

THE SCOPE OF REMEDY

The remedy of equitable compensation following the England and Wales case of *Auden McKenzie (Pharma Division) Limited v Amit Patel*

BY JENNIFER SEAMAN

ABSTRACT

- *In England and Wales, equitable compensation is awarded to make good a loss caused by the breach of an equitable duty.*
- *Equitable compensation is different from a proprietary remedy and a personal remedy to reverse an unjust enrichment. It is more akin to common-law damages, but there are variances in assessment.*
- *The England and Wales Court of Appeal case of Auden McKenzie (Pharma Division) Limited v Amit Patel raises questions about causation when awarding equitable compensation.*

EQUITABLE COMPENSATION FOLLOWING AUDEN MCKENZIE (PHARMA DIVISION) LIMITED v AMIT PATEL¹

WHAT IS EQUITABLE COMPENSATION?

In basic terms, equitable compensation is awarded to make good a loss caused by the breach of an equitable duty, i.e. breach of trust or breach of fiduciary duty. It is now generally seen as a personal, reparative remedy.² Equitable compensation is available to claimants where there is no fund of which an account can be taken (an action for an ‘account’ is traditionally the

¹ [2019] EWCA Civ 2291

² Equitable compensation could also be seen as ‘substitutive compensation’, calculated as equivalent to an asset that, if it were available, the defendant would be obliged to deal with in a particular way; see *Snell’s Equity*, 34th edition, at 20-034 and 20-035. This article, however, focuses on equitable compensation as a reparative remedy.

‘When awarding equitable compensation, the courts will generally look at what would have been the position if the trustee (or fiduciary) had performed their obligation’

main remedy for a breach of trust), to ensure that any loss caused by a breach of fiduciary duty is not left unremedied.

How does it differ from a proprietary remedy?

Equitable compensation is very different from a proprietary remedy, e.g. claiming a continuing proprietary right in the assets disposed of in breach of trust, and following or tracing that proprietary right in assets held by a defendant or third party. This is because claimants claiming equitable compensation are asking a defendant to personally restore a lost value to a trust fund, rather than trying to assert a claim over the lost assets themselves. Further, concepts such as causation are not relevant in a proprietary remedy.

How does it differ from a personal remedy to reverse an unjust enrichment?

Equitable compensation is also different from a personal restitutionary award made against a defendant who is unjustly enriched at a claimant’s expense. The remedy of restitution looks at the gains the defendant has made, not the loss to the claimant. As Lord Hope observed in the judgment of *Sempre Metals Ltd v IRC*,³ the ‘gain needs to be reversed if the claimant is to make good his remedy’. The order made to reverse the gain for a personal restitutionary award is that the defendant is to pay the claimant a sum of money representing the value of the benefit they received at the claimant’s expense. In contrast, equitable compensation aims to remedy the loss suffered by the claimant as a result of the defendant’s breach of trust or fiduciary duty.

How does it compare with common-law damages?

This is a complex question and there is significant academic material on this point.⁴ However, in broad terms, there is a close analogy between a claim for equitable compensation and a claim for common-law damages. In both cases, the aim is to compensate the claimant; to provide a monetary equivalent of what has been lost as a result of a breach of duty.⁵

There is a question as to whether and, if so, how common-law rules of causation apply in assessing equitable compensation.⁶ As to this, it is important to note that when awarding equitable compensation, the courts will generally look at what would have been the position if the trustee (or fiduciary) had performed their obligation.

In *Target Holdings v Redferns (A Firm)*,⁷ Lord Browne-Wilkinson said:

‘Even if the immediate cause of the loss is the dishonesty or failure of a third party, the trustee is liable to make good the loss to the trust estate if, but for the breach, such loss would not have occurred ... Thus the common law rules of remoteness and causation do not apply. However there does have to be some causal connection between the breach of trust and the loss to the trust estate for which compensation is recoverable, viz. the fact that the loss would not have occurred but for the breach ...’⁸

⁴ For further analysis, see *Lewin on Trusts*, 20th edition, at 41-011-41-016 and *Underhill and Hayton: Law of Trusts and Trustees* at art.87

⁵ Lord Reed in *AIB v Redler* at [136]

⁶ For an interesting analysis of when trustees or fiduciaries are required to make equitable compensation with ‘but for’ causation considerations, see M. Phua’s article in *Tru.L.J.* 2020, 34(2) at 117-124.

⁷ [1996] AC 421

⁸ At 434E-F

³ [2007] UKHL 34; [2008] 1 AC 561 at [28]

In *AIB Group (UK) plc v Mark Redler & Co*,⁹ Lord Toulson said:

‘Equitable compensation and common law damages are remedies based on separate legal obligations. What has to be identified in each case is the content of any relevant obligation and the consequences of its breach. On the facts of the present case, the cost of restoring what the bank lost as a result of the solicitors’ breach of trust comes to the same as the loss caused by the solicitors’ breach of contract and negligence.’

In equitable compensation, the measure of compensation is normally assessed at the date of trial, with the benefit of hindsight.¹⁰ The foreseeability of loss is generally irrelevant, but the loss must be caused by the breach of trust, in the sense that it must flow directly from it.¹¹ In other aspects, however, it is clear that equitable compensation is not assessed on the same basis as common-law damages. For example, it is assumed that a fiduciary is not able to assert contributory fault to reduce the award.¹²

THE CASE

Auden McKenzie (Pharma Division) Limited v Amit Patel has raised interesting questions on how the courts should approach causation in the context of equitable compensation.

FACTUAL BACKGROUND

In January 2015, the holding company of Auden McKenzie (Pharma Division) (AMcK), Auden McKenzie Holdings Limited, was purchased by Actavis Holdings UK (Actavis) for an initial consideration of GBP323.5 million. Chilcott UK (Chilcott), which was the assignee of the rights and interests of Actavis, became the ultimate owner of AMcK.

The previous shareholders of AMcK were Amit Patel and Meeta Patel (Mr Patel’s sister). Mr and Ms Patel founded AMcK in 1999 and were, at all material times, the sole directors of the business.

It transpired that between 2009 and 2014, Mr Patel caused AMcK to pay more than GBP13.7 million against sham invoices raised

purportedly for research and development. AMcK received no value for these payments. The sham invoices were produced to extract funds from AMcK for the personal benefit of Mr and Ms Patel in a way that would avoid payment of tax.

Her Majesty’s Revenue & Customs (HMRC) investigated and Mr Patel entered into a settlement, paying HMRC around GBP14.6 million in respect of income tax, national insurance contributions, corporation tax and interest, and penalties. At this time, AMcK and Chilcott were not involved in or aware of the disclosures to HMRC or the settlement with HMRC.

In November 2017, AMcK, Actavis and Chilcott issued proceedings against Mr and Ms Patel. In the proceedings, AMcK applied for summary judgment against Mr Patel on its claim for ‘damages and/or equitable compensation for breach of statutory fiduciary duties’ in the sum of GBP13.7 million, on the basis that Mr Patel acted in breach of his fiduciary duties as a director of AMcK.¹³

Mr Patel accepted that he acted in breach of his fiduciary duties as a director. However, among other defences, Mr Patel said that if the payments under the sham invoices had not been made, the then-shareholders (i.e. himself and his sister) would have caused AMcK to pay equivalent lawful payments to themselves, e.g. as dividends. AMcK accepted that this allegation should be assumed to be true for present purposes. Mr Patel said that AMcK could therefore show no loss because the payments to himself and his sister would have been made in any event.

FIRST INSTANCE DECISION

The summary judgment application was heard by Justice Robin Knowles. On 17 May 2019, Knowles J gave summary judgment against Mr Patel on AMcK’s claim for damages or equitable compensation following the payments made under false invoices. In fixing the judgment at GBP13 million, credit was given in the agreed amount of GBP615,000 for corporation tax paid by

⁹ [2015] AC 1503

¹⁰ See *Snell’s Equity*, 34th edition, para.20-029

¹¹ Lord Reed in *AIB v Redler* at [135]

¹² See *Snell’s Equity*, 34th edition, at 7-060

¹³ This article focuses on AMcK’s application for summary judgment against Mr Patel on the claim for equitable compensation only. The ongoing litigation between the parties includes other claims arising out of the same facts, which were not the object of the summary judgment application, and also claims in deceit by Actavis and Chilcott against Mr and Ms Patel, where it is alleged that Mr and Ms Patel misrepresented the financial circumstances of AMcK.

Mr Patel as part of his settlement with HMRC.¹⁴ In his reasoning, the judge held:

‘There is no question that [Mr Patel] caused loss in the amount of the payments by reason of the breaches. If the payments had not been made unlawfully then the company would still have the money “in the till”.¹⁵

‘The court is as well placed now as it will be at trial to make an assessment with the full benefit of hindsight and one that takes a practical and common sense view of causation. None of the avenues to which [Mr Patel] now refers were in fact pursued at any point when it was in the power of the Defendants to do so, including by reversing the unlawful payments and then taking the steps to which [Mr Patel] refers. The availability of the avenues was as apparent at the time as it is now, and yet the Defendants chose not to pursue those avenues. It would be wrong to treat them as having been pursued. [Mr Patel] has no foundation for a claim that there was an obligation on the First Claimant to make a payment of £13 million...’¹⁶

THE APPEAL

Mr Patel appealed against the summary judgment on the claim for equitable compensation. The appeal was heard by Lewison LJ, Richards LJ and Newey LJ. On 20 December 2019, the England and Wales Court of Appeal allowed the appeal and set aside the summary judgment against Mr Patel.¹⁷

Richards LJ reasoned:

‘The issue that arises on this appeal, and arose on the application before the Judge, is one of law. In a claim for equitable compensation in respect of the misappropriation by a director of a company’s funds, is a defence open to the director on the grounds that, if the misappropriation had not occurred, the funds would have been lawfully transferred to the same persons for no value, so that it can be said that the company has sustained no loss as a result of the misappropriation that can be recovered by way of equitable compensation? The question is not,

of course, whether that is right as a matter of law but whether the defendant has a real prospect of successfully defending the claim on that basis.¹⁸

‘Equitable compensation is the personal remedy (as opposed to a tracing or proprietary remedy) available against trustees, or others in a fiduciary position, whose acts or omissions amount to a breach of trust or fiduciary duty.’¹⁹

The case fell within the ‘breach of duty’ category of transactions, being the unauthorised payment or disposal of, or damage to, trust assets, causing loss to the trust.²⁰ Richards LJ continued:

‘If an account in common form were ordered to be taken, the Payments would be disallowed (or “falsified”) as legitimate expenditure and Mr Patel would be ordered to make good the loss.²¹ This would be a form of equitable compensation.²²

‘The use of the phrase “equitable compensation” in this context has attracted some controversy, principally because it has been suggested that it detracts from the basic purpose of the remedy to make good the deficit in the fund. In *Libertarian Investments Ltd v Hall* [2013] HKFCA 93, a decision of the Final Court of Appeal of Hong Kong, Lord Millett said at [168] that the order was “not compensation for loss but restitutionary or restorative” but he accepted that the order is sometimes described as the payment of equitable compensation. While noting this point, it is said in *Lewin on Trusts* (2015, 19th ed.) at para 39-002 that the remedy is generally called equitable compensation.’²³

Richards LJ analysed the decisions of *Target Holdings v Redferns (A Firm)*²⁴ and *AIB Group (UK) plc v Mark Redler & Co*,²⁵ which he said were ‘of great importance because of the qualification that they introduced to the previously strict application of the obligation of a trustee to restore to the trust fund the value of any assets

¹⁴ [2019] EWHC 1257 (Comm)

¹⁵ At [21]

¹⁶ At [22]

¹⁷ [2019] EWCA Civ 2291

¹⁸ At [22]

¹⁹ At [31]

²⁰ At [31]-[32]

²¹ At [32]

²² At [33]

²³ At [35]

²⁴ [1996] AC 421

²⁵ [2015] AC 1503

‘Both *Target Holdings* and *AIB* involved funds being paid to solicitors to be held on a temporary basis for the purpose of giving effect to agreements for secured loans against property’

transferred, or the amount of any payments made, without authority’.²⁶

Both *Target Holdings* and *AIB* involved funds being paid to solicitors to be held on a temporary basis for the purpose of giving effect to agreements for secured loans against property. The solicitors’ instructions were to release the loan monies to the borrowers when the security was granted. In both cases, the solicitors released the funds without the security first granted.

In *Target Holdings*, the security was granted a month later. In *AIB*, a second charge was ultimately secured against the property, but due to the breaches of the solicitors, a prior charge was not discharged and the claimant received a lesser sum than the loan back when the property was sold.

In *Target Holdings*, Lord Browne-Wilkinson said:

‘The quantum is fixed at the date of judgment at which date, according to the circumstances then pertaining, the compensation is assessed at the figure then necessary to put the trust estate or the beneficiary back into the position it would have been in had there been no breach.’²⁷

The fact that *Target Holdings* obtained the security and the conveyancing transaction was completed was taken into account in concluding that no loss flowed from the breach of trust in the premature release of loan monies.

In *AIB*, Lords Toulson and Reed concluded that where the trustee has prescribed duties,

the trustee’s obligation to make good any unauthorised application of the trust funds is limited by the loss that the beneficiary would have suffered if the trustee had fully performed its duties. Lord Reed said:

‘the model of equitable compensation, where trust property has been misapplied, is to require the trustee to restore the trust fund to the position it would have been in if the trustee had performed his obligations’.²⁸

The loss to the claimant as a result of the breach was the value of the extra security the bank would have had over its loan by way of a first legal charge.

Richards LJ held that *Target Holdings* and *AIB* were distinguishable from the case before him:

‘They are restricted to circumstances where the beneficiary obtained the full benefit for which it bargained or where, if the trustee had fully performed its obligations, the loss would have been less than the amount of the unauthorised payment made by the trustee. In each case, the reduced figure is the loss that flowed directly from the breach of trust. In the case of Mr Patel, not only were the hypothetical dividends not paid but there was no obligation on the company or its directors to pay any such dividends.’²⁹

Richards LJ went on to say:

‘No case of which counsel or the court are aware has raised facts as stark as these. While the decisions in *Target Holdings* and *AIB* do not directly assist Mr Patel for the reasons I have given, they do demonstrate a willingness on the part of the courts to develop the equitable remedies for breach of trust and breach of fiduciary duty and, where required to do what is practically just, to entertain some departure from the strict obligation of trustees and fiduciaries to restore the fund under their control. This potential for flexibility has been emphasised in many cases and commentaries, not least *Target Holdings*, *AIB* and *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* at [47].’³⁰

²⁶ At [38]
²⁷ para.437

²⁸ At [134]
²⁹ At [49]
³⁰ At [60]

In response to the argument of the respondents that if Mr Patel could rely on his defence, it would enable a dishonest director who steals money from the company to escape without redress, Richards LJ said:

‘The possibility of a fraud exception has been criticised; see Lewin at 39-014. It does not seem to accord with principle that equitable compensation should be payable only because the defendant has acted dishonestly.³¹

‘I am far from saying that Mr Patel has a defence that will succeed if he establishes the facts on which he relies, but nor I am prepared to say that it is unsustainable in law. As with many questions in a developing area of the law, it is an issue which requires much fuller submissions than is normally appropriate on a summary judgment application. It is also an issue best decided on the facts as found at trial.³²

On the second issue of whether the quantum of the judgment should be net of the corporation tax that the company would have paid if the ‘sham’ payments had not been made and the profits of the company had increased, Richards LJ concluded that:

‘In my view, the treatment of tax on the basis of differential tax rates in the years of the Payments and in the year in which any compensation falls for payment raises an issue which is open to serious argument on both sides.³³

Lewison LJ held that:

‘... whether or not it ultimately succeeds, the argument advanced on Mr Patel’s behalf is a serious one. Although conciseness in judgments

is admirable, that argument deserved more focussed consideration than the judge gave it in the two brief paragraphs of his judgment which contain his reasoning.’³⁴

FUTURE QUESTIONS FOR THE COURT

Unless the case settles, Mr Patel’s defence is set for debate at trial. It raises important issues about the scope of the remedy of equitable compensation; in particular, what considerations the court should take into account when determining what would have happened but for the breach of fiduciary duty.

By raising these questions, the defendants-appellants persuaded the court that this is not territory to make a summary judgment. For example, should the court take into account hypothetical scenarios of what the trustee or fiduciary say they would have done with the money under its control, to argue that the claimant suffered no loss? What evidential considerations should the court take into account in order to assess the strength of a hypothetical counterfactual put forward by a defendant? Further, should it take account of a hypothetical scenario that the fiduciary is not obliged to perform? Mr Patel did not have a fiduciary duty to pay out GBP13 million in dividends to himself and his sister as shareholders.

It is clear that the merits are not on Mr Patel’s side, but it will be interesting to see how the arguments develop on the concept of equitable compensation and if the case makes inroads on the obligations of trustees and fiduciaries to restore funds under their control.

JENNIFER SEAMAN IS A BARRISTER AT OUTER TEMPLE CHAMBERS, LONDON

³¹ para.[63]

³² para.[64]

³³ para.[70]

³⁴ para.[73]