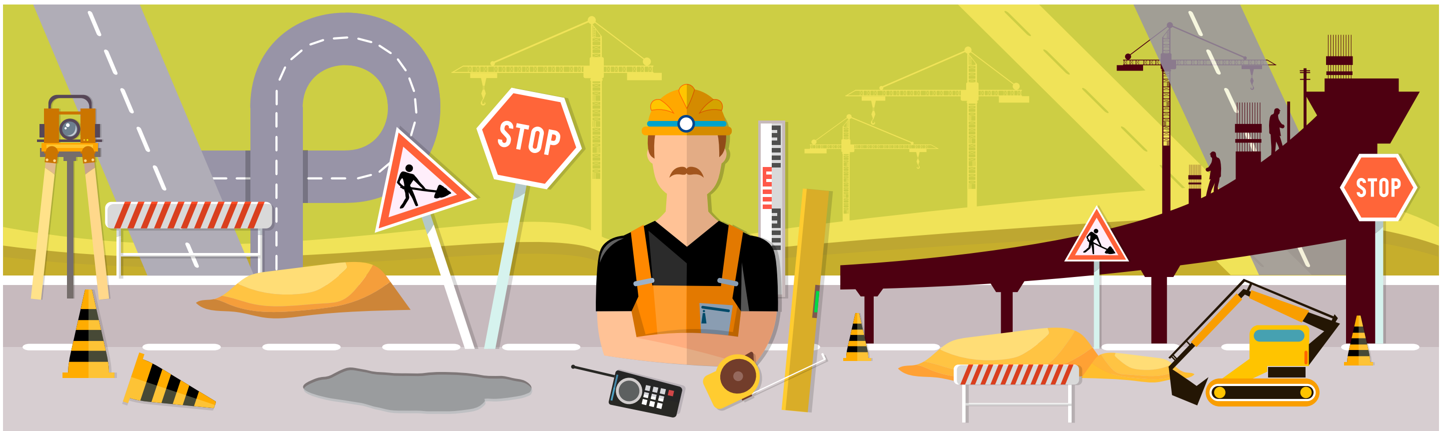
UNDER CONSTRUCTION:

THE INTERACTION OF CONFISCATION ORDERS AND CONSTRUCTIVE TRUSTS



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In the Crown Prosecution Service v Aquila [2021] UKSC 49, the Supreme Court considered whether a company could assert its rights under a constructive trust in the face of confiscation orders obtained by the Crown Prosecution Service ("CPS") over the proceeds of crime.

THE FACTS

Two directors of a company called VTL facilitated false claims for tax relief and made a secret profit of £4.55 million. The directors were convicted in a criminal court of cheating the public revenue and the CPS obtained confiscation orders under the Proceeds of Crime Act 2002 ("POCA") over a portion of the proceeds of the crime.

However, there was a competing interest over the money: Aquila, the company which had acquired VTL's proprietary rights, asserted a claim over the entirety of the £4.55 million. Aquila argued that the directors had acquired the profit on behalf of the company in breach of their directors' duties, and therefore that the profit was beneficially owned by VTL under a constructive trust. This is in line with the principles set out in FHR European Ventures LLP v Mankarious [2014] UKSC 45; [2015] AC 250 ("FHR"), which follows a long line of English authority that secret profits made by an agent in breach of fiduciary duty are held on constructive trust. Aquila argued that its proprietary claim had priority over the CPS's criminal confiscation orders.

THE ISSUES

The court at first instance decided that Aquila's proprietary claim had priority and declared that the secret profit was held on constructive trust for VTL. The CPS appealed. It accepted that the confiscation orders did not give it a proprietary claim, and it also accepted that VTL had a proprietary claim to the £4.55m in accordance with the decision in FHR. However, the CPS argued that the constructive trust was unenforceable because the illegal acts of its directors should be attributed to VTL itself.

The Court of Appeal applied Bilta (UK) Ltd v Nazir [2015] UKSC 23; [2016] AC 1 ("Bilta"). Bilta confirms that a director who is sued by a company for a loss caused by a breach of their fiduciary duties cannot rely on principles of attribution to defeat the claim, even if the illegal scheme involved the company in the fraud. The Court of Appeal therefore dismissed the CPS's appeal.

In the Supreme Court, the CPS sought to distinguish Bilta and argued that the directors' fraud should be attributed to VTL in this case because VTL stood to profit from the fraud, rather than being the target or victim. The CPS also argued that VTL should not be allowed to benefit from the proceeds of crime as it would be inconsistent with the purpose of POCA.

THE DECISION

The Supreme Court unanimously dismissed the CPS's appeal. The Court confirmed that the illegality of a director cannot be attributed to the company as that would offer the director a defence to the company's potential claim against them for breach of their director's duties. The Court also rejected the CPS's argument that a constructive trust in favour of VTL is inconsistent with the regime established by POCA.

CONSEQUENCES

In none of the previous secret profits or bribes cases, including FHR, has the English court had to consider whether a director's fraud should be attributed to the principal so as to prevent the principal, by reason of the defence of illegality, from relying on a constructive trust in priority to the claims of unsecured creditors.

This case reaffirms the fundamental principles around a director's fiduciary duties to a company. The decision confirms that a director cannot be allowed to benefit from his or her breach of fiduciary duty regardless of whether the company also benefited from the illegal scheme. This applies even where it may be argued that there are public policy reasons for a director not to account to the principal.

If the CPS had been successful, directors might in future have been allowed to argue that they should keep a secret profit just because they also intended the company to benefit from the fraud. The Supreme Court's decision therefore avoids creating real uncertainty in the law. It also maintains the important deterrent that a director who breaches their fiduciary duty knows they will be stripped of their profit.

The CPS's other key argument was that POCA should not permit Aquila to benefit from the actions of criminals. However, the Supreme Court noted that POCA is intended to protect existing property rights regardless of how they arise. The Court was clear that the operation of POCA was not frustrated in this case. The CPS could have chosen to use certain other provisions in POCA to deprive VTL of the secret profit. For example, the CPS could have added VTL to the indictment and sought a confiscation order against the company, but it did not do so in this case. It may well be that this case leads to a change in the CPS decision-making at the prosecution stage, and how it goes about trying to recover the proceeds of crime from convicted criminals.