Neutral Citation Number: [2019] EWCA Civ 1246

Case No: A3/2018/1785

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE, CHANCERY DIVISION
His Honour Judge Stephen Davies
(sitting as a Judge of the High Court)
C30MA690

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 16th July 2019

Before :

LORD JUSTICE LEWISON
LORD JUSTICE McCOMBE
and
LORD JUSTICE BEAN

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Between :

COLIN ROBERT PARR	**Appellant**
- and -	
(1) KEYSTONE HEALTHCARE LIMITED	**Respondent**
(2) KEYSTONE HEALTHCARE HOLDINGS LIMITED	
(3) MARK REYNARD	
(4) MEDIPRO RECRUITMENT LIMITED	

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MR NICHOLAS MASON (instructed by **Martin Gaffney Solicitors, Ilkley**) for the **Appellant**
MR MARTIN BUDWORTH (instructed by **FrontRow Legal, Leeds**) for the **Respondent**

Hearing date : 9th July 2019

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Approved Judgment

Lord Justice Lewison:

1. Keystone Healthcare Ltd ("Keystone") carries on business as a healthcare employment agency. At the relevant time it was owned and controlled by Mr and Mrs Ward and Mr Parr. Mr Parr was also a director of the company. Following Mr Parr's departure from the company, Keystone brought a number of claims against him. We are concerned only with what has been called the "overpayment claim". Following a lengthy trial, in which he considered a whole range of issues which no longer arise, HHJ Stephen Davies gave judgment for Keystone against Mr Parr in the sum of £650,612.04 in respect of the overpayment claim. Mr Parr appeals against that part of the order. Having heard Mr Mason's submissions on behalf of Mr Parr, we announced our decision to dismiss the appeal, with written reasons to follow. These are my reasons for joining in that decision.

2. That claim arises in the following way. Keystone was regulated by its articles of association. There was also a shareholders' agreement made between Mr and Mrs Ward and Mr Parr. The articles gave each member of the company a right of pre-emption over shares which another member wished to sell. The sale price was to be determined (in default of agreement) by an independent expert, who was to assess the fair value of the shares. The articles and the shareholders' agreement also contained provisions (commonly called "bad leaver provisions") which deemed a transfer notice to have been given where one shareholder had been in persistent breach of a relevant agreement. In that event, the sale price of the shares was to be discounted by 50 per cent.

3. Unknown to Keystone and to Mr and Mrs Ward, from April 2014 Mr Parr was a party to a fraud on the company the immediate result of which was the transfer to his personal account of £128,022. By the spring of 2014 Mr Parr was looking to sell his shares. Mr Ward was willing to pay the price that Mr Parr had named; that is to say £1.2 million which, after tax, would leave Mr Parr with £1 million. However, the share sale was not structured as a simple transfer of shares by Mr Parr to Mr Ward. Instead, Mr and Mrs Ward arranged the incorporation of a new company, Keystone Healthcare Holdings Ltd ("Holdings") to which all the shareholders transferred their shares. It was Holdings that paid the purchase price of Mr Parr's shares.

4. It is now common ground that, by participating in the fraud, and by failing to report his own misconduct, Mr Parr was in breach of the fiduciary duties which, as a director, he owed Keystone. Sir Geoffrey Vos C gave summary judgment against him for the amount of which he had defrauded Keystone. Keystone alleges that if it or Mr and Mrs Ward had known of the fraud, the circumstances would have been such as to trigger a deemed transfer notice. That would have resulted in the compulsory sale of Mr Parr's shares at a 50 per cent discount. Under article 18.10 of the articles of association, the shares which were subject to a compulsory sale would have to have been first offered to Keystone; and, if it did not wish to buy them, then to Mr and Mrs Ward. As things happened, however, in order to facilitate bank lending, the shares were acquired by Holdings. Holdings thus paid 50 per cent more than it would have done if the true facts had been known. The difference between the price paid and the discounted price was an unauthorised profit in the hands of Mr Parr, which equity requires him to disgorge to Keystone.

5. The essential point which Mr Mason takes on Mr Parr's behalf is that there was a mismatch between the company to which the fiduciary duty was owed (Keystone) and the company which made the overpayment (Holdings). Mr Parr was not liable for losses sustained by Holdings, to which he owed no fiduciary duty. In essence, he says, the claim is a claim for the loss sustained by Holdings. It is not a claim for the benefit that accrued to Mr Parr.

6. Paragraph 58 of the Amended Particulars of Claim allege that by failing to report his own wrongdoing in breach of fiduciary duty Mr Parr "caused the Claimants [i.e. Keystone and Holdings] loss." The allegation of causation of loss is repeated at paragraph 62; and the prayer for relief claims:

> "Damages for breach of fiduciary duty re the monies paid by [Holdings] for Mr Parr's shares…"

7. Thus, as the judge correctly observed at [152], the claim was indeed pleaded as a claim for damages for breach of fiduciary duty. A claim put in that way would be vulnerable to the objection that there was a mismatch between the company to which the duty was owed and the company which suffered the loss. But he had already said at [142] that the way the claim was put by Mr Budworth in opening on Keystone's behalf was a claim for the disgorgement of benefit. He considered at [143] and [152] whether it was necessary for the statement of case to be formally amended to plead the case in that way. It appears to have been agreed between counsel that a formal amendment was unnecessary; and in any event the judge said at [152] that there could be no possible objection to an amendment. Mr Mason's point is therefore essentially a pleading point. But it was accepted before the judge that there was no need for a formal amendment.

8. In those circumstances, I consider that we should approach this appeal on the basis that what Keystone seeks is recovery of the unauthorised profit made by Mr Parr consequent on the sale of his shares at full value rather than at a 50 per cent discount.

9. Mr Mason argued that there was no "profit" for which Mr Parr was accountable. The only possible "profit" was the difference between the full value of Mr Parr's shares and the 50 per cent discount that would have applied if the bad leaver provisions of the articles had been invoked. But Holdings would not have been entitled to take advantage of the bad leaver provisions in the articles, because it was neither the company whose articles they were; nor was it a member of the company before its acquisition of Mr Parr's shares. There were thus no circumstances in which Holdings could have benefitted from the 50 per cent discount. Although in form the judge gave judgment for Keystone, in substance he gave judgment for Holdings. That was impermissible because Mr Parr owed no fiduciary duty to Holdings.

10. The fundamental principle is best expressed by Lord Russell in *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134:

> "The rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of bona fides; or upon such questions or considerations as whether the profits would or should otherwise have gone to the plaintiff, or

> whether the profiteer was under a duty to obtain the source of the profit for the plaintiff, or whether he took a risk and acted as he did for the benefit of the plaintiff, or whether the plaintiff has in fact been damaged or benefited by his action. The liability arises from the mere fact of a profit having, in the stated circumstances, been made. The profiteer, however honest and well-intentioned, cannot escape the risk of being called upon to account."

11. As Jonathan Parker LJ put it in *Murad v Al Saraj* [2005] EWCA Civ 959, [2005] WTLR 1573:

> "It is thus clear on authority, in my judgment, that the `no conflict' rule is neither compensatory nor restitutionary: rather, it is designed to strip the fiduciary of the unauthorised profits he has made whilst he is in a position of conflict."

12. Thus, where a fiduciary takes a bribe or commission from a third party, he is not only liable to account to his principal for the amount of the bribe or commission; but the principal also has a proprietary interest in it: *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2015] AC 250. The fact that the money has been paid by a third party to whom no fiduciary duty is owed makes no difference.

13. The statutory codification of the equitable principles applicable to company directors makes the same point. Section 176 of the Companies Act 2006 provides:

> "(1) A director of a company must not accept a benefit from a third party conferred by reason of:
>
> (a) his being a director; or
>
> (b) his doing (or not doing) anything as director."

14. Section 178 provides that the civil consequences of a breach of that duty are the same as if the corresponding equitable principle applied.

15. It follows, in my judgment, that the supposed mismatch between the company to which Mr Parr owed fiduciary duties (Keystone) and the company that suffered the loss (Holdings) is no bar to the recovery by Keystone of a secret profit made by Mr Parr. The fact that Keystone itself would not have made the profit is irrelevant. That is clear enough from *Regal*; but if further authority is needed it is to be found in the judgment of Arden LJ in *Murad* at [67]:

> "The fact that the fiduciary can show that that party would not have made a loss is, on the authority of the *Regal* case, an irrelevant consideration so far as an account of profits is concerned. Likewise, it follows in my judgment from the *Regal* case that it is no defence for a fiduciary to say that he would have made the profit even if there had been no breach of fiduciary duty."

16. Mr Mason submitted that the breach of fiduciary duty must be a cause of the profit before the liability to account is engaged. He supported his submission by reference to the decision of this court in *Swindle v Harrison* [1997] 4 All ER 705. Mummery LJ said at 733:

> "Although equitable compensation, whether awarded in lieu of rescission or specific restitution or whether simply awarded as monetary compensation, is not damages, it is still necessary for Mrs Harrison to show that the loss suffered has been caused by the relevant breach of fiduciary duty. Liability is not unlimited. There is no equitable by-pass of the need to establish causation."

17. That, however, was a case of equitable compensation; not a claim for an unauthorised profit. In *Murad* at [57] Arden LJ cited with approval the following passage from the judgment of Morritt LJ in *United Pan-Europe Communications NV v Deutsche Bank AG* [2000] 2 BCLC 461:

> "If there is a fiduciary duty of loyalty and if the conduct complained of falls within the scope of that fiduciary duty … then I see no justification for any further requirement that the profit shall have been obtained by the fiduciary `by virtue of his position'. Such a condition suggests an element of causation which neither principle nor the authorities require. Likewise it is not in doubt that the object of the equitable remedies of an account or the imposition of a constructive trust is to ensure that the defaulting fiduciary does not retain the profit; it is not to compensate the beneficiary for any loss. Accordingly comparison with the remedy in damages is unhelpful."

18. Jonathan Parker LJ made the same point at [110], contrasting a claim for equitable compensation with one for disgorgement of an unauthorised profit. I do not, therefore, accept Mr Mason's argument that the breach of fiduciary duty must be a cause of the profit. There must, of course, be a sufficient degree of connection between the breach of fiduciary duty and the receipt of the secret profit. In *Murad* Jonathan Parker LJ said at [112] that the fiduciary is liable to account "only for profits which he has made within the scope and ambit of the duty which conflicts or may conflict with his personal interest". In *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704, 732 Lawrence Collins J said that there must be "some reasonable connection between the breach of duty and the profits for which the fiduciary is accountable." In *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch), [2007] WTLR 835 at [1588] I said that there must be a "reasonable relationship" between the breach of duty and the profit for which an account is ordered.

19. Mr Mason sought to suggest that if Mr Parr had disclosed his wrongdoing, neither Keystone nor Mr and Mrs Ward would have triggered the bad leaver provisions; or at any rate that they would not have acquired his shares at the 50 per cent discount. This submission faces two difficulties: one legal and the other factual. As Arden LJ explained in *Murad* at [76]:

> "For policy reasons, the courts decline to investigate hypothetical situations as to what would have happened if the fiduciary had performed his duty."

20. In the same case, Jonathan Parker LJ cited a number of authorities to the same effect, including the following passage from the judgment of Mummery LJ in *Gwembe Valley Development Co Ltd v Koshy* [2004] BCLC 131:

> "In considering whether the director should account for unauthorised profits, what would have happened, if the required disclosure had been made, is irrelevant."

21. The factual difficulty is that, on my reading of the judgment, the judge found at [149] that if Mr Parr had disclosed his wrongdoing he would have been removed as a director and also as a shareholder under the bad leaver provisions, which would have entitled Keystone to acquire his shares. The judge recorded at [146] that it was not suggested that Keystone would have been disabled from acquiring those shares.

22. It was for these reasons that the judge held at [150] that there was a "sufficient nexus" between the breach of fiduciary duty and the enhanced price that Mr Parr received for his shares. In my judgment he was entitled so to hold.

23. Mr Mason argued that there was no evidence to suggest that the value of Mr Parr's shares was enhanced by his breach of duty. It may well be the case that the intrinsic value of the shares was unaffected by the breach (although since the effect of the fraud must have been to reduce Keystone's profitability that is in itself doubtful). But that misses the point. Whatever was the value of Mr Parr's shares, he was only entitled to receive half of that value under the terms of the articles of association and the shareholders' agreement. His concealment of his breach of duty (which was itself a breach of duty) led to his receipt of twice as much as he was entitled to. In my judgment, that is a sufficient connection between the breach and the profit to bring the equitable principle into play.

24. It is important to note that the judge's order gave no relief to Holdings. I do not, therefore, consider that Mr Mason was correct to submit that in substance the judge gave judgment for Holdings. He did not. What Keystone does with the judgment sum is a matter for it. There is no substance in the criticism that the judge gave equitable relief to an entity to which no fiduciary duties were owed.

25. In my judgment, therefore, the judge was entitled to hold as he did; with the consequence that I joined in the decision to dismiss the appeal.

26. Finally, by way of postscript, it is a matter of considerable regret that the practice direction on the citation of authorities at [2012] 1 WLR 780 (referred to in PD 52C paragraph 29 (2)) has been almost wholly ignored. We were supplied with print outs and handed down transcripts of authorities that have been reported in the official law reports (e.g. *Bristol & West BS v Mothew* [1998] Ch 1; *A-G v Blake* [2001] 1 AC 280; *Stein v Blake (No 2)* [1998] 1 All ER 724). Unreported cases were cited for propositions that could be found in reported ones. The whole of my gargantuan judgment in *Ultraframe (UK) Ltd v Fielding* (which runs to 494 pages) was copied, even though only a few pages were of any conceivable relevance to the issues on the

appeal. Contrary to PD 52C paragraph 29 (2) many of the authorities were supplied without marking the relevant passages.

27. Judges of this court have limited time for pre-reading in advance of an appeal. Adherence to the practice directions means that that limited time can be more productively spent. Parties can expect that the cost of preparing a non-compliant bundle of authorities is at risk of being disallowed.

Lord Justice McCombe:

28. I agree.

Lord Justice Bean:

29. I also agree.