[23] Lord Stephens consequently clarifies that *Bilta* remains good law and, without a finding of attribution, there should be no consideration as to whether

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[18] (n 3) [42]

[19] See *Bray* v *Ford* [1896] AC 44, *Boardman* v *Phipps* [1967] 2 AC 46, and *FHR* (n 8) which detail how constructive trusts exist to ensure compliance with fiduciary duties

[20] See *FHR* (n 8) which calls for such simplicity

[21] (n 1) [75] (Lord Stephens)

[22] See *Boardman* v *Phipps* [1967] 2 AC 46 and *Regal Hastings Ltd* v *Gulliver* [1967] 2 AC 134 where it has long been held that it does not matter if the directors acted in good faith or with the best interests of the company in mind

[23] (n 3) [89]

the attribution falls within *Patel's* principles of illegality to prevent the company from exercising a constructive trust over the secret profits.

Thus, the Supreme Court confirmed the continued application of *Bilta's* authority that unlawful acts cannot be attributed to the company to either afford the director an illegality defence against a claim for their breach of fiduciary duties, or undermine established rules on constructive trusts, even where the company has suffered no loss, but stood to profit from the breach; *Bilta's* remit and application following *Patel* has been clarified.

Ground Two: POCA and the Public Policy Requirement for Illegality

The second ground for appeal surrounded the claim that POCA's regime is undermined if Aquila are allowed to enforce their proprietary rights in priority to the confiscation order, thereby allowing them to benefit from their directors' criminality, and thus would constitute a public policy concern under *Patel*.

As with the rationale provided to dismiss ground one, Lord Stephens similarly dismissed ground two to uphold the ordinary and established principles of equitable ownership. As explained, POCA is a scheme which seeks to protect the property rights of third parties, regardless of how those rights arise. Its confiscation orders are not intended to interfere with such rights unless the state believes these should be overridden where an offence under parts 2 and 5 of POCA have been committed. Accordingly, in order to uphold the priority of a confiscation order, one would have to bring a claim under POCA's provisions against the company, or individual, holding proprietary rights to the proceeds of crime.[24] This, as Lord Stephens notes, would allow the public interest to be upheld and protected without the need to distort the principles of equitable ownership using *Patel's* illegality defence; public policy cannot be used to alter established property rights unless POCA allows for this, meaning *Patel* is not applicable in such cases.

[24] *R (Best)* (n 12) [95] was upheld here for its judgment that POCA is its own separate regime

This judgment aligns with the precedence provided in *Stoffel* v *Grondona*, which explained the public policy test for illegality under *Patel*.[25] In its judgment, the Supreme Court clarified that, where one seeks to rely on the illegality defence, the essential question following *Patel* is now whether allowing the claim to proceed would be inconsistent with legal policies and would damage the legal system's integrity. The Supreme Court explained that, in some instances, permitting a claim would not undermine public policy but, instead, denying that same claim would. The Supreme Court thus clarified that where it would be incoherent with established legal principles to refuse a claim on the basis of illegality, allowing this claim does not damage the integrity of the legal system, but upholds it.

Akin to *Stoffel's* interpretation of *Patel,* the Supreme Court similarly dismissed ground two given the public policy implications of denying an established constructive trust claim for a breach of fiduciary duties; **barring Aquila's proprietary interest is not a matter of public policy or illegality since POCA is its own statutory scheme** meaning, as no criminal charges were brought against Aquila or VTL, the constructive trust would remain in priority to the confiscation order and attribution could not be used simply to achieve the outcome the CPS desire to the detriment of established rules.[26]

Accordingly, the priority to be given to equitable rights of ownership was upheld in the judgment; established equitable principles cannot be set aside using the illegality defence in the absence of attribution, and instead should be overruled using POCA's provisions itself. POCA's integrity was thus not undermined by the finding of a constructive trust, and Aquila's proprietary rights in the secret profits would prevail in the absence of any POCA charge being brought against them.

[25] (n 11)

[26] (n 1) [86] (Lord Stephens)

Ground Three: Affirming the Imposition of Constructive Trusts for Unauthorised Benefits

The final appeal put forward by the CPS surrounded Mann J's declaration of a constructive trust. The CPS argued that, even in the absence of attribution and illegality, discretion should not have been exercised to grant the company declarative relief. Lord Stephens was quick to dismiss this claim, and instead held that discretion was exercised appropriately in light of the decision in *FHR*. Namely, despite once being disputed, any unauthorised benefit accrued by a fiduciary in breach of their duties are now subject to a constructive trust, regardless of the circumstances.[27] The constructive trust is therefore institutional and arises automatically from the moment that, in breach of fiduciary duties, a director receives secret profits, profits they never own in equity, a proposition the declaration clarified.[28]

Accordingly, despite the criminal offences imposed on Faichney and Perrin, their breach of fiduciary duties and acquisition of secret profits resulted in the imposition of a constructive trust on Aquila's behalf, giving the company a proprietary remedy which takes priority over any personal claims, including a CPS confiscation order; **even though the profits are proceeds of crime, this does not alter the working of equitable rules on constructive trusts**.

The CPS were consequently ordered to transfer to Aquila the money confiscated from Perrin and Faichney, demonstrating the continued importance of equitable rules surrounding secret profits and fiduciary duties today.

Conclusion

Therefore, the Supreme Court have provided much needed clarity on the interrelationship between the attribution rules in *Bilta* with the newly formulated illegality defence under *Patel*, and the priority to be given to a constructive trust held over secret profits over CPS confiscation orders.

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[27] (n 8) [7], [33] (Lord Neuberger)

[28] (n 1) [88] (Lord Stephens)

The judgment clarifies that *Bilta* remains good law following *Patel*, meaning the illegality defence cannot be enforced to deny a company their proprietary interest in secret profits accrued by a director in breach of their fiduciary duties, even where the company does not suffer a loss, but stands to profit from the breach. Claiming that the company have benefitted from the breach, or were intended to benefit, is not enough to set aside the breach of duty exception from attribution, even in the face of a confiscation order. To attribute the directors' actions to the company in such circumstances would result in the deterrent effect of fiduciary duties and constructive trusts being undermined, a consequence the Supreme Court made sure did not occur.

The Supreme Court further clarified that the illegality defence can only be considered once attribution is established, and that POCA is not a public policy concern for *Patel's* purposes; to override proprietary interests, POCA's provisions must instead be directly enforced to vindicate the public interest without distorting equitable rules on fiduciaries and constructive trusts.

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