

Chapter 16: Resulting and Constructive Trusts

Summative Assessment Exercise - Outline Answer

In *AG for Hong Kong v Reid* [1994] 1 All ER 1, the Privy Council held that whenever a fiduciary receives property of his principal in breach of his fiduciary duty, he is a constructive trustee of it, and of any traceable profit from and proceeds of it. Mr Reid was acting Director of Public Prosecutions in Hong Kong. In breach of his fiduciary duty to the Crown he received substantial bribes in consideration of which he obstructed the prosecution of certain criminals. The Crown was able to trace the bribe monies through to three freehold properties in New Zealand, and to assert a restitutionary claim to them under a constructive trust. Lord Templeman held: 'Equity considers as done that which ought to be done. As soon as the bribe was received, whether in cash or in kind, the false fiduciary held the bribe on a constructive trust for the person injured.'

It is by means of a constructive trust that English law requires a 'false fiduciary' to disgorge unauthorised profits. Consequently, the unauthorised profits in the hands of the fiduciary are regarded as a trust fund. Every private trust must have a beneficiary, and English law has chosen to fasten on the fiduciary's principal as being the appropriate beneficiary. There are a number of reasons for this choice. One is the fact that English law does not recognise pure remedial constructive trusts, but only acknowledges constructive trusts where they vindicate pre-existing proprietary entitlements (*Re Sharpe (a bankrupt)* [1980] 1 All ER 198; *Chase Manhattan Bank NA v Israel-British Bank (London) Ltd* [1981] Ch 105). Thus the principal is in most cases automatically better placed to claim the benefit of the constructive trust than would be the fiduciary's creditors or society at large. A second reason is the principle of insolvency law that the creditors of the insolvent should not be placed in a position better than the insolvent himself could have occupied. If the insolvent (the false fiduciary) would not have been permitted to retain the profits as part of his estate, those profits cannot be permitted to form part of his estate for the purpose of meeting the claims of the insolvent's creditors.

The first of these reasons is, of course, rather circular, for its justification for the law's approach is the law's usual practice. It is therefore not surprising that it is a reason that

does little to illuminate the actual judgments in a number of decided cases. The *Reid* case is itself a good example. In what sense did the constructive trust in that case operate to vindicate the Crown's pre-existing proprietary entitlement to the bribe? The Crown was surely no more entitled to the bribe prior to its receipt by Reid than was he himself.

Another interesting case is *Boardman v Phipps* [1967] 2 AC 46. There, Boardman (the solicitor to the trust) wrote to the beneficiaries outlining his plans to take a personal interest in the company, thus giving them an opportunity to raise any objections they might have to his so doing. No objectors having come forward, Boardman proceeded with the take-over. In the event the take-over was very successful and the value of all the shares in the company increased in value. The present action was brought by Phipps, a beneficiary under the trust, for an account of profits made by Boardman in his fiduciary capacity. The trial judge found as a fact that Phipps had not been fully informed by Boardman as to the precise nature of his plans. A bare majority of their Lordships (Viscount Dilhorne and Lord Upjohn dissenting) held that Boardman had placed himself in a fiduciary position in relation to the trust and would therefore be accountable for the profits that he had made on information obtained in his fiduciary capacity. There was only a slight suggestion in their Lordships' speeches that the inside information had itself been property of the trust. In fact, Boardman was held to be a constructive trustee, not to vindicate the beneficiary's pre-existing rights in property held by Boardman (he had not held any such property), but 'by reason of the fiduciary *position* in which [he] stood' (emphasis added).

Professor Birks has suggested ((1988) LMCLQ 128) that the use of constructive trust language was inappropriate to the facts of this case. For Birks, *Boardman v Phipps* was a case which should have been disposed of as a straightforward personal claim against the principal, and that in essence, despite the occasional unconvincing reference to constructive trusteeship, this is how the case was disposed of. It is true that the House of Lords made no order requiring that the defendants should transfer the shares to the plaintiff. Against this Professor Andrew Burrows points out that a declaration that the defendant held the shares on constructive trust was made at first instance, and (that judgment having been upheld) 'it must follow that the plaintiffs would have been entitled to proprietary remedies, affording priority, had the defendants been insolvent' (*The Law of Restitution* (1993), p. 413).

The second reason for English law's preference for the fiduciary's principal ahead of his creditors, namely that the creditors of the insolvent fiduciary cannot be placed in a better position than the fiduciary himself, is surely open to attack. For the fiduciary's creditors do not claim any part of the unauthorized profits, but merely that their legitimate contractual claims will be satisfied out of the fiduciary's general estate. They might legitimately argue that equity, with its purported concern for justice, has no business awarding a windfall to the fiduciary's principal (especially where it cannot, without straining imagination, be said to vindicate a pre-existing proprietary entitlement) when that windfall must inevitably be taken from the total fund available to satisfy the creditors' various claims.

It is suggested that the right approach would be for the courts to find a constructive trust in favour of the principal where the unauthorized profits were made through the use of the principal's property in the hands of the fiduciary, but in other cases to allow the creditors to prove their claims ahead of any windfall to the principal in the guise of a constructive trust.