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PROPERTY IN BRIBES REVISITED IN A CROSS-DISCIPLINARY PERSPECTIVE

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Taking its point of departure from the decision of the United Kingdom Supreme Court in *FHR European Ventures*, this article seeks to bring cross-disciplinary perspectives to bear on the question whether an agent should hold the bribe he has received on constructive trust for his principal. Economising models are employed and the results interpreted by reference to the Calabresi and Melamed tripartite scheme of property rule, liability rule and inalienable right. The results are at least three-fold. First, an effective legal rule responding to the problem of harm caused by corruption must recognise and take account of differences between competitive and non-competitive environments and auditing or monitoring possibilities. Second, a property rule fails to do that. Third, ignoring such endogenous and exogenous variables, it overestimates or underestimates the harm suffered by victims of corruption.

I. INTRODUCTION

This article seeks to evaluate the persistent debate over property in bribes from the perspectives of theories of economic efficiency. In recent cases, the courts have held that the bribee is not only personally accountable to his principal for the value of the bribe; the bribee also holds the bribe and its traceable substitutes on constructive trust for the principal. Deterrence of immoral and opportunistic behaviour, it will be argued, is an over-simplistic justification for this result if efficiency is a key goal in the implicated activity. Studies on the economics of corruption are far from supporting a wide-scale deterrence-based instrumentalist policy for the sake of efficiency. Applying the Calabresi and Melamed tripartite efficiency model of property rule, liability rule and inalienable right, this article argues that where the conditions posited by the model for optimal market decision-making exist, deterrence has only an auxiliary role. It is simply not efficient to vest the property in bribes in the principal in all circumstances. Perhaps more importantly, where competitive conditions obtain, it is not efficient to vest the property in bribes in the principal *irrespective of fault on the principal's part*. If the need for principal-vigilance in detecting, avoiding or curbing bribee-proclivity for bribes is relevant, personal liability will be more efficient.

To achieve the above demonstrations, the article is structured as follows. The progression in the case law towards a universal property rule in bribes is outlined very briefly in Part II. The building blocks for the efficiency-based arguments in the article begin in Part III with a sketch of the nature of utility-maximising efficiency.

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The discussion continues with a description of the Calabresi and Melamed model and arguments for its applicability to the problem of corruption under market conditions. Part IV sets out the main arguments from an efficiency perspective for preferring a liability rule over a property rule.

Building on the general conclusions reached, this article finally argues in Part V that the corrupt trustee, and the corrupt agent, when receiving a bribe, stand on very different grounds. The settlor as the trustee's principal operates in a non-competitive context and is a benevolent principal who has little left to do when he has set up the trust and imposed on the trustee (his quasi-agent) accomplishment of a non-contractible output. The trustee thereafter acquires and is expected to acquire full information on cost and demand conditions without accountability to the settlor. Accountability to the beneficiaries also plays a diminished role since, as is well known, the trustee is authorised to exert free rein in trust administration. The concern accordingly is primarily with his autonomy to perform the trust and a property rule that the trustee holds a bribe on constructive trust is both efficient and appropriate. Brief concluding remarks follow in Part VI.

II. Recent Case Law

Judicial recognition of a property rule in bribes in the case law probably began in a Singapore case in the 1990s. In *Sumitomo Bank Ltd v Thahir Kartika Ratna*,[1] Lai Kew Chai J was persuaded by the logic that a dishonest agent could not be better off than an honest fiduciary. If an honest fiduciary was required to hold secret or unauthorised profits he made on constructive trust for the beneficiaries, much more the dishonest agent ought to hold the bribe he received on constructive trust.[2] When the case was heard on appeal, this reasoning ceased to be influential. In the interim, the Privy Council had decided in a case from New Zealand, namely *Reid*,[3] that the former Acting Director of Public Prosecutions held the bribes he had received whilst in office on constructive trust. The ground of liability was that equity looked upon that as done which ought to have been done.[4] The agent owed a duty to account as a fiduciary for the bribes to his principal; and by a proleptic operation of equity, he was to be treated as if he had so accounted and transferred the bribes to his principal. Citing the Privy Council decision, the Singapore Court of Appeal in *Pertamina* reached a similar conclusion.[5]

The immediate English reaction to the Privy Council decision was sceptical and unfavourable.[6] Among academics, opposite arguments against the imposition of a constructive trust prevailed strongly for a season. The most important objection of

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1 [1992] 3 SLR (R) 638 (HC) [*Sumitomo Bank*].

2 It has been conceptualised that *AG for Hong Kong v Reid* [1994] 1 AC 324 (PC) [*Reid*] and *Thahir Kartika Ratna v PT Pertambangan Minyak dan Gas Bumi Negara* [1994] 3 SLR (R) 312 (CA) [*Pertamina*] "related to a form of trust which does not exist until the bribes are received by a fiduciary in breach of his duties": *Public Prosecutor v Ng Teck Lee* [2011] 4 SLR 906 at para 56 (HC).

3 *Ibid.*

4 *Ibid* at 331, 332 (Lord Templeman). Lord Templeman purported to rely on Sir Peter Millett, "Bribes and Secret Commissions" (1993) 1 RLR 7 at 20.

5 *Supra* note 2 at para 56.

6 See *eg*, Darrel Crilley, "A Case of Proprietary Overkill" (1994) 2 RLR 57; WJ Swadling, "Property and Unjust Enrichment" in JW Harris, ed, *Property Problems: From Genes to Pension Funds* (London: Kluwer Law International, 1997) 130.

policy[7] was that the new direction charted by the Privy Council (and the Singapore courts) created an unfair insolvency advantage for the principal and conversely unfair prejudice to creditors of the bribee. The new path moreover ran contrary to doctrinal considerations of property law.[8] Under the influence of these criticisms, the English Court of Appeal in *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd (in administrative receivership)* 'strove' to keep to doctrinal considerations of property, attempting to draw the line more exactly between property and liability.[9] The result was a dichotomous rule which arguably stretched property distinctions to a vanishing fineness.[10] Apparently, the slender line could not bear the strain.[11] In *FHR European Ventures LLP v Cedar Capital Partners LLC*,[12] the United Kingdom Supreme Court considered that the efforts of the Court of Appeal could not withstand scrutiny and came round to the position established in *Reid*. Although the Supreme Court was faced with a fiduciary who had made unauthorised profits, the Court made a conscious decision to settle also the English law on bribes received by an agent. Intimating no distinction between receipt by an agent of unauthorised profits and a bribe, the unanimous judgment of the Court listed a multiplicity of reasons for holding that an agent should hold a bribe on trust: the inconsistency in the case law upholding the personal liability view, the difficulties in the case law distinguishing between misuse of the principal's property and beneficial ownership of the principal's opportunity for gain, the undesirability that an egregious breach of fiduciary duty should be subject only to a personal right, the fact that the interests of unsecured creditors of the agent have limited force, the fact that a proprietary right would support tracing into the value of secondary profits, the fact that a proprietary right would harmonise better with judicial development in the Commonwealth, as well as wider policy considerations relating to corruption and bribery. The surprising and almost oracular conclusion was that there being no plainly right answer, and in the absence of any other good reason against it, the simple answer was the property answer.

Judging from the mixed reception to the decision, the property debate is not over. When the Privy Council in *Reid* decided for property rights in bribes, detractors were quick to criticise the unfair insolvency advantage the decision seemed to create. Over time, it is fair to say, insolvency advantage arguments have receded in importance.[13]

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7 According to those who cast their weight in favour of the orthodoxy of *Lister & Co v Stubbs* (1890) 45 Ch D 1 (CA) [*Lister*].

8 See JE Penner, "The Difficult Doctrinal Basis for the Fiduciary's Proprietary Liability to Account for Bribes" (2012) 18:10 Trusts & Trustees 1000 who argued that the decision rested on mutually inconsistent doctrinal bases that the bribee as a wrongdoer must be stripped of his gains or that as a fiduciary he is under a pre-existing liability to account for his unauthorised gains.

9 [2012] Ch 453 (CA).

10 For there to be property in a bribe, the effect of the decision was that either the bribe had to be acquired through misuse of the principal's property (as in *Daraydan Holdings Ltd v Solland International Ltd* [2005] Ch 119 (ChD)) or by taking advantage of a right or opportunity which was properly that of the beneficiary.

11 Sir Terence Etherton, "The Legitimacy of Proprietary Relief" (2014) 2:1 Birkbeck L Rev 59 at 84 was strongly critical of the elusive line based on 'beneficial ownership' of an opportunity. William Swadling, "Constructive Trusts and Breach of Fiduciary Duty" (2012) 18:10 Trusts & Trustees 985 at 993 called it the Achilles' heel of the Court of Appeal decision, though he welcomed and applauded the decision.

12 [2014] 3 WLR 535 (SC) [*FHR European Ventures*].

13 There are muted or moderated criticisms that the Supreme Court failed to acknowledge that there are some circumstances where interests of unsecured and secured creditors are important. See Elizabeth Houghton, "Equity's New Darling and the Pitfalls of Remedial Absolutism" (2016) 22:9 Trusts & Trustees 956.

The more serious and on-going criticisms now direct attention to the failure of the Supreme Court to offer a clear justification for the simple (proprietary) solution. Supporters of the decision, on the other hand, seem to have been inspired by the renewed focus on the duty of loyalty as the conceptual underpinning or lynchpin of the property in bribes rule. In their view, the obliteration of any distinction between illegal profits and unauthorised profits is underscored by the principle that both forms of profit damage the duty of loyalty and that both invite and demand nothing less than a property solution.

In the present view, it is not entirely clear that the Supreme Court was predicating its decision in *FHR European Ventures* upon the duty of loyalty owed by a fiduciary. In several places, the judgment refers to the receipt by an agent of unauthorised financial benefits, albeit there are many more references to the fiduciary. But an agent is not always a fiduciary in all that he has undertaken to do; such an agent may occasionally, perhaps exceptionally, owe merely a contractual duty of loyalty. If the references to an agent who may not be a fiduciary are not merely unintended slips, the Court's reasoning could imply that the proprietary right in bribes is rather based on the duty to account for the bribes whether arising from a fiduciary relationship or contractual relationship of loyalty. Again, there is some ambivalence in the Court's recognition that a non-fiduciary parallel exists:

> The principal is entitled to the benefit of the agent's unauthorised acts in the course of his agency, in just the same way as, at law, an employer is vicariously liable to bear the burden of an employee's unauthorised breaches of duty in the course of his employment.[14]

Would this parallel suggest that there is no distinction between receipt of a bribe in breach of a fiduciary duty and receipt in breach of the contractual duty of loyalty? Another observation not mentioned in the judgment adds to the uncertainty. A bribe is considered objectively in terms of whether the briber believes or has reasonable grounds to believe that the bribee is able to favour him in relation to a principal. It is not required that the bribee should actually be in the position of a fiduciary and able to show favour. This too may make it less significant whether the bribe-taking agent owes a duty of loyalty as a fiduciary.

To complete this brief survey of the case law, it should be added that a different deterrence-based policy rationalisation appealed to the Singapore High Court in a recent case. It was there suggested that property in a bribe went to the principal of the agent as a matter of policy, because "[corruption is] such a scourge".[15] In the United States, on the other hand, a more familiar sentiment would be disgorgement and restitution rather than deterrence. A constructive trust to strip the criminal of the

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[14] *FHR European Ventures*, *supra* note 12 at para 33.

[15] *Beluga Chartering GmbH (in liquidation) v Beluga Projects (Singapore) Pte Ltd (in liquidation)* [2013] 2 SLR 1035 at para 166 (HC) (Vinodh Coomaraswamy JC):

> One jurisdiction may consider bribery such a scourge that it recognises a proprietary claim to the bribe or its traceable proceeds vested in the principal, one result of which is to accord the principal of an insolvent bribe-taker *de facto* priority over the bribe-taker's preferential and unsecured creditors: see *Sumitomo Bank*[, *supra* note 1]. Another may consider it undesirable as a matter of policy to do so: *Lister*[, *supra* note 7]; *FHR European Ventures LLP v Mankarious* [2013] EWCA Civ 17. All of these choices rest on policy, not principle.

profits of his crime is recognised.[16] To follow through this reasoning, an agent need not be shown to be a fiduciary before he can be held to be a constructive trustee of the bribe he received. The constructive trust arises not on account of any duty he has undertaken toward the principal but by virtue of reversing the unjust enrichment.[17]

This article takes its point of departure from the dichotomous institutional premises, namely, that either there is or there is not property in a bribe, which has remained a firm and constant assumption in the English and Singapore case law and academic literature.[18] There are essentially two central tenets underlying the English and Singapore case law's simple proprietary solution to the problem of bribes: (1) the necessity and sufficiency of the duty to account for the bribe; and (2) the rejection of any middle ground dependent on the exercise of judicial discretion to impose a constructive trust. The question which will be explored in a cross-disciplinary perspective is whether these tenets are faithful to economic reasoning. If they are not, the so-called wider policy considerations which support the simple proprietary solution ought to be re-examined and the solution qualified according to those results.

III. Efficiency and the Calabresi and Melamed Model

Two preliminary considerations are helpful in charting the investigations in this article. Among the different kinds of perspectives that can be brought to bear on the capitulation to a property rule in the treatment of bribes, that of economic efficiency must be helpful where corruption has a market context. The subject of market-based corruption in the law, it will be argued, lends itself to neo-classical economic treatment; and that furnishes sufficient reason to make this the first line of inquiry. The terms of this inquiry are already familiar and uncontroversial if one accepts the neo-classical premises of utility maximisation as an idealised way of understanding market decision-making. Economic efficiency comprises productive efficiency which describes the state where goods and services are produced at the least cost possible. Productive efficiency combines technical efficiency, that is producing any given level of output utilising the fewest resources, and input allocative efficiency. This implies that the marginal rate of technical substitution between inputs matches the input price ratio. There is a second measure of efficiency, namely that for any given cost, the bundle of goods and services produced maximises the aggregate welfare of consumers, commonly called output allocative efficiency. Output allocative efficiency is achieved when total marginal rates of substitution for all consumers equal the marginal rates of transformation in the production of goods. Last but not least, Pareto efficiency describes the state where the outputs are distributable among

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[16] To be sure, some cases rely on the policy that a person should not benefit from his crime while others are content simply to prevent unjust enrichment of a criminal. See Austin Wakeman Scott & William Franklin Fratcher, eds, *The Law of Trusts*, 4th ed (Boston: Little, Brown and Company, 1989) vol 5 at 436.

[17] See *Re Pechar (Deceased)* [1969] NZLR 574 (SC).

[18] This contrasts sharply with Australian case law, where the remedial constructive trust may be imposed on a bribe if considered appropriate in the court's discretion: see *Grimaldi v Chameleon Mining NL (No 2)* (2012) 200 FCR 296. See also The Honourable Paul Finn, "Common Law Divergences" (2013) 37 Melbourne UL Rev 509.

differentiated groups. When Pareto efficiency is reached, there is no way to reallocate outputs to make one person better off without hurting someone else. All possible efficiency gains will have been exploited in this happy state.

The second preliminary observation is that in order to identify and diagnose corruption's effect on efficiency, and determine whether a property or liability rule is a more appropriate response to injury caused by corruption, the Calabresi and Melamed model is a viable tool.[19] This model distinguishes the incidence of initial entitlement from the protection of entitlement. Initial-entitlement incidence depends on efficiency considerations, distributive and corrective justice considerations (such as wealth distribution and rewards for effort preferences) and 'other justice considerations'. No single consideration is entirely determinative and complexity may be inevitable. Fortunately, this does not impede the important predictive assertion that in practice initial entitlements which lead to optimal market decision-making are more likely to emerge than those which do not.

Besides the importance of optimal market decision-making, another key insight delivered by the Calabresi and Melamed model is the influence of the value of the activity in question. The more valuable the activity, the greater the need to foster optimal decision-making. Thus when considering entitlements in relation to accidental activities, the model argues:

> (1) [T]hat economic efficiency standing alone would dictate that set of entitlements which favors knowledgeable choices between social benefits and the social costs of obtaining them, and between social costs and the social costs of avoiding them; (2) that this implies, in the absence of certainty as to whether a benefit is worth its costs to society, that the cost should be put on the party or activity best located to make such a cost-benefit analysis; (3) that in particular contexts like accidents or pollution this suggests putting costs on the party or activity which can most cheaply avoid them; (4) that in the absence of certainty as to who that party or activity is, the costs should be put on the party or activity which can with the lowest transaction costs act in the market to correct an error in entitlements by inducing the party who can avoid social costs most cheaply to do so; and (5) that [however] in an area where by hypothesis markets do not work perfectly—there are transaction costs—a decision will often have to be made on whether market transactions or collective fiat is most likely to bring us closer to the Pareto optimal result the 'perfect' market would reach.[20]

The third important insight is that protecting the initial entitlement is not a redundant matter. It is one thing to specify the initial entitlement but another to specify how to avoid its infringement. An economic society cannot, indeed must not, protect an entitlement by a property rule in all cases. That kind of protection entails that a person's entitlement cannot be taken away except upon his free and subjective consent. He cannot be compelled to surrender his entitlement even though the objective value of his entitlement is less than his own subjective estimation. Conversely, if he can be compelled to yield to the objective value, his entitlement is not protected by a

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[19] Guido Calabresi & A Douglas Melamed, "Property Rules, Liability Rules, and Inalienability: One View of the Cathedral" (1972) 85:6 Harv L Rev 1089.

[20] *Ibid* at 1096, 1097 [footnotes omitted].

property rule but a liability rule. The model posits that there are significant reasons that the protection of an entitlement must be variable. Protection of initial entitlement is not unipolar. It also depends on considerations of efficiency, of distributional preference and other justice considerations. For example, protection of an activity where optimal decision-making is important by a property rule will be inefficient whenever it is too costly to talk things through. In cases of accidental liability, for example, pre-accident negotiations would be prohibitively expensive even though a transfer of the entitlement would benefit both. Post-accident negotiations on the other hand would be fraught with holding out by potential victims and free rider problems in relation to potential actors and victims. In contrast, a liability rule that imposes a collective valuation of the injury will be more efficient. It will avoid the prohibitive costs of negotiations as well as holding out and free rider problems, thus facilitating the beneficial transfer between the actor and the victim of the actor's negligence.[21] An important corollary is that considerations of efficiency will often predominate in the choice of protecting an entitlement. The reason is that locating the distributional preference for options of protection will often be difficult and expensive. It will be more economical to let considerations of efficiency predominate in the selection of options, accommodating distributional preferences as modulations of selected protection option.

To apply the Calabresi and Melamed model to our study, it is necessary to describe the conditions under which corruption exists both where the pertinent markets work and do not work and where they do not work, to specify the imperfections which impair their workings and heighten the danger of corruption. Minimally, such danger exists only where imperfections in the market or cultural conventions, including social or religious beliefs or conditions of competitiveness, create the potential for inducing an agent who knows that corruption is wrong to act contrary to his conscience. This article postulates that irrespective of where the initial entitlement to the bribe should lie,[22] the Calabresi and Melamed model as applied to the protection of initial entitlement in relation to accidental harm is adaptable to harm caused by corruption in market contexts.[23]

First, accidental liability although arising from a non-market tort typically implicates a valuable activity where optimal decision-making should be fostered. This is doubly true of liability for market-based corruption. Not only is valuable market-based trade and commerce implicated, legal representation by agents is undoubtedly also a valuable activity in cost-benefit terms. In both respects, optimal market decision-making is to be fostered. Against that, corruption is aberrational, being contrary to social morals as much as accidents are unintended loss-making acts. Efficiency and not moral denunciation is pivotal where the implicated activity is valuable although subject to aberrational occurrences. Deterrence as moral denunciation or some other distributive or justice consideration is pivotal only to the extent

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21 *Ibid* at 1107.

22 It is noted that initial entitlement in property often depends critically on acquisitional or creative effort and appropriatory intention.

23 There is of course a difference between potentially beneficial market activities which are carelessly undertaken, that is accidental harm, and market activities such as bribe-giving and taking which are deliberately undertaken for self-gain or benefit in breach of duty. An extreme view is that optimal market decision-making is irrelevant since corruption is a deliberate infliction of immoral harm; and a criminal or quasi-criminal deterrence model is apposite.

that it will increase efficiency by lowering the potential for corruption.[24] Second, even supposing that the harm caused by corruption should be regarded as moral harm more than economic loss, it is the perspective of protection against the harm that should count. Where moral harm has the same or a similar extent or reach as accidental harm, it ceases to be materially different from economic harm. The same or similar economic considerations of reducing harm become pertinent. Importantly, there is no material difference in the incidence of harm between accidental harm arising in the conduct of beneficial activity and corruption arising in the conduct of agency in trade and commerce. The potential for carelessness references an actor who launches a potentially harmful but generally beneficial activity but so also is the potential for corruption peculiarly related to a corrupt agent and briber. The careless actor is not necessarily less motivated than the corrupt actor for gain. The desire for gain and the prospects for gain do not necessarily differ between them. Differences in scale and dimension exist of course. The scale of accidents varies according to numerous exogenous variables, paramount among which is the state of technological advances in safety control or harm prevention. The scale of corruption is variable in a different manner. Competitiveness and cultural attitudes are more important variables than the state of technology. But nothing much turns on these differences of degree. The only impact they have is to enlarge or reduce the quantum of loss that the victim of corruption will suffer. On the other side, there are impressive similarities. Where potentially beneficial activities incur a risk of accidental loss, the protection against the accidental loss by objective compensation strikes a better balance between innovation and the risk of harm. This is equally true of beneficial agency activities which incur a risk of deliberate harm. Where the good or service is heterogeneous, it would be prohibitively expensive for a producer to attempt to negotiate with all other producers a transfer or re-allocation of entitlements beneficial to all, thus eliminating the potential for corruption. The costs are still not insignificant where the good or service is homogeneous. Ante-harmful event negotiations are equally expensive. Post-corruption negotiations would similarly be fraught with holding out and free rider problems.

In short, the Calabresi and Melamed economising model is or should be applicable to deliberate harm caused by corruption where optimal market decision-making is imperative and moral distributive considerations are recessive.

IV. Corruption and Economic Efficiency

After setting the stage for investigation, the first argument of this article is that corruption affects the efficiency of the activity to which it relates in a non-uniform manner. Popular belief posits that corruption is detrimental to economic efficiency in all three manifestations. It impairs productive efficiency, output allocative efficiency, and distributional efficiency. That corruption impairs efficiency appears to

[24] A more extreme position is argued in Yock Lin Tan, "Deterrence in Private Law" in Andrew Robertson & Tang Hang Wu, eds, *The Goals of Private Law* (Oxford: Hart Publishing, 2009) 311 that deterrence in private law is a tax (relevant only in relation to systemic harm) and is neither distributive nor corrective in essence or motivation. The position implicit in the Calabresi and Melamed model is merely that deterrence may play an auxiliary role as tipping consideration in affecting the conduct of potential bribees.

be uncontroversial. This may explain why there are many more theoretical studies which examine the different but related question of the relationship between competition, as a corrective or suppressive prescription against corruption, and the incidence of corruption. Some of these aim to show that competition and corruption are inversely related and recommend greater competitiveness as a way to combat corruption.[25] Other studies indicate that the effect of competitiveness on corruption is more equivocal. Where corruption is based on informational advantage, the effect of competition depends on the substitutability between competing goods or services and low-powered incentives in diminishing the advantage or the rent which may be extracted from the informational advantage.[26] Probably the most counter-intuitive results are that greater competition in a procurement context may lower or raise corruption levels depending on the heterogeneity of good or service being transacted and intensity of competition among agents.[27]

For the purposes of this article, the existence of a non-linear relationship between competition and corruption does not detract from the central argument. This is because all studies agree that competition and corruption are interdependent although the relationship is not necessarily an inversely linear relationship because of the influence of multiple causalities, such as the non-heterogeneity of goods or services and hence complementarities instead of substitutabilities between facilely competing goods or services, institutional settings, social or religious beliefs or dispositions, and other cultural sub-dimensions. The simplest argument building on the mixed conclusions of these studies is that if competition affects corruption but does not unequivocally lower corruption, there can be no warrant to impose a property rule on the fruits of corruption as a simple answer and as *ex post* deterrent. A property rule as *ex post* deterrence-sanction superficially reduces the gain and therefore the incentive to want a bribe. There are serious doubts about this[28] but assuming the equation to be true, there would still only be warrant to impose a property rule where greater competition has the effect of raising corruption.

Eschewing the simplest argument, this article considers the more basal question of the nature of the effect, at a given level of competition, of corruption on efficiency. The proposition under examination of vesting property in a bribe for the sake of greater efficiency is immediately falsified if it can be shown that bribery does not impair economic efficiency uniformly, in the same proportion, and on the same scale under all circumstances. Important to the argument is the thesis of Burguet and Che that corruption may be another form of competition, where contracts are to be awarded in competitive biddings based on quality and price.[29] Suppose a procurement context where there are efficient and inefficient sellers. Suppose further that at the given level of competition, the agent for the buyer has some but not

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25 See Susan Rose-Ackerman, "The Economics of Corruption" (1975) 4:2 J Public Economics 187.

26 See Jean-Jacques Laffont & Tchétché N'Guessan, "Competition and Corruption in an Agency Relationship" (1999) 60:2 J Development Economics 271.

27 See Marco Celentani & Juan-José Ganuza, "Corruption and Competition in Procurement" (2002) 46:7 European Economic Rev 1273.

28 They arise from studies on criminal liability for corruption. Rose-Ackerman, *supra* note 25, for example, demonstrated that higher punishment does not mean lower corruption. See also Richard A Posner, *Economic Analysis of Law*, 3d ed (Boston: Little, Brown and Company, 1986).

29 Roberto Burguet & Yeon-Koo Che, "Competitive Procurement with Corruption" (2004) 35:1 RAND J Economics 50.

substantial discretion to manipulate the quality but not the price. Then the efficient seller can win the procurement tender despite the existence of corruption. This is because the efficient firm can lower its product price by lowering its quality premium. The outcome is very different if the agent has substantial manipulative power over the price. Whether he has this power because of the level of competition in the market or heterogeneity of the good or service or because he has been conferred it by the inefficient seller does not matter. Such agent does affect allocative efficiency by his corrupt manipulations. Burguet and Che explained more exactly that substantial manipulative power can soften price competition and pointed out that this may not coincide with the quantum of the bribe.

A. *Output Allocative Efficiency*

From the perspective of output allocative efficiency, these findings have significant implications for applying a property rule to bribes under the Calabresi and Melamed model. Where the buyer's agent has little manipulative power to affect the price, the corrupt agent will ask for and accept a bribe from the inefficient seller that can be extracted from the efficient firm's superior quality of product. The efficient firm however can lower its price to eliminate the quality differential and nullify the agent's corruption. A property rule is not needed and would be inefficient in reinforcing the inefficiency of the inefficient seller. A property rule in favour of the efficient firm would merely reward the efficient firm for inaction in eliminating corruption when it is well able to do so. It would be inefficient in encouraging the efficient firm to be inefficient. A property rule for the buyer as the bribee's principal would transfer the efficient seller's quality premium to him, rewarding the buyer who has paid the price for the lower quality with a windfall, and also be inefficient. A property rule would still not be efficient even if the incidence of corruption requires prediction or needs effort to uncover. Superficially the restitutionary effect of a property rule might serve in these circumstances to disincentivise the agent more strongly from corruption. The fact remains that the ability to eliminate it exists. An efficient firm will *ex hypothesi* lower its price by factoring in the likelihood of corruption. So again, a property rule would merely encourage the efficient firm to be inefficient. A property rule that requires the efficient seller and the buyer to share the quality premium would of course not be sensible.

Corruption under these predicates will no doubt prejudice the buyer if the efficient firm in fact makes a misprediction or delays taking action and the buyer gets a lower quality product at a higher price. A property rule in favour of the buyer might in these more exceptional circumstances seem to be efficient in transferring the price differential from the corrupt agent to the buyer for the sake of spurring the efficient firm to avoid misprediction or take more timely action. There is however only an appearance of efficiency. To adopt a property rule in such exceptional circumstances would incur prohibitive costs of investigation. It would not incentivise the efficient firm to act in exceptional cases beyond what it can already do and has done. It would on the other hand encourage the agent to risk extracting a premium from the bribe in the hope of escaping detection by the buyer and seller. A liability rule by contrast is more effective since it denies the efficient firm an uncompromising remedy, forcing it to eliminate corruption when elimination is well within its reach and power. On

the other hand, it provides a remedy to the buyer to reverse his prejudice without eliminating buyer-vigilance. At least until detection, the agent is the owner of the bribe. It is his to use and any exceptional value or consumer surplus derived from this will accrue to him. This incentivises the seller and buyer alike to act promptly to obtain their remedies under a liability rule.

Where the buyer's agent has substantial manipulative power over the price, a property rule, perhaps paradoxically, proves to be even more inefficient. A key postulate of the Burguet and Che analysis is that there is no necessary relationship or correlation between the quantum of the bribe and the price differential; particularly the quantum of the bribe is no longer limited by the quality premium. The corrupt agent for the buyer can inflate the price beyond the level of the inefficient seller's low quality to above the efficient firm's quality premium. The efficient and vigilant firm cannot nullify or eliminate the corruption by lowering its price to eliminate its quality premium since the agent has substantial manipulative power over the price. Superficially, it seems that a property rule in favour of the efficient firm would now protect the efficient firm against the loss of a sale and its profits therefrom. If, however, the bribe is no longer limited by the efficient firm's quality premium, a property rule in favour of the efficient seller giving the efficient firm more than its putative profits after deducting its quality premium will have a reward element. A property rule in favour of the buyer on the other hand would arbitrarily award and transfer the loss suffered by the efficient firm to the buyer.

In any event, if a property rule is adopted, it would have to be a rule of co-ownership of the bribe. Two further problems will arise if there is to be co-ownership. First, as the bribe is no longer a measure of the quality premium, there will be formidable difficulties in valuing or measuring the efficient seller's hypothetical loss and hence his share of co-ownership. These cannot be avoided by party consent. Pre-bribe negotiations between the efficient firm and the buyer would be prohibitively expensive. Post-bribe negotiations would be fraught with and impeded by holding out problems. Second, from the inefficient seller's perspective, he makes a gain by obtaining a sale at the expense of the efficient firm. The efficient firm's loss is in truth a systemic loss because there is no market mechanism of transfer of the gain from the inefficient firm to the efficient firm. The efficient firm cannot price out the bribe and the contract goes to the inefficient firm, the seller, at the former's expense. Under such circumstances, the systemic loss is best protected by criminalising the act of corruption. The problem then is that a property rule in favour of the buyer leads to a cumulation of reward and redress. It is unable to shift the systemic loss from the inefficient seller to the efficient seller or neutralise it, since some of that loss is included in recovery under a property rule. At the same time, the buyer who obtains the systemic loss does not have to bear the costs of prosecution but can simply take the criminal results as a platform for claiming the benefit of the property rule. This cumulates to the criminalised effects, producing further inefficiency.

B. *Productive Efficiency*

So far as productive efficiency is concerned, the Calabresi and Melamed model directs attention to the impact of transaction costs and avoidance costs. An important variable is the effect of monitoring and accounting costs in curbing corruption. These

costs clearly vary significantly. The higher the investment in monitoring activities on the part of the principal, the less likely corruption of his agent will occur or remain undetected. At one end of possible agency relationships where the agent is appointed for his expertise, the only monitoring that is feasible is a one-time appointment monitoring for the purposes of selecting an honest agent for the task at hand. Thereafter, typically because of the information-intensive nature of the task entrusted to the agent or its specificity, the principal is seldom in a position to monitor on an on-going basis the exercise of discretions by his agent.

Under these circumstances, a property rule is inefficient because it relieves the buyer of his duty to tailor agent-discretions to his precise needs even at the outset. A property rule can thus have the effect of providing a windfall or an insurance to a buyer who declines to incur costs of selection of an honest agent since any losses may be recouped by recovering the bribe or its substitute. Burguet and Che showed that scoring rules can be devised to monitor on-going agent activities. The seller or buyer by relying on such rules can to an extent neutralise incidences of corruption. A property rule is indifferent to this. It especially ignores that deeper on-going monitoring as a scoring rule certainly makes economic sense where the agent is a part of the principal's hierarchy of autonomous or semi-autonomous decision-makers.[30]

There is a further complication which suggests that a property rule can yield distortionary effects on productive efficiency. A property rule ought not to be adopted if it would lead to substitution of less quantifiable non-pecuniary rent for pecuniary rent. Bribees faced with a property rule have an incentive to ask for non-pecuniary bribes such as the promotion of friends or family members to positions which they are unqualified or ill-qualified to hold. Such loss of efficiency is not likely to be immediate. To be sure, when it occurs, the unsuitable appointments can be terminated but the principal will have incurred further consequential loss through inefficient and unsatisfactory performance by the procured appointees. The firm can sue to recover provable loss but this will come at greater cost since such recovery will often require

[30] This article has not considered whether under conditions where the property rule is less efficient than compensation for loss, the alternative personal liability to account for a bribe will also be less efficient and so in the same manner. In cases where the bribe paid is in substance extracted from the principal as a premium on the price which he pays, there may be little difference in the valuation of the claimant's loss in terms of compensation for loss and the liability to account. (Under market conditions, we can assume that proof that a bribe has been given and that the amount of it equals the premium on the price paid will not be unusually difficult or onerous. See also *Fairstar Heavy Transport NV v Adkins* [2013] EWCA Civ 886.) In that sense, both remedies may be more or less as efficient, and the more efficient remedy will depend on the claimant's election in the circumstances. In cases where market conditions obtain and the bribe is not a sum of money, but non-monetary property, there may also be more similarities between the liability to account and compensation for loss than between the property rule and the liability to account. Compensation for loss and the liability to account will be more or less similar in their dependence on the objective market valuation of the non-monetary property. The property rule in contrast will give the consumer surplus in the property to the principal. It should not be overlooked that the liability to account is different from the property rule not only by reason that it is a personal liability. While the rules of causation are equally inapplicable under the property rule and accounting rules (instead the courts look for a nexus in terms of scope of duty or transactional intention), there is greater judicial flexibility to award an allowance for skill and unusual effort under accounting rules. This flexibility of course will hardly be available to the dishonest bribee from whom an account is demanded. But it may make an important difference from proprietary relief where the bribe is given to a third party at the behest of the person inducing it and an account of profits is sought from the recipient third party. *Cf Novoship (UK) Ltd v Mikhaylyuk* [2014] EWCA Civ 908.

tracing backward to the bribe. Both considerations come at a price, suggesting that the substitution of non-pecuniary for pecuniary bribes which is driven purely by the avoidance of the property rule will be distortionary in a greater or lesser degree.

V. Bribes in Non-Competitive Trusting Contexts

In this final Part, it will be shown that the foregoing conclusions have an important orientation for a trust relationship. They imply that there is an important difference between the corrupt trustee and the corrupt commercial agent. The absence of competition in the case of the corrupt trustee needs to be factored in while the duty of the trustee to manage the non-contractible business of the trust as an ordinary man of business managing his own affairs[31] suggests that there must be some concern with a notion of efficiency. The purpose of the arguments in this Part is to show that the property rule finds a proper place under the kind of non-competitive conditions in which the trustee must discharge his duties. The corollary is that its extension to all other fiduciaries irrespective of context is mistaken.

The case of the trustee is an excellent example of a non-competitive context which produces two kinds of economic rent. The first type of rent arises out of legal as well as non-legal restrictions on who can be a trustee. There is additionally information rent derived from the provision of information to the trustee not available to the beneficiary. One may call the trustee a monopolist agent with a fairly non-contractible output, which is determined by a trust instrument that cannot easily be varied or modified. Studies relating particularly to the corruption of the trustee as a monopolist agent are obscure but there is no shortage of studies on government corruption. Those studies which adopt a transaction cost analysis, broadly new institutional economics, are a useful source in which to locate and develop the arguments in this Part. To be more specific, economic principal-agent models which focus on economising exchanges[32] will be the methods to be used rather than social exchange models which posit inter-organisational relationships as social exchanges of human agency attributes such as trust and commitment.[33] Economising models are more suitable for a simple reason. The trust relationship is one of a formal or legal relationship whereby the beneficiary has a right to performance of the trustee's duty to act. Social exchange models, however, work best when formal negotiations or agreements are absent or inconspicuous.

In particular, reliance will be placed on the results of Aidt's review of the efficiency literature which is a good and still topical starting point.[34] There is no intention to recount completely Aidt's review of the literature since the present aim is merely to show that one of the models reviewed suggests or implies the relevance of the property rule in non-competitive environments.

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31 *Speight v Gaunt* (1883) 9 App Cas 1 (HL).

32 Oliver E Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting* (New York: Free Press, 1985); Stephen A Ross, "The Economic Theory of Agency: The Principal's Problem" (1973) 63:2 American Economic Rev 134.

33 Paul J DiMaggio & Walter W Powell, "Introduction" in Walter W Powell & Paul J DiMaggio, eds, *The New Institutionalism in Organizational Analysis* (Chicago: University of Chicago Press, 1991) 1.

34 Toke S Aidt, "Economic Analysis of Corruption: A Survey" (2003) 113:491 The Economic J F632.

Aidt began by identifying four models of corruption (of which only the first three need to be considered) where the corrupt agent is a monopolist. Under the first model of efficient corruption, a corrupt monopolist agent in queuing models takes bribes from consumers or users who seek to jump the queue for economic activity, the demand for which exceeds supply. The idea is that scarce resources such as licences and permits go to those willing and able to pay a higher price (inclusive of the bribe offered), *ie* those who value not waiting for the service, which enhances efficiency in a second best world. This is unlikely to be the case with trustees. There is no evidence that persons seeking to transact with trustees would prefer to deal in trust assets or that they perceive trust assets to be superior to non-trustee assets. Moreover, efficient corruption models appear to premise a malevolent principal who creates shortages in service outputs that the corrupt monopolist helps to clear.

In those premises, queuing models (and for that matter auction models) have little to offer by way of positive insights for the trust and beneficiary relationship. But for reasons of completeness, the efficient corruption models proposed by Shleifer and Vishny should not be missed.[35] These do not premise a malevolent principal and may superficially shed some light on the monopolist trustee if we assume that the trust instrument contains all the information there is on the desired output. They advocated a variant model which posits that the government has full information on the cost/demand conditions facing a monopolist agent who provides a non-contractible output. The conclusion they drew is that the agent sells the monopoly output and collects a scarcity rent equal to the monopoly profit. The corrupt monopolist agent in other words provides an efficient clearing function by selling the output to those who most value it and are prepared to pay a bribe for it. One need not follow them on the conclusion which is invalid or highly dubious. Dhami and al-Nowaihi argued with justification that, under full information, the monopoly profits are public information and so charging the public-agent a transfer/franchise fee equal to the monopoly profit ensures the first best non-distortionary outcome.[36] This prescription for efficiency is of little relevance for the trust and beneficiary relationship. Obviously, the settlor never has full information on the cost/demand conditions facing the trustee as a monopolist agent. Second, trustees discharge a gratuitous office and it would be incongruous to contemplate the settlor charging his trustee a fee.

In the same article, Dhami and al-Nowaihi went on to consider under certain conditions a monopolist agent who provides a public good or service under benevolent political supervision. On premises such as these, they argued that there is a difference between honest and dishonest political supervision, that the costs of the monopolist agent exert a significant influence on corruption, that these costs vary among monopolist agents some of whom are low cost providers and others high cost providers, and that the auditing benefits in reducing corruption are minimal where political supervision is dishonest. The agent commits corruption by selling above the official price set by the politician. This may be described as the benevolent model which is the second model reviewed. If Dhami and al-Nowaihi's conclusions

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35 Andrei Shleifer & Robert W Vishny, "Corruption" (1993) 108:3 QJ Economics 599. See also Andrei Shleifer & Robert W Vishny, "Politicians and Firms" (1994) 109:4 QJ Economics 995.

36 Sanjit Dhami & Ali al-Nowaihi, "Corruption and the Provision of Public Output in a Hierarchical Asymmetric Information Relationship" (2007) 9:4 J Public Economic Theory 727.

are valid, the economic analysis of corruption significantly depends on whether the principal is benevolent, whether the agent is a low cost or high cost provider, and whether there are auditing mechanisms.

The benevolent model examples what Aidt described as an agency model with a benevolent principal. This model sheds more light on the trust and beneficiary relationship than the first. Others such as Aidt who discussed or explored this model pointed out the importance of institutional factors and emphasised more institutional arguments (how well the institutions are designed) and perceptions of rewards of corruption by individual agents more than the considerations identified by Dhami and al-Nowaihi. Individual agents allocate contracts according to rewards of bribes and have little incentive to take bribes where they are paid a salary uplift which rewards honesty and fidelity or efficiency wages. Aside from efficiency wages, the level of corruption turns on institutional controls and legal remedies. These create multiple-path dependencies. Aidt therefore argued that an optimally designed corruption-free system with high incentive contracts is inefficient. It is more efficient to tolerate some corruption (to be dealt with in terms of existing legal remedies) by trading off the cost of allowing some corruption and the cost of rewarding honesty. The benevolent principal model matches some of the conditions in a trust. The settlor easily matches the description of a benevolent principal.

Aidt's third model which involves the malevolent principal has less bearing on the trust. It is enough to point out that the third and first model have a point of convergence in the premises. The agent is corruptible. The difference is that in the third, both principal and agent are corruptible. Principals create restrictions and adopt restrictive policies to generate scarcity rents while agents exploit the potential for corruption. Unlike the first model, these shortages are not pre-existing but endemic because motivations are skewed and the consuming public has no way to price the bribe.

Clearly, the third model does not capture the distinctive feature of premium selection of a trustee which marks out the backdrop of trustee corruption. A benevolent principal (or the court in his place) selects a moral person as his trustee and the trustee who accepts does so under the tenet of no reward for his exertions. This flatly contradicts the conditions of the third model that both principal and agent are malevolent. How does the Calabresi and Melamed model fare under the circumstances? The question is a leading one of course. It supposes that even under the conditions of quasi-monopoly and non-contractibility, an efficiency model is apposite instead of a deterrence or quasi-deterrence model. The applicability of Aidt's second model is important since it means that we are not constrained to reject economic reasoning even under trusting conditions. When initial descriptions of the second model were made earlier, enough was said about the similarities between the agent-benevolent principal model and the trusting relationship. These include the fact that the trusting relationship exhibits a similar combination of non-contractible output and full information on cost/demand conditions. On-going auditing considerations are likely to be perfunctory tokens created by the trustee himself and of an *ex post facto* nature. Beneficiaries are not in an appointing position and are ill-equipped to adopt auditing measures while trustees exercise supreme autonomy. Restrictions on trustee autonomy may be imposed obviously. Even so, there is a notable time interval during which a trustee's exercise of *de facto* autonomy will go undetected and any damage

done may be irreversible. Not all conditions obtain, to be sure. While multiple-path dependencies also exist in trusting relationships (for instance trustees may be given incentives to encourage loyalty and fidelity), there is a reduction in the degrees of causalities in the trusting relationship. The benevolent principal in the second model can modify the contract by raising output as an integral part of the design. This ability to influence the agent's control over non-contractible outputs is missing in the trusting relationship.

Aidt's concluding arguments in respect of the second model of corruption are therefore generally applicable. The main argument is stated as follows:

> Would a benevolent government allow corruption to persist? The answer is a qualified yes. The optimal design of incentives in bureaucracies often leaves room for corruption. The optimal level of corruption trades off the cost of allowing corruption (in terms of misallocation of resources due, for example, to misreporting) and the cost of designing incentives to eliminate it: corruption persists when the cost of eliminating it is too high. Shleifer and Vishny... call this the 'helping hand theory of corruption' because of the maintained assumption that the government is benevolent in the double sense that it wants to implement socially beneficial policies *and* it attempts to optimise the working of its institutions.[37]

An important sub-argument is stated as follows:

> This illustrates an important point: eliminating corruption by means of a high powered incentive contract is partly expensive because the government cannot screen its agents before they are hired. Thus, it is the lack of an effective screening mechanism that makes it optimal under some circumstances to allow corruption.[38]

There are two general economising transaction cost arguments in these conditions. With respect to the trusting relationship, these general arguments lead to the opposite particular conclusions. Under the moral person premises, the trustee is a good person chosen by the principal to act in his stead who would want the beneficiaries to have the property if the settlor would have done the same. The cost of designing incentives to eliminate corruption is wasteful under the premises. Second, the cost of eliminating post-appointment corruption is too high. A property rule under the Calabresi and Melamed model in such circumstances is therefore efficient. This is not necessarily going round in a circle saying that in the end we come back to legal deterrence, thus falsifying the validity of an economising model. The general reason that deterrence does not predominate in the second model is precisely because the phenomenon of corruption is complex. There are multiple causalities. The particular reason that deterrence still does not predominate in the trusting relationship is that the trustee is chosen because he is a good person or presumptively so. This results in a reduction of causalities, not their overthrow.

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[37] Aidt, *supra* note 34 at F638 [emphasis in original].
[38] *Ibid* at F641.

VI. Conclusions

The clash of opinions between those who welcome the broad sweep of *FHR European Ventures*[39] and those who remain sceptical of its pragmatic reasoning is more than one of doctrine and insolvency advantages and disadvantages. In bringing cross-disciplinary perspectives to bear on the debate, we appreciated that there were significant limitations. First, the economic perspectives chosen were limited. No attempt was made to include others. The reason for this lay in the modest ambition of this article. The objective was to question the simple property rule answer, not to prescribe the necessary qualifications for a better one. There are as a result key questions that remain unanswered by this article. Second, while economising models were employed, there was no attempt to do this in a completely general way. So there was a degree of eclecticism and heuristics in the choice of models which was made.

Nevertheless, the methods employed as tools to evaluate the property rule were useful in obtaining unequivocal initial insights. The efficiency perspectives which were invisible hand arguments confirmed the dispensability of deterrence as a primary policy and the validity of efficiency reasoning. More singular conclusions could be reached. First, an effective legal rule responding to the problem of harm caused by corruption must recognise and take account of the differences between competitive and non-competitive environments and auditing or monitoring possibilities. Second, a property rule fails to do that. Third, ignoring such endogenous and exogenous variables, it overestimates or underestimates the harm suffered by victims of corruption.

[39] *Supra* note 12.