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# Crime and Punishment – an Examination of a Punitive Outcome

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*HPOR Servicos De Consultoria Ltda* v *Dryships Inc & Anor* [2018] EWHC 3451 (Comm) was handed down on 13 December 2018, too late for discussion in the last edition of The Arbiter. The case is an example of an appeal on a point of law from the decision of an arbitral tribunal – relatively rare, since so many arbitration agreements exclude such appeals (pursuant to section 69(1) of the Arbitration Act 1996). The arbitrators were two former high court judges and one deputy high court judge who were split 2-1 on the point of law in question. The judge then agreed with the majority in the result, but disagreed with their reasoning – ample indicators that the legal issue was not straightforward.

**Compensation, restitution and punishment**

Perhaps the most striking thing about the case is that it provides an example of a situation where:

- a party breached a purely private law duty (i.e. a duty owed to another person, not a duty owed to the state, as in a criminal law);
- the private law duty comes from common law / equity (i.e. this is judge-made law, not a legal duty imposed in a statute by parliament);
- the duty arose in the context of a commercial transaction; and yet,
- the remedy for that breach of duty is not to compensate the innocent party for a loss it suffers, nor even to reverse an enrichment obtained by the breach. Rather, the remedy is expressly imposed for the purpose of *punishing* the duty breaker.

Briefly, an agent did valuable work for a principal over a period of years, securing contracts for the principal which appear to have been worth more than $1.3 billion. The principal later discovered that, when the principal retained the agent, the agent had failed to disclose a conflict of interest. The majority of the tribunal, and the court, held that the agent had to repay all the fees which the principal had ever paid the agent. The arbitrators characterised this as an ‘account of profits’, the court as ‘forfeiture’.

Whatever label one applies, the effect was evidently not to compensate the principal for a loss it had suffered through the agent’s breach of duty. It is not really clear whether the agent’s breach of duty caused the principal any loss, and it seems possible, that the principal could even have been *better off* for having retained an agent which was subject to the conflict of interest in question (discussed further below).

Even if the principal did suffer loss as a result of the agent’s failure to disclose the conflict, there can have been no reason to think that its loss will have been exactly the same as the fee which the agent was ordered to repay. Hence the result which was achieved in the award / judgment cannot be characterised as compensatory.

The award / judgment also cannot be characterised as having reversed an enrichment the agent enjoyed by reason of its breach of duty since:

- The judgment does not say whether the arbitrators found, as a matter of fact, that the principal would never have hired the agent if the agent had disclosed the conflict. This leaves open the possibility that the principal would always have hired the agent, irrespective of the breach of duty. Thus it is not clear whether the fee could properly be described as an enrichment which the agent enjoyed by reason of its breach of duty.

- If this judgment / award had been aimed at reversing an enrichment which the agent had enjoyed because of its breach of duty, one would have expected the agent to have been entitled to set-off against that any reciprocal benefit it had conferred on the claimant (in *Halpern* v *Halpern* [2007] EWCA Civ 291 the Court of Appeal called this right of set-off "*counter restitution*"). Here the agent was ordered to repay its entire fee whilst being given no credit whatever for the value of services it had provided in exchange for that fee.

- The judgment itself states that the principal's claim to forfeiture of the agent's fees was "*not a restitutionary claim*" (paragraph 114 of the judgment).

The judgment is, in fact, clear that the forfeiture ordered in this case is not intended to represent compensation or restitution but is purely punishment. For example the test for whether to order forfeiture is said to be: "*whether this case falls on the side of the line where the most serious breaches are punished (and sometimes over-punished for sound policy reasons)*" (paragraph 114 of the judgment).

The agent's actions which gave rise to the conflict of interest did in fact amount to a crime in the country where they took place (Brazil). The agent was prosecuted and convicted in Brazil, fined $22.1 million and sentenced to 12 years in prison, though this was commuted to a period of community service because the agent had cooperated with prosecutors. The agent having been punished in Brazil under Brazilian law, English law nonetheless took it upon itself to punish the agent some more, as described below.

**Facts**

The case concerns a principal (OR) which owned two offshore drilling rigs. OR retained an agent (URCA) to negotiate contracts with Petrobras (P) for the hire by P of the two rigs. OR agreed to pay URCA a fee equal to 2% of whatever P paid OR under any contracts URCA obtained. URCA procured two "**Drilling Contracts**" for OR.

It is unclear who owned URCA, but it was undoubtedly controlled by Hamylton Padilha ("**Padilha**") and URCA had in any case agreed to pay any fees it was paid by OR to a company which Padilha did own.

Before the rigs came on-hire OR's relationship with URCA was restructured. The contract between OR and URCA was terminated by agreement. In place of that agreement OR entered into two new "**Agency Agreements**" with a newly created company called "**HPOR**" which was both owned and controlled by Padilha. HPOR would be paid 2% of whatever P paid OR under the Drilling Contracts, and it was agreed that HPOR's right to be paid this 2% fee would survive any termination of the Agency Agreements. Thus, in effect, URCA's right to a 2% fee for having procured the Drilling Contracts was transferred or novated to HPOR.

HPOR also agreed to represent OR in any future dealings with P regarding the Drilling Contracts. This would principally involve trying to secure extensions to the Drilling Contracts. HPOR would be paid for these services because the 2% fee would also apply with respect to any extension HPOR secured.

HPOR did procure extensions to the Drilling Contracts. OR stood to be paid more than $1.3 billion over a period of six years under the Drilling Contracts as extended. HPOR therefore stood to be paid more than $26 million in fees over the same period (the precise figures are not in the judgment, but can be deduced).

It later emerged that, some years before OR retained URCA/HPOR, Padilha had brokered a payment of substantial bribes to Petrobras employees in order to secure the award of a similar contract to a third party. Upon becoming aware of this, OR purported to terminate the Agency Agreements and ceased paying HPOR's 2% fee.

Because of OR's relationship with Padilha, Petrobras considered OR to be a compliance risk, and "*red-flagged*" OR. This appears to have meant that, for a period, Petrobras would not enter into any new contracts with OR.

The Drilling Contracts came to an end in March 2018 and were not renewed or extended, but it is unclear whether that was because of the "red flag" or for economic reasons, unrelated to anything Padilha had done. It appears from public sources (a 2019 press release from Transocean, which has acquired OR) that new drilling contracts have only just been secured for the two rigs in question, to commence in November 2019, so that the rigs will have been off-hire for around a year and ten months from the end of the Drilling Contracts.

HPOR brought a claim asserting that OR remained obligated to continue paying the 2% fee. OR not only denied liability to make any further payments, but also counterclaimed, seeking to be paid back around $16.5 million of commission which it had already been paid.

**Agents' fiduciary duties**

In *Bristol and West Building Society* v *Mothew* [1998] Ch 1 Lord Millett said:

> "*A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. A fiduciary … must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict …*"

Thus a fiduciary's core duties are not to make a secret profit and not have any undisclosed conflict of interest.

There is no definitive statement in English case law of the "*circumstances*" which will give rise to such relationships. In *Re Coomber* [1911] 1 Ch. 723 Fletcher-Moulton LJ observed that "[f]*iduciary relations are of many different types … from the relation of myself to an errand boy who is bound to bring me back my change up to the most intimate and confidential relations which can possibly exist between one party and another where the one is wholly in the hands of the other because of his infinite trust in him*". The relationship between agent and principal, though, is undoubtedly a fiduciary relationship, and an agent owes its principal fiduciary duties including to avoid undisclosed conflicts of interest.

**HPOR's breach of its fiduciary duty to avoid undisclosed conflicts of interest**

OR's case depended upon an assertion that, as OR's agent, HPOR had been under a fiduciary duty to avoid undisclosed conflicts of interest. The fact that HPOR's owner/controller had brokered the payment of bribes to Petrobras employees was said to amount to such an undisclosed conflict, and thus to a breach of that duty.

The tribunal accepted there was an undisclosed conflict of interest and so a breach of fiduciary duty on the part of HPOR. This is dealt with very briefly indeed in the judgment (paragraphs 34 and 35) but the nature of the conflicts which are identified by the court and tribunal is worth reflecting upon:

- It was in HPOR's interest to represent OR in negotiations with Petrobras because, insofar as HPOR succeeded in securing contracts or extensions to the contracts, HPOR would enjoy 2% of the additional remuneration which resulted. It was contrary to OR's interests to be represented by HPOR insofar as, if Petrobras ever discovered Padilha's past wrongdoing, OR would be at risk of being "*red-flagged*" by Petrobras and prevented from bidding for future Petrobras contracts, by reason of OR's association with HPOR/Padilha. This is obviously correct, although:
    - Being red flagged would not itself necessarily cause OR any loss. OR would only suffer loss if, during the period of being red flagged, Petrobras declined to award to OR a contract which Petrobras would otherwise have awarded. In the event, Petrobras evidently did not extend the Drilling Contracts, but that might have been for economic reasons, unconnected with the "*red flag*".
    - The judgment is silent on the question of whether OR would still have been awarded the Drilling Contracts if it had not retained Padilha. OR evidently thought that retaining HPOR/Padilha would improve OR's chance of being awarded the Drilling Contracts (why else would OR ever have retained HPOR, and agreed to pay $20m+ for its services if it were otherwise?). It might be that some other agent, who had no history of corruption and no undisclosed conflict of interest, or OR acting alone without an agent, would not have been able to secure the Drilling Contracts.
- The judge also described a second species of conflict of interest to have been present here: "*HPOR had … disabled itself from advising OR or negotiating on OR's behalf in a disinterested manner from the outset. Where the interests of Petrobras and OR were in conflict HPOR could be subjected to pressure and influence because of the corrupt relationships which Mr Padilha had had*" (paragraph 35). This supposed conflict is slightly less convincing:
    - The idea of a corrupt Petrobras executive threatening to expose Padilha in order to secure more favourable terms seems far-fetched. Any Petrobras executives probably had more to lose than Padilha did if their past wrongdoing was exposed, so if anyone was vulnerable to "*pressure and influence*" because of their past wrongdoing it was the Petrobras executives – so, if fear of exposure by the other party was even a factor, one would have expected it to work to OR's advantage. That Padilha had less to lose can be seen in the fact that, when the corruption was exposed, Padilha, by cooperating with the Brazilian authorities, received a short community sentence, and a fine (albeit a substantial one). The Petrobras executives have generally received prison sentences of around 12 years as well as having large quantities of assets confiscated.
    - Leaving aside the notion of Padilha threatening to expose one another's past misconduct, it seems possible that his past corrupt relationships might have worked to OR's advantage in a more subtle way. Padilha had, after all, obtained substantial payments in the past for the executives in question, so it is not unreasonable to think that they will have felt well disposed towards him and, by extension, his client OR. A resulting sense of reciprocal obligation, plus

> camaraderie between Padilha and the executives by reason of their being 'partners in crime' could have operated to Padilha's (and thus OR's) advantage.

The above is obviously speculation. Perhaps OR would have refused to retain HPOR if HPOR had disclosed Padilha's past conduct. Perhaps OR would still have obtained equivalent, or better, Drilling Contracts without HPOR/Padilha's help. And perhaps the red flag has indeed caused great harm to OR, causing HPOR to lose out on contracts it would otherwise have been awarded as a result.

The point is that the judgment is silent on all these questions, and so the court's decision does not seem to have been dependent upon any of these things having been shown to be the case. To put it another way, HPOR's undisclosed conflict would still have entitled OR to recover all the fees it paid HPOR even if it was the case that:

- OR would still have retained HPOR on the same terms even if HPOR had disclosed Padilha's past misconduct; or
- OR would have been worse off if it had not retained HPOR, because:
    - absent HPOR's help OR would not have obtained either the Drilling Contracts and would not have obtained some other equivalent contract; and
    - absent the red flag OR would still never have been awarded any contract by Petrobras in the period during which the red flag applied.

**Remedy for this breach of duty**

In the event, the tribunal ordered that HPOR repay the fees it had been paid under the Agency Agreements, characterising this as an "*account of profits*". The court upheld the award, though characterised this result as an instance of "*forfeiture*" rather than an "*account of profits*".

To put those remedies in context, and emphasise how anomalous those punitive remedies are, it is useful to look first at what other remedies might have been available to OR, and difficulties OR would have faced in pursuing them.

**Implied term and termination for its breach**

The duty to avoid undisclosed conflicts is an equitable duty imposed on HPOR by reason of the relationship between HPOR and OR having been one of trust and confidence. For the duty to arise, it is sufficient merely that HPOR act as OR's agent. There is no need to find HPOR to have promised "*HPOR is not subject to any conflict of interest*".

It does seem, however, that in addition to the equitable duty there was also in this case a concurrent contractual duty to the same effect. This judgment describes the arbitrators having found "*that … Padilha's conduct was a repudiatory breach on the part of HPOR, destroyed the relationship of trust and confidence, disabled HPOR from future performance and entitled OR to terminate the Agency Contracts*".

It is, of course, commonplace for parties to contracts to provide undertakings in various forms broadly to the effect that they, and their affiliates, have not been involved in corruption. So far as one can tell the Agency Contracts did not contain any such express term.

Evidently, therefore, the arbitrators were prepared to imply some condition or innominate term into the Agency Contracts, such that HPOR's failure to disclose its conflict of interest was not only a breach of its equitable duty, but also a breach of that term which amounted to a repudiation and so entitled OR to terminate the Agency Contracts.

It might be interesting to know a little more about the term which the arbitrators implied. For example, is it always a *condition* implied into any agency agreement that the agent is not subject to any undisclosed conflict of interest, so that every undisclosed conflict will always be grounds for terminating? Alternatively, is such implied term merely an *innominate term*, so that some more minor breach would not have given rise to any such right to terminate?

As discussed below, a breach by the agent of its equitable duty to avoid conflicts does not mean that the principal is then automatically entitled, as of right, to insist upon forfeiture of the agent's remuneration. Rather, the availability of that remedy depends upon the breach having been sufficiently egregious. One can foresee a situation where an agent commits some breach of the 'no undisclosed conflicts' duty which is not serious enough to justify forfeiture. Does such a breach, being also a breach of an implied contractual term, still give rise to a distinct right to terminate in those circumstances? The *HPOR* case does not provide the answer.

**Equitable compensation / compensatory damages for breach of contract**

One remedy for breach of the equitable 'no conflict' duty is to claim equitable damages. One remedy for breach of an implied term that there are no conflicts would likewise be damages for breach of contract.

Usually damages for breach of contract would fall to be calculated with a view to compensation – i.e. with a view to putting OR in the same position which it would have been in if there had been no conflict. The difficulties with claiming damages on that basis have been alluded to above. It is by no means clear whether OR proved in this case that it would really have been any better off if there had been no conflict of interest, and OR might even have been worse off.

The same position seems to apply with respect to equitable compensation – i.e. there is a need to identify what loss has been caused by the breach (e.g. *Murad & Anor* v *Al-Saraj & Anor* [2005] EWCA Civ 959 "*in addressing a claim for equitable compensation for breach of trust the court may have regard to what would have happened but for the breach*"). Presumably this is why OR did not claim equitable compensation or compensatory damages for breach of contract.

**Rescission for misrepresentation**

Where a party has entered into a contract based upon a misrepresentation by the other party, that party may be entitled to the remedy of "*rescission*" whereby each party is returned to the position they were in before they entered into the contract.

For example: D induces C to enter into a contract to buy a car by making a fraudulent misrepresentation (say as to the car's mileage or fuel consumption). C is entitled to rescind the contract and to be placed in the same position as if it had never entered into the contract – C is entitled to have restitution of the price C paid subject to C giving counter restitution of the car or its value.

Traditionally it was a bar to such rescission if it was not possible to achieve *restitutio in integrum* (i.e. if it was impossible to return the parties precisely to their pre-contract positions). In the modern case law the courts

generally allow rescission provided that *restitutio in integrum* can be achieved in a rough and ready way by ensuring that the party seeking rescission gives credit for any benefits they have received (the value of the car in the example above).

It appears that, at one point, OR did in fact seek to argue that it had been induced to enter into the Agency Agreements by a misrepresentation, and sought rescission of the Agency Agreements on that basis. OR did, however, abandon that claim in its closing submissions in the arbitration (see paragraph 58 of the judgment). Exactly why OR abandoned that claim is unclear, but some possibilities are:

- Difficulty in establishing that there had been any misrepresentation by HPOR. OR would have been arguing that HPOR made an implied representation to the effect that HPOR was not subject to any conflict of interest. Without wishing to get too far into the detail of misrepresentation, it is fair to say that there are relatively few instances in the case law of arguments based upon implied misrepresentations having succeeded, and there is authority to the effect that courts should not be too ready to find an implied misrepresentation (*Property Alliance Group Ltd* v *Royal Bank of Scotland* [2018] EWCA Civ 355).

- Difficulty in establishing the necessary reliance upon any such misrepresentation (i.e. that OR would not have entered into the Agency Agreements but for HPOR's implied misrepresentation that it was not subject to any conflict of interest).

- The need to give credit ("*counter restitution*") for benefits received, and which one would not have received if one had never entered into the Agency Agreements. The fact is that HPOR did help OR obtain the Drilling Contracts and the extensions to those contracts. It would at least have been arguable that the value of HPOR's work to OR, which OR did receive, simply exceeded HPOR's fees.

**Rescission for non-disclosure in breach of fiduciary duty?**

*Logicrose Ltd* v *Southend United Football Club Ltd* [1988] 1 WLR 1256 concerns an agent who *received* a bribe and thus made a secret profit. The judge in that case indicated that a remedy to which a principal is entitled when its fiduciary breaches the 'no secret profits' duty is rescission of the contract. It seems likely that rescission is also available for breach of the 'no undisclosed conflicts' duty. If that is right then a claim by OR seeking to rescind the Agency Agreements on this ground would have avoided the need to prove that there was an implied misrepresentation by HPOR, and that OR would not have entered into the Agency Contracts but for that misrepresentation. The same fundamental problem still remains, however – the need to give credit for benefits OR received.

**Restitutionary damages for breach of contract**

For completeness it should be mentioned that there are some exceptional cases where, rather than claiming compensatory damages for a breach of contract, a party will instead be entitled to restitutionary damages. The most famous example is *Attorney General* v *Blake* [2000] UKHL 45. Blake, an MI6 agent, worked as an agent for the Soviet Union which, as well as being a crime, was also a breach of his employment contract. After escaping to the Soviet Union Blake wrote a memoir. Their Lordships characterised the royalties Blake was to be paid for this memoir as gains which Blake had made through breaching his employment contract. Blake had given an undertaking never to divulge any information he gained as a result of his employment. The information in the book, though no longer confidential, was information gained as a result of his employment. Acting as a spy for the Soviet Union was also a breach of his contract and: "*but for his notoriety as an infamous spy his*

*autobiography would not have commanded royalties of the magnitude* [the publisher] *agreed to pay*". Blake was thus ordered to pay damages in the amount of his royalties.

There is little to be said for a claim by OR seeking such restitutionary damages for breach of an implied promise by HPOR that HPOR was not subject to any undisclosed conflict. Such a claim might avoid the need to prove an implied misrepresentation, but OR would instead have had to satisfy the arbitrators / court that this was an exceptional case, like *Blake*, where restitutionary damages should be available for breach of contract. OR would also have had to prove that the fees were benefits HPOR received as a result of the breach (i.e. that OR would not have entered into the Agency Agreements and so not have paid HPOR the fees if HPOR had disclosed the conflict), and there would still have been the issue of what credit OR should give for benefits OR received as a result of the performance rendered by HPOR.

**Account of profits for breach of fiduciary duty and the irrelevance of causation**

According to the judgment, the majority of the arbitrators "*came to the conclusion that OR was entitled to repayment of HPOR's fees as an account of profits for HPOR's breach of fiduciary duty*" (paragraph 50). The judgment discusses at some length why the court considered that OR was not properly entitled to an "*account of profits*" but, rather, to an order that HPOR "*forfeit*" the fees, to the same effect. Before looking at that critique, it is worth saying something about how an account of profits usually works, particularly with respect to causation.

An account of profits is a remedy for a breach of fiduciary duty whereby a court orders that a defendant pay over to ("*account to*") a claimant for gains which the defendant has gained from its wrongdoing.

This is relatively easy to apply where the breach is a breach of the 'no secret profits' duty - the fiduciary must simply pay over the secret profit. Where the breach is a breach of the 'no undisclosed conflicts' duty, the position will be less straightforward. In theory, there are two ways of analysing HPOR's profit consequent upon its breach of the 'no conflicts' duty:

- One way is to say that HPOR's breach consisted of *having acted as OR's agent* in circumstances where HPOR was subject to an undisclosed conflict. How much profit did HPOR make *by reason of having acted as HPOR's agent*? The answer is: the fee which HPOR was paid, less the costs HPOR incurred in order to deliver those services. From the description in the judgment, it appears as if the award gave no credit for HPOR's expenses. But, otherwise, one can see that the award seems to have followed essentially this reasoning, focusing on what HPOR was paid for acting as OR's agent.

- A different approach would be to say that HPOR's breach consisted in having *failed to disclose the conflict*. What profit did HPOR make by reason of having failed to disclose the conflict? The answer depends upon what would have happened if the conflict had been disclosed. If OR would still have retained HPOR, for the same fee, the answer would be that HPOR did not make any profit by reason of having failed to disclose the conflict of interest.

In *Murad & Anor* v *Al-Saraj & Anor* [2005] EWCA Civ 959 the Murads entered into a joint venture with a Mr. Al Saraj to buy a hotel from a Mr. Al Arbash which the joint venture later sold for a profit. It emerged that, at the time of the purchase, Al Saraj had been subject to an undisclosed conflict of interest (he stood to be paid a commission by Al Arbash for having procured a buyer). Al Saraj was ordered to account to the Murads for his profits from the sale of the hotel. Al Saraj argued that, even if he had disclosed the conflict, the Murads would still always have participated in a joint venture with him to buy the hotel, he would just have been entitled to some lesser proportion of the profit, and the Murads to some greater proportion, than provided for in the

agreement they made. It can be seen that Al Saraj's argument is akin to the second approach described above.

The Court of Appeal appears to have been unanimous that:

- When calculating Al Saraj's profit, he was entitled to credit for his expense – i.e. what he had paid in connection with the joint venture.

- The court also had a discretion to allow a fiduciary which is ordered to give an account of profits some credit for his skill and effort (paragraphs 88, 162).

A majority of the court, however, dismissed Al Saraj's argument that he should also be entitled to credit for that part of the profit which he would always have earned even if he had given the requisite disclosure. The majority held, in effect, that when calculating an account of profits causation is irrelevant and that it is irrelevant what the principal to whom the fiduciary duty is owed would have done if full disclosure had been made. The minority (Clarke MR) considered that the no conflicts rule should not be so inflexible, and that the fact the Murads would still have entered into the joint venture with Al Saraj was relevant to calculating Al Saraj's profit.

**The court's critique of the arbitrators' award of an account of profits**

In support of their position that HPOR was entitled to an account of profits on the basis described above, the tribunal had cited three cases: *FHR European Ventures LLP* v *Mankarious* [2014] UKSC 45, *Logicrose Ltd* v *Southend United Football Club Ltd* [1988] 1 WLR 1256 and *Aberdeen Rail Co* v *Blaikie Bros* (1854) 1 Macq 461.

In *FHR* an agent represented a principal in connection with the principal's purchase of (again) a hotel. The agent was, at the same time, party to an undisclosed contract with the vendor, whereby the agent stood to be paid a €10 million commission by the vendor upon the sale of the hotel. It was held that the agent held the fee on trust for its principal and was liable to account to its principal for the associated profits. The judgment in FHR describes the case as being concerned with bribes and secret commissions.

*Logicrose* similarly concerned a principal's claim in respect of a bribe paid to its agent by a third party. In *Aberdeen* the director of a rail company purported to enter into a contract binding the rail company to purchase a quantity of chairs from a supplier where he was also a director of that supplier. The contract was held to be unenforceable against the rail company.

None of the three cases was directly concerned with the question whether an agent which is in breach of the 'no conflicts duty' must account to its principal for any fee it has been paid by the principal. The judge was of the view that:

> "*the remedy of account of profits is directed to sums which should have come to the principal, if to anyone. They are therefore sensibly to be seen as profits from misuse of the principal's property. That analysis does not sit comfortably when one turns to consider payments for contractually agreed remuneration where the contract has been performed and so the agent is contractually entitled to the sum paid to it. It makes sense that there should be some other way of dealing with such issues*."

The suggestion that an account of profits is only concerned with 'sums which should have come to the principal, if to anyone' as distinct from 'payments of contractually agreed remuneration' seems at odds with the view of the majority in *Al Saraj* that causation is irrelevant, so that the test is not: (1) "*would the money have come to (or*

*remained with) the principal if the fiduciary had complied with its duty?*". It is instead (2) "*would the money have come to (or remained with) the fiduciary if they had not been in that fiduciary position?*". See paragraph 67 in *Al Saraj*:

> "*the fact that the fiduciary can show that* [its principal] *would not have made a loss is … an irrelevant consideration so far as an account of profits is concerned. Likewise … 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.*"

*Regal (Hastings) Ltd* v *Gulliver* [1967] 2 AC 46, per Lord Russel reinforces this point (<u>emphasis</u> added):

> "*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 … <u>whether the profit 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</u> … 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.*"

Against that background, the suggestion in HPOR that money which should have gone to the principal is caught by an account of profits, but money which the principal paid to the fiduciary appears unsatisfactory. From the principal's point of view, there is of course no distinction between money the principal does not receive and money the principal pays to the errant fiduciary. The principal is worse off, and by the same amount in both instances.

A further difficulty with HPOR is that, in the judgment, the reason for not ordering an account of profits is said to be because the fee was "*payment … for contractually agreed remuneration where the contract has been performed and so the agent is contractually entitled to the sum paid to it*". Yet, elsewhere, the judge wrote that with respect to "*the question of whether HPOR became entitled to remuneration … the Majority left this point open*" (paragraph 107).

Note also that, in the *Al Saraj* case, what seems to have happened was that: (i) the holding company sold the hotel; (ii) a contract between Al Saraj and the Murads said that, in those circumstances, Al Saraj was to be paid 50% of the profit; (iii) the Murads therefore caused the holding company to pay the relevant amount to Al Saraj. That payment to Al Saraj was no less a "*contractually agreed payment*" which Al Saraj had earned than was the fee which OR paid to HPOR. It does not seem sensible to distinguish *Al Saraj* on the ground that in *Al Saraj* the Murads caused the fee to be paid by the holding company whereas in HPOR OR paid the fee itself – in substance these scenarios are entirely equivalent.

Compare:

- OR is paid day rates by Petrobras under the Drilling Contracts. OR pays 2% of those day rates to HPOR as HPOR's fee.

- The parties have a different arrangement whereby Petrobras pays the day rates to HPOR. HPOR takes its 2% fee and pays the 98% balance to OR. This is not a far-fetched scenario. The bribes which Padilha paid in 2008 had been to secure a drilling contract for a rig called *Titanium Explorer*. The drilling contract was awarded to a management company which did not own Titanium Explorer. Rather, it was

to operate the rig, deduct its fee for doing so and pay the balance over to the rig's owner. See the SEC's orders of 19 November 2018 in *Re Vantage Drilling*.

Does the reasoning in HPOR lead to a different result in these scenarios? The answer is unclear. In the first scenario the 2% is a "*contractually agreed payment*" so presumably no account of profits is available. In the second scenario one could say this was a contractual entitlement which HPOR effected by set-off, but one could equally say that 2% was money which OR would have received if HPOR had not been acting as OR's agent.

**Forfeiture**

Having held that OR was not entitled to recover the 2% fee by way of an account of profits, because it was a contractual payment, the court went on to hold, that OR nonetheless had a right to forfeiture, with the exact same end result as the arbitrators had ordered in their award.

Does it therefore matter whether contractual payments are caught by an account of profits? The answer, of course, depends on whether, in every case where: (i) you seek to recover a contractual payment from a fiduciary; and (ii) you are entitled to an account of profits; you will also (iii) be entitled to forfeiture.

Recall that in *Al Saraj* the majority emphasised the strict nature of an account of profits, citing the passage from *Regal* which has already been set out above i.e.: "*the rule 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 … 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*".

This is slightly mitigated that, although a profiteer (or conflicted) fiduciary who acts in good faith to the benefit of the principal must still give up his own profits, he may nonetheless be entitled to some credit for his expense and for his skill and effort.

The test for forfeiture appears different. Per Atkin LJ in *Keppel* v. *Wheeler* [1927] 1 KB 557, 592 (CA):

> *"… if an agent in the course of his employment has been proved to be guilty of some breach of fiduciary duty, in practically every case he would forfeit any right to remuneration at all. That seems to me to be well established. On the other hand, there may well be breaches of duty which do not go to the whole contract, and which would not prevent the agent from recovering his remuneration; and as in this case it is found that the agents acted in good faith, and as the transaction was completed and the appellant has the benefit of it, he must pay the commission."*

Later cases, discussed in HPOR, refer to breaches which are "*honest breaches*" or breaches which are instances of "*harmless collaterality*". The judge in HPOR held:

> *"On my reading of the cases the line which the Court is seeking to draw in them is between serious breaches and relatively harmless ones – of which those described under the label of "harmless collaterality" are probably the archetype. The result will be fact dependent.*
>
> *The outcome turns on the nature and seriousness of the breach, not upon harm; the principal need not demonstrate he has suffered any loss"*

Note that in the first of these paragraphs the relevant distinction is said to be between serious breaches and "*relatively harmless*" ones, but that is then immediately followed by a contradictory statement to the effect that "*harm*" is not relevant.

**Conclusion**

*HPOR* concerns the situation where a principal retains an agent and the agent performs its contractual obligations such as to be entitled to payment of its contractual fee. It is later discovered that the agent was subject to an undisclosed conflict. Someone who has acted as an agent while subject to an undisclosed conflict is under a strict duty to account to their principal for any profit they have made by reason of having performed that role. The case holds that an agent's contractual remuneration paid by the principal does not, however, constitute such a profit and so the agent is not under a strict liability to repay that remuneration in every case. Rather the agent's contractual remuneration will be forfeit only if the agent's breach was sufficiently serious.