What is the purpose of the ongoing use of fiduciary duties in English business law, with particular reference to breaches of duty in relation to bribery, secret profits, conflicts of interest and unconscionability?

Matthew Atkins

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Introduction

Fiduciary duties are complex legal obligations. The duties arise from the presence of an equitable obligation of trust and confidence owed by one party in a fiduciary relationship to the other.[1] This is known as the fiduciary obligation.[2] Yet a fiduciary is not said to be subject to the rules of the duties because he occupies the position of a fiduciary in a relationship, but rather he is said to be a fiduciary because he is subject to the rules of the duties for the purposes of that relationship.[3] The duties restrain the behaviour of fiduciaries by proscribing actions at a high level of generality, through the duty to avoid conflicts of interest and the duty to avoid unauthorised or secret profits. Thus they are usually considered to be proscriptive legal rules,[4] prohibiting any activity which leads to those consequences. However, the fiduciary obligation which gives rise to the duties has been called prescriptive, and a "compound obligation".[5] This is because, in the words of Lord Millett, "the distinguishing obligation of a fiduciary is the obligation of loyalty".[6] The objective of the fiduciary obligation is that the fiduciary will pursue the best interests of his principal or beneficiary, that he will be loyal to the interests of another. This is a prescriptive idea. The intention is not merely that the fiduciary will avoid taking actions which are negative to his legal obligations, but rather that he will act positively to promote the interests of his trust.

Fiduciary duties are about the service of a deeper purpose, an equitable purpose, which grasps at a more complete justice than the common law obligations to merely fulfil bargains and meet minimum standards of behaviour. The question posed by this thesis is the extent to which that purpose accords with the values and expediencies of law in the business environment. Law which regulates business transactions must be streamlined and efficient, only restraining economic activity where strictly necessary. In a free market economy a law which costs the market money or opportunities must be justified either by facilitating the creation of greater wealth elsewhere or by some strong moral or social imperative. It stands to be proven whether an equitable concept such as the fiduciary duty, with its origins in the rules of the management of traditional trusts, can remain analytically coherent and practically justifiable when transferred to the context of arms-length and competitive commercial relationships.

[1] *Bristol and West Building Society v Mothew* [1998] Ch 1
[2] Finn, P; *Fiduciary Obligations*, (1977, Law Book Company)
[3] *Ibid.* n1 & n2
[4] *Tito v Waddell (No. 2)* [1977] Ch 106
[5] Birks, PBH: "The Content of Fiduciary Obligations" (2000) 34 *Israel Law Review 3, pp 12*
[6] *Supra* n1, p18

In the final report of a government review Professor Kay gave a positive assessment of the potential for fiduciary duties, or at least "fiduciary standards" to contribute to the regulation of business in English law.[7] He believed they were essential in promoting responsible and sustainable business practices, something of an expansion of the classic role of the obligation in protecting the proprietary interests of beneficiaries from the power and excess of dishonest trustees. At around the same time, fiduciary duties and the imposition of a proprietary remedy in cases of breach of the "no profits" rule took centre stage in two landmark cases in the courts. The cases of *Sinclair v Versailles*[8] and *FHR European Ventures LLP v Cedar Capital Partners LLC*[9] reignited a fierce academic debate about the proper role and formulation of the fiduciary duty. This was especially focused on the severity of the remedy imposed in cases of breach of duty and the difficulty in establishing the proper justification required for such an imposition.[10] This debate calls into question Kay's confidence in the appropriateness of the fiduciary obligation in a commercial context, given the legal complexity and analytical difficulty it created. The case law ultimately resolved in a clear but arguably unsatisfying conclusion.[11]

At the same time there is ongoing tension in English law at the cutting edge of the law's understanding of the fiduciary obligation in the business context.[12] The duty to avoid conflicts of interest, and the requirement of "good faith" created by the obligation of loyalty, have been at the centre of a number of legal controversies. These include: fiduciary obligations arising out of commercial and contractual relations in joint ventures,[13] allied questions about the ability of parties to modify or exclude fiduciary duties in the terms of their contracts,[14] the precise confines of the duty to avoid conflicts placed on professional advisors who act for multiple clients with competing interests,[15] and the extent of the restriction the fiduciary duty places on

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[7] *Final Report of the Kay Review of UK Equity Markets and Long-Term Decision Making* 2012 http://webarchive.nationalarchives.gov.uk/20121204121011/http://www.bis.gov.uk/assets/biscore/business-law/docs/k/12-917-kay-review-of-equity-markets-final-report.pdf, last accessed July 2018

[8] [2012] Ch 453

[9] [2014] UKSC 45

[10] See for example: Worthington, S; "Fiduciary Duties and Proprietary Remedies: Addressing the Failure of Equitable Formulae" [2013] 72 CLJ 720, Millett, P; "Bribes and Secret Commissions Again" [2012] CLJ 583, Smith, L; "Constructive Trusts and the No Profit Rule" [2013] CLJ 260, and Goode, Roy; "Proprietary Liability for Secret Profits: a Reply" [2011] 127 LQR 493, among others

[11] See below, Chapter 3

[12] See Yip, M and Lee, J; "The commercialisation of equity" (2017) 37 *Legal Studies* 647 as well the legal disputes referenced in fn 13-15 below

[13] See *Ross River Ltd & another v Waverly Commercial Ltd & ors* [2013] EWCA Civ 910

[14] Law Commission Report No. 350; *Fiduciary Duties of Investment Intermediaries* (2014) HMSO Cm 350 para 3.37-3.39

[15] *Marks and Spencer plc v Freshfields Bruckhaus Deringer* [2004] EWCA Civ 741

actions of directors which may compete with the interests of their company or former company.[16]

Purpose of this Review

Set against this backdrop, this thesis examines the following key questions regarding the use of the fiduciary obligation as a regulatory tool in the business environment:

1. What theories underlie the imposition of the fiduciary obligation, and how do these translate to the business environment? What are the intended regulatory aims in using the fiduciary duty to regulate commercial actors and are they valuable?

2. Is fiduciary law sufficiently certain to provide effective business regulation without damaging commercial certainty and efficiency? Can acceptable answers or ways forward be identified in existing situations of legal controversy?

3. How effective is the fiduciary obligation in regulating the behaviour of commercial actors? Can this be measured or is the effectiveness of this jurisdiction essentially to be taken on trust?

Answers to these questions can provide a valuable contribution to scholarship in this area of law. The aim of pursuing such answers is to create a more complete picture of the purpose behind the regulation created by the fiduciary obligation in order to draw together disparate strands of legal thought and isolated principles into a more coherent and functional jurisdiction. It has been observed that, like equity itself, there may be no universal rule which governs the imposition of the fiduciary obligation.[17] A fiduciary relationship arises from the confluence of a sufficient number of a loose set of legal principles. However, it is the hypothesis of this review that there may be a common purpose in the specific examples of fiduciary regulation. Identifying this is an as yet unexplored avenue towards clarifying and illuminating this complex and often difficult area of law.

[16] Lim, E; "Directors' fiduciary duties: a new analytical framework." (2013) 129 LQR 242
[17] *Bristol and West Building Society v Mothew* [1998] Ch 1, and Finn, P; *Fiduciary Obligations*, (1977, Law Book Company)

This thesis builds on existing scholarship by recognising that the discussion on fiduciary duties has stagnated into, broadly speaking, two almost irreconcilable positions. The first could be loosely described as the proprietary approach.[18] This asserts the necessity of justifying trusts concepts as flowing from the best and most coherent analysis of property rights. It asserts that the best description of the fiduciary obligation is merely as a system of rules and causes of action designed to vindicate the rights of the beneficiary.[19] The alternative to this is what might be called the equitable approach.[20] This asserts a foundation of the fiduciary duties in equitable principles which are designed to mitigate against the arbitrary consequences of the strict application of legal rules. As a result the lack of full proprietary justification does not undermine the analytical basis of the duties. Conaglen has proposed a more pragmatic of the fiduciary duties, analysing them in terms of their function, which he identifies as the prophylactic protection of non-fiduciary duties.[21] His work has advanced the understanding of this complex area of law but has not fully resolved some of the questions posed by the controversies listed above.[22]

This original contribution of this thesis is to take the progress made by Conaglen and suggest that the fiduciary obligation is better explained if its function is understood in slightly wider terms than he proposed. The prophylactic protection offered is the guarantor of the integrity of the fiduciary relationship and its values of loyalty, trust and confidence.[23] This is then developed into a new analytical tool, by which disputes and difficulties caused by uncertainty and inconsistency in the application of the legal rules can be resolved.[24] This will ensure coherent decision making by the courts. A purposive analysis of fiduciary relationships can be used to identify the potential harm, the inequity, which an equitable rule is designed to prevent and, in the case of breach, remedy. Difficult questions can then be resolved by limiting the application of the rules to cases and situations where there is a risk of the harm, and excluding those situations where the risk is not present. In the case of the fiduciary duties,

[18] Typified by scholars such as Birks, PBH: "The Content of Fiduciary Obligations" (2000) 34 *Israel Law Review 3*, Goode, R; "Proprietary Liability for Secret Profits – a Reply" [2011] 127 LQR 493, Worthington, S; "Fiduciary Duties and Proprietary Remedies: Addressing the Failure of Equitable Formulae" [2013] 72 CLJ 720 and Swadling, W; "Constructive trusts and breach of fiduciary duty" (2012) 18 (10) *Trusts and Trustees* 985.

[19] At its most extreme scholars even assert that the fiduciary obligation is best understood as based on unspoken agreement and quasi-contractual in nature. See for example Langbein, J; "The Contractarian Basis of the Law of Trusts" (1995) 105 Yale LJ 625

[20] Most notably associated with Millett, P; "Bribes and Secret Commissions Again" [2012] CLJ 583, and Smith, L; "Constructive Trusts and the No Profit Rule" [2013] CLJ 260

[21] Conaglen, M; *Fiduciary Loyalty: Protecting the Performance of Non-fiduciary Duties* (2010, Hart: Oxford)

[22] *Supra* n12-15 and see Chapter 1 for further discussion.

[23] See Chapter 1 and Chapter 2

[24] See Chapter 3 and Chapter 4

they should be applied to actions of the fiduciary which could objectively appear disloyal or which risk undermining the trust and confidence placed in him by the beneficiary.

In a further novel contribution this thesis attempts to push the debate beyond the theoretical and tests the effectiveness of the fiduciary obligation as a regulatory tool.[25] Existing legal and professional rules and codes of conduct are reviewed.[26] Additionally this thesis undertakes an entirely new approach to the study of fiduciary duties by surveying 12 years of available case law and reporting findings relating to the successful use of breach of fiduciary duty as a cause of action. In doing so it establishes the importance of fiduciary regulation in the modern commercial environment.

Methodology

The primary form of research used is a detailed review of recent and historical case law relating to the fiduciary obligation and the core fiduciary duties, the "no profits" and the "no conflicts" rules. This is used in tandem with examination of relevant statutes, governmental reviews, industry codes and publications, and academic commentary on the pertinent legal controversies. This method is expected to be sufficient and effective in addressing the questions raised as the key elements of this task are to clarify the theory and law on the fiduciary obligation. In re-examining older case law, as it is informed by recent and new decisions, the defining principles of the jurisdiction can be more clearly identified. A review which spans a number of different topics in fiduciary law may also better identify common ground between different authors and publications and refine or eliminate obsolete or unhelpful analyses.

A brief secondary method will also be used, particularly to answer the third key question of this review and to better inform the answers to the first and second questions. In Chapter 5 there is an informal review of all published case law relating to breach of fiduciary duty over a 12 year period. This is not an empirical study but rather a passing reflection on the use of the jurisdiction as a means of vindicating legal rights in the courts. This is an essential part of the function of the fiduciary obligation. Actions against managers of property, be it in derivative shareholder actions, actions against trustees, or actions against agents or advisors, are notoriously difficult to pursue successfully and profitably. The fiduciary duty at the most

[25] See Chapter 5
[26] See for example Financial Conduct Authority Handbook available at https://www.handbook.fca.org.uk/ last accessed July 2018

basic level must provide effective and useable means for commercial actors to successfully pursue legal claims. An over-arching review of case law, while not necessarily contributing directly to more advanced understanding of the legal principles behind the jurisdiction, is an invaluable tool in assessing the effectiveness and true functionality of the fiduciary obligation in the context of business law. For a more precise description of the methodology behind this brief review, please consult the relevant sections of Chapter 5.

Chapter 1

The Current State of Fiduciary Duties in English Law

1.1 Introduction

Fiduciary duties have been a part of the law for a long time. The word "fiduciary" is Latin in origin and the legal concept has its roots in Roman law and the contract of Fiducia.[1] The concept of a legal relationship which included elements of trust or responsibility for the property of another is even older. There are rules in the oldest legal text in the World, The Code of Hammurabi, which show similarities to this legal concept.[2] It is a principle of almost natural justice that a person should bear responsibility for the property of another if they agree to become a custodian of that property. Yet that simplicity of thought is a far cry from the complexity of the modern English Law fiduciary duty, which applies to legal actors in a myriad of different circumstances. The flexibility and uncertainty in the modern concept is well documented, however the force of legal norms created by fiduciary obligations and the strength of the remedial response to breaches is almost unparalleled in English civil law. This has created academic controversy about the limits and use of fiduciary duties in the law.[3] The purpose of this chapter is explore currently accepted theoretical considerations which underpin the presence of fiduciary duties in the commercial context and assess how these concepts can be seen in the context of case law on fiduciary duties. This chapter serves as a review of the current literature on the fiduciary duty and shows that perspectives sharply divide on the proper analytical justification for the fiduciary obligation. Despite this divide, it can be observed that there is a generally accepted necessity that fiduciary duties should serve not only a direct legal purpose in creating rights, liabilities and obligations, but that they must also serve a function of creating a culture of fiduciary responsibility and behaviour.[4] This functional approach provides a new way to understand fiduciary duties and allows this review to cut through much of the controversy and provide a clear way forward to provide greater certainty and clarity in the law. Commercial actors can be discouraged from breaches of duty that

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[1] See Sherman, CP; *Roman Law in the Modern World* (1937, New York: Baker Voorhis & Co.)

[2] For example Rule 102 of Hammurabi's Code states that "If a merchant entrust money to an agent (broker) for some investment, and the broker suffer a loss in the place to which he goes, he shall make good the capital to the merchant." Rules 104 - 107 relate to property held by an agent. Translation by King, L. W. http://avalon.law.yale.edu/ancient/hamframe.asp last accessed July 2018.

[3] Worthington, S; "Fiduciary Duties and Proprietary Remedies: Addressing the Failure of Equitable Formulae" [2013] 72 CLJ 720, Millett, P; "Bribes and Secret Commissions Again" [2012] CLJ 583, Smith, L; "Constructive Trusts and the No Profit Rule" [2013] CLJ 260, and Goode, Roy; "Proprietary Liability for Secret Profits: a Reply" [2011] 127 LQR 493, among others

[4] Heydon, D; "Modern fiduciary liability: the sick man of equity?" (2014) 20 *Trusts & Trustees* 1006

involve bribery, self-interested profit making behaviour and conflicts of interest, not only by the disincentives created by liability but also through the 'soft-law' approach of voluntary compliance.

1.2 The Kay Review, Stewardship and the 'Good Man' of Equity

1.2.1 The Kay Review

The *Final Report of The Kay Review of UK Equity Markets and Long-term Decision Making*[5] is a fascinating place to start this discussion for a number of reasons. Firstly, as an inquiry set up by the UK government, it was well financed, and its consultation provoked responses from the full spectrum of stakeholders affected by business law. Responses came from companies, businesses, business people, government bodies, trade bodies, individuals, lawyers and academics.[6] Secondly, the report purported to be primarily economic in its focus. The terms of reference for the review were as follows:

> "To examine the mechanisms of corporate control and accountability provided by UK equity markets and their impact on the long term competitive performance of UK businesses, and to make recommendations."[7]

The terms make it clear that what is at stake is the economic performance of UK business. It is worth noting that this Review took place against a backdrop of a recession blamed on corporate irresponsibility. It is relevant for the purposes of an inquiry into fiduciary duties because one of the central conclusions[8] was that "fiduciary standards" should be observed by all participants in the equity chain. The Review makes it clear at paragraphs 9.5 - 9.8 that what it means by "fiduciary standards" are the core fiduciary duties of loyalty and prudence.[9] A

[5] *Final Report of the Kay Review of UK Equity Markets and Long-Term Decision Making* 2012 http://webarchive.nationalarchives.gov.uk/20121204121011/http://www.bis.gov.uk/assets/biscore/business-law/docs/k/12-917-kay-review-of-equity-markets-final-report.pdf, last accessed July 2018.
[6] A full list of respondents is available in links from this page: http://webarchive.nationalarchives.gov.uk/20121204121011/http://www.bis.gov.uk/policies/business-law/corporate-governance/kay-review/kay-review-responses, last accessed July 2018.
[7] *The Kay Review: Terms of Reference* 2011, available at http://webarchive.nationalarchives.gov.uk/20121204121011/http://www.bis.gov.uk/assets/biscore/business-law/docs/k/11-1015-kay-review-terms-of-reference.pdf, last accessed July 2018.
[8] *Supra* n5 p65-69
[9] *Ibid.* pp 66

famous passage is quoted from the dicta of Millett LJ from *Bristol and West Building Society v Mothew*,[10] a leading case on the nature of fiduciary duties. I will return to this case in some detail later, but what it is important to note here is the manner in which the Kay review views the concept of fiduciary duties and the purpose for which it believes they should be imposed on the investment chain. The point of view is best express in paragraph 9.8. I have included this paragraph in full below as it is of particular significance to this discussion:

> "The Review does not believe that there could be any sound basis for placing trust in an intermediary who does not recognise these duties of loyalty and prudence, and considers that a relationship that falls short of these standards fails to show appropriate respect for an investing client. Whatever the current legal position governing particular relationships in the equity investment chain, effective stewardship is possible only if trust, confidence and respect are established and the steward proceeds on the basis of obligations of loyalty and prudence. Stewardship implies the management of funds to fiduciary standards. Good practice statements for asset managers or for asset holders should incorporate these fiduciary standards."[11]

Clearly this is not a strictly legal approach, and I am not in any way suggesting that fiduciary duties should be reduced to a non-legal character,[12] however what is of interest are the functions the Kay Review felt that fiduciary duties have that go *beyond* their strict legal imposition. Kay suggests that the existence of fiduciary duties in parts of the investment chain can and should create "fiduciary standards" across the whole investment environment and that these are the bedrock of the soft law concept of stewardship. The Review considered that these fiduciary standards were economically efficient and essential to a functioning investment chain; without these standards there could be no "sound basis" for such investment. This should be a natural proposition of the role of fiduciary concepts in the law. Ensuring investor and trust settlor confidence that their property is secure is the most basic rationale for

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[10] [1998] Ch 1

[11] *Final Report of the Kay Review of UK Equity Markets and Long-Term Decision Making* 2012, p66

[12] The government response document to The Review notes the possibility that the approach taken to fiduciary duties had the potential to cause "confusion". Department for business Innovation & Skills; *Ensuring Equity Markets Support Long-Term Growth: The Government Response to the Kay Review* 2012, 3.34 p24, available at http://webarchive.nationalarchives.gov.uk/20121204121011/http://www.bis.gov.uk/assets/biscore/business-law/docs/e/12-1188-equity-markets-support-growth-response-to-kay-review.pdf, last accessed July 2018.

regulatory intervention by property law.[13] At the same time Kay's position is quite radical on a strict legal analysis. The idea that the fiduciary duties should serve a greater purpose than the direct protection of the rights of the beneficial owner is controversial. To serve any other purpose could undermine that very protection and requires theoretical justification in the face of competing interests. There is a possibility that this is an inherent and irreconcilable contradiction; if serving the narrow and specific interests of the property rights of individual citizens requires that the relevant legal rules have an effect on the general business environment, then it may be legitimate to include considerations that go beyond the property rights of those individuals when forming and enforcing those rules.[14] As I proceed I will analyse some of the possible lines of support, positive effects, and pitfalls of that approach.

1.2.2 Stewardship

It will assist this analysis to further consider the concept of stewardship and soft law regulation of the business environment. There are clear differences between the strict legality of fiduciary duties and the soft law principle which define the concept of stewardship. However, there is undoubtedly crossover between the two in a business context. The standards of behaviour that are espoused by stewardship have developed out of equitable and fiduciary concepts. If the imposition of fiduciary duties could have effects on a broader business culture then stewardship is a good place to start at looking at how the two interact.

The most prominent use of stewardship in English law is in the FRC UK Stewardship Code.[15] This code is a soft law approach to the problem of a lack of institutional investor involvement in corporate governance of the firms they control. The code is designed to encourage institutional investors to become better "stewards" of the property of their members, and the smaller members of the companies they control, by taking a more active role in company oversight. There are a number of concepts in this code which are similar to fiduciary obligations. Principle 2 of the code mirrors a fiduciary concept in that it provides for the avoidance of conflicts of interest as far as possible.[16] Principle 3 could be described as a reasonable care and skill, or due diligence provision, providing for a satisfactory level of

[13] The security created by property rights is one of the 6 "Killer Apps" that Niall Ferguson identifies in his book *Civilisation: the West and the Rest* (2011, London: Allen Lane) as being responsible for prosperity in the Western world.
[14]This may be the crux of some of the significant points of dispute in this area of the law. Some scholars believe that it is appropriate for fiduciary duties to be modified by considerations outside of property rights, others believe it is not, yet few address this question directly.
[15] http://www.frc.org.uk/FRC-Documents/FRC/The-UK-Stewardship-Code.aspx, last accessed July 2018.
[16] *Ibid*. Principle 2

monitoring on the property company by the institutional investor.[17] Most of the rest of the principles relate to disclosure requirements which could be compared to a fiduciary's obligation to account for their actions. The code principles are loosely mandated on a "comply or explain" basis, meaning those under the code need not comply but must explain why if they choose not to do so.[18] This is a necessarily flexible approach given the complexities of the statutory and other direct legal obligations both on the company and on the investors.

It is easy to see the manner in which fiduciary duties and stewardship differ. Fiduciary duties are mandatory, there is no comply or explain. Finn describes the strict inquiry that the courts make as dependent on the outcomes for the beneficiary, not merely the intentions of the fiduciary.[19] The breach of fiduciary duty also gives rise to strong remedies to restore the losses of a beneficiary: an equitable account against the fiduciary in breach or an ability to recover property through the imposition of a constructive trust.

However, it is also clear that stewardship owes a great deal of its content to the requirements of fiduciary obligations. Milman defines stewardship broadly as any situation where one party acts as a ward or keeper of the interests of another.[20] Reisberg similarly concludes that stewardship is "any situation in which people are looking after assets on behalf of another"[21] and that "stewards are people who look after the resources entrusted to them".[22] These could easily be a layperson's description of fiduciary duties. Stewardship is a means by which business regulation recognises the value of fiduciary concepts, fiduciary standards as Kay called them, in situations beyond the strict application of the legal duty. Both Milman and Reisberg note the increasing importance of stewardship in the English law. This demonstrates that the impact of fiduciary duties has been felt in English business law both in the creation of hard legal rights and in the soft-power legal culture that they have created. The purpose of the two concepts is not identical, fiduciary duties have a narrower focus. They are designed to proscribe certain specific activities, such as creating a conflict of interest or engaging in financially self-interested behaviour, in a narrowly defined legal relationship. However, while performing this narrow function, fiduciary duties can discourage similar negative behaviour throughout the business environment. Fiduciaries duties are part of the complex web of English Law which has produced a business culture that is both flexible and characterised by confidence in the security of property.

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[17] *Ibid.* Principle 3
[18] *Ibid.* Preface
[19] Finn, PD; *Fiduciary Obligations*, (1977, Law Book Company) p46
[20] Milman, D; *Governance of Distressed Firms* (2013, Cheltenham: Edward Elgar) p20
[21] Reisberg, A; "The Notion of Stewardship from a Company Law Perspective" (2011) 18.2 Journal of Financial Crime 126
[22] *Ibid.*

The soft law approach of the Stewardship Code has significant limitations. Its lack of mandatory norms or effective enforcement mechanisms has led to doubt whether it will achieve significant results.[23] The existence of the Stewardship code could also be said to demonstrate that the principles of fiduciary obligations have required further codification for them to have effect outside of strict fiduciary relationships. The complex nature of fiduciary duties, an understanding of which is often the sole preserve of legal scholars, is a challenge to any suggestion that they can be used to modify behaviour. Yet the continuing spread of the ideals of stewardship throughout the business world is strong evidence of the inherent value of those ideals which have their roots in fiduciary concepts.

1.2.3 Fiduciary Duties and the 'Good Man' of Equity

The discussion in the previous section does not represent a conventional approach to the reasoning behind the use of fiduciary duties in English Law. However it is doubtful whether there is a single conventional approach to that question. Finn's definition of a fiduciary is a common starting point. He stated that:

> "It is not because a person is a "fiduciary" or a "confidant" that a rule applies to him. It is because a particular rule applies to him that he is a fiduciary or confidant *for its purposes."*[24]

This definition was affirmed in a leading case[25] which clarified that the most significant aspect of the fiduciary obligation is the legal rule itself, the activity which is prohibited. This means that a person is a fiduciary because he is subject to the fiduciary obligations of loyalty, fidelity and prudence. That in itself is the reason for fiduciary duties; a fiduciary relationship is one which necessitates those obligations by its very nature. This position, while correct in English Law, is unsatisfactory in some respects. How is such a relationship identified? This controversy will be reviewed later in the chapter, but perspectives on this issue range from the strictly legal to broadly contractarian approaches. What is known is that there are particular

[23] See for example: Cheffins, BR; "The Stewardship Code's Achilles Heel" 2010 73(6) MLR 1004, Mckersie, M; "The Stewardship Code and the pattern of engagement by institutional shareholders with listed companies" 2010 5(4) *Capital Markets Law Journal* 439, and Arsalidou, D; "Institutional investors, behavioural economics and the concept of stewardship" [2012] *Law and Financial Markets Review* 6 410
[24] *Supra* n19, p2
[25] *Bristol West & Building Society v Mothew* [1998] Ch 1

relationships in the law which are fiduciary relationships. Trustees, agents, partners, and company directors, among others, are all subject to fiduciary duties in relation to particular activities they undertake. The basic principle is that these are known to be relationships in which certain standards of behaviour are expected with regard to the use of powers granted by a legal relationship with another. This can be summarised by the equitable maxim "Equity sees that as done what ought to be done". The technical meaning of this maxim is that the law of equity will treat as complete a legal transaction or activity which an individual was under an equitable legal obligation to perform, whether or not the performance has yet taken place. This approach has been developed into an equitable theory that might explain the use of fiduciary duties by Lord Millett in extra-judicial writings.[26]

The essence of the theory is as the maxim suggests, that breach of fiduciary duty demands a remedial response. That it is a breach of trust and loyalty and a violation of an essential relationship. Millett puts it in these terms:

> "The relationship between the fiduciary and his principal is a relationship of trust and confidence. The duty of the fiduciary is to serve the interest of the principal to the exclusion of his own, and the breach of this duty does not consist in making a profit but in keeping it for himself. That is not a breach of a personal obligation; it is an abuse of trust and confidence placed in him by his principal who put him in a position to make the profit because he trusted him not to serve his own interests by making it for his own benefit. Equity's response to the breach of this trust is not to give redress for the breach but to enforce the duty;"[27]

Here Lord Millett is not directly expounding a theory of fiduciary duties but addressing the narrow question of whether a breach by accepting a bribe gives rise to a proprietary remedy. He states that it is not the nature of the transaction that determines the remedy, it is the fact of the broken duty itself.[28] This can be described as a theory of the rationale for the use of fiduciary duties because it makes assumptions about those duties to reach that conclusion. Firstly, as with the maxim above, the essential element is to ensure that that correct behaviour is treated by the law as having occurred and to create that position in reality. Secondly, Millett's

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[26] Millett, P; "Bribes and Secret Commissions" [1993] R.L.R. 7, Millett, P; "Remedies: The Error in Lister v Stubbs" in Birks, P (ed.); *The Frontiers of liability: Vol I* (Oxford1994), p51 and most recently in Millett, P; "Bribes and Secret Commissions Again" [2012] 71(3) CLJ 583

[27] Millett, P; "Bribes and Secret Commissions Again" [2012] 71(3) CLJ 583

[28] *Ibid.*

analysis requires accepting that the breach itself is more significant than the manner of the breach. It is likely this second proposition is correct.[29] As we saw above in the work of Finn, the court is concerned with the end results of the actions of a fiduciary and whether they constitute a breach, beyond whether he intended that breach or not.[30] In arguing that the damage caused by breach of fiduciary is to the trust and confidence created by the relationship, Millett says that the normative purpose of the imposition of a fiduciary duty is to ensure the sanctity of a relationship of trust and confidence. In the Hong Kong case of *Tang v Tang* Millett said that the policy behind the fiduciary duty not to make a secret profit was to "enforce the trust which the principal place in the undivided loyalty of his fiduciary."[31]

If this is correct then it is fair to say that fiduciary obligations can be used to generate soft-law legal norms as well as hard-law obligations. The nature of fiduciary duties is such that they are protectors of trust and confidence in relationships and not just a form of legal protection for the property rights or powers invested in that relationship. This is particularly important in a business situation where investment and mutual reliance is involved. Specific legal rights should be vindicated, but the parties must also maintain standards of behaviour where no infringement of legal rights is likely to occur. This account of fiduciary duties is based more on acceptance of the pre-existing value of a particular relationship than on the remedial necessity of compensating an individual for the loss of legal rights. This account could allow one to place the consideration of the paradigm relationship above the specific property rights of the individual involved, to further the overall goal of protecting fiduciary relationships from breaches of duty on the society wide level.

1.3 The Restitutionary Approach and the Remedial Analysis of Fiduciary Duties

Most strongly opposed to the above is either a remedial analysis of fiduciary duties or a resitutionary analysis of equity as a whole. A remedial analysis of fiduciary duties would hold that the purpose of the duties is to provide an adequate remedy where a beneficiary suffers loss for which his fiduciary can be held responsible due to breach of duty. The primary ideal of such an approach is to ensure the protection of rights by the provision of a remedy. This approach may be the most common among scholars of equity and would tend to be characterised by a strict and narrow analysis of the function and imposition of fiduciary

[29] Flannigan, R; "Compound fiduciary duty" (2017) 23 *Trusts & Trustees* 794
[30] *Supra* n19
[31] *Tang Ying Ip & Ors v Tang Ying Loi* [2017] HKCFA 3, at p26

duties.[32] The restitutionary approach is similar in its effect for our present discussion, although it differs significantly in its detail.[33] This approach considers that the primary importance of fiduciary duties is that they prevent unjust enrichment, the ability of the fiduciary to profit unjustly at the expense of his beneficiary.

These two viewpoints on equity and fiduciary duties would not allow for the inclusion of any consideration outside of the core protection of property rights. There are principled reasons for this. Firstly, it is difficult to justify on a technical legal analysis. Any account of fiduciary duties that goes beyond the protection of the property rights of a specific individual in a closely defined relationship must assume a pre-existing value in the promotion of certain ideals of legal behaviour. The simplest account of fiduciary duties in the law is that they provide valuable remedies where loss is suffered as a result of breach. There is also a concern about the creeping expansion of equity. Equitable values and remedies can be strict and unyielding and proprietary remedies can have far reaching legal consequences. It is necessary that strict limits are placed on the application of these doctrines. Birks in particular believes that any approach that might give scope for the interference of judicial conscience in the law is wholly inappropriate.[34]

However, to limit a purposive theory of fiduciary duties purely to their remedial or restitutionary effect is to miss the significance of the equitable jurisdiction. Equitable concepts have always included a level of judicial discretion and a form of legal morality which was intended to go beyond the ordinary application of legal rules. A full account of the purpose of fiduciary duties in the commercial context should go beyond the simple practical effect. The voluminous quantity of academic and judicial commentary on the role of equity in the law, what Birks would call “taxonomical debate”,[35] has been unable to settle the question of how judicial discretion and “equitable morality” should be defined, but this does not mean it is without importance. Reading the literature it is difficult to see how the narrow approach will assist in justifying the use of fiduciary duties. It does not render them less complex or more accessible, rather it renders the fiduciary obligation more inflexible, raising the possibility of injustice when it is applied and limiting its application to the strict enforcement of rights and wrongs in

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[32] For proponents of this approach Goode, RM; “Proprietary Liability for Secret Profits - a Reply” [2011] 127 LQR 493, Finn,P; "Fiduciary Reflections' (2014) 88 ALJ 127 and Worthington, S; “Fiduciary Duties and Proprietary Remedies: Addressing the Failure of Equitable Formulae” (2013) 72 CLJ 720

[33] For the restitutionary approach see Swadling, W; “Constructive trusts and breach of fiduciary duty” 2012 18 (10) *Trusts & Trustees* 985, Birks, P; *An Introduction to the Law of Restitution* (1989, Oxford) and Birks, P; “Equity in the Modern Law: An Exercise in Taxonomy” (1996) 26 *University of Western Australian Law Review* 1

[34] As he put it: “One large scale danger to the rationality of our law lies in the exaggeration of the historical mission of equity to do justice, as though it had some special licence to ignore the requirements of legal certainty.” *Ibid.* (1996), p22

[35] *Ibid*. p16

individual relationships. The difficulty which arises is how to justify basing the enforcement of the substance of fiduciary duties on principles of equity rather the simpler principles of the common law of contract and torts, and the clearer response of statutory obligations and implied terms. If the object is absolute taxonomical coherence and legal certainty such an approach would seem much more direct. However, English law has always thrived on its ability to balance certainty and coherence with flexibility and justice, and Equity is at the heart of that process.

1.4 Economic and Contractarian Theories of Commercial Fiduciary Duties

The desire to strip much of the equitable approach from the law on fiduciary duties is the position adopted by Law and Economics theorists and Contractarians. These theorists, particularly Langbein,[36] hold that fiduciary duties constitute default rules which can be freely contracted out of by the parties to any legal arrangement. This approach is driven by the primacy of market freedom and the ability to conduct legal relations as parties see fit. In theory this would make the law more economically efficient as the individual best placed to decide their own relationship would do so. Langbein argues that fiduciary duties have always been contractarian in nature, based on mutual agreement to enter into that particular legal relationship.[37] He later argues that the fiduciary obligation is not always efficient, as avoiding conflicts of interests represents the "sole" but not necessarily the "best" interests of the beneficiary and that a fiduciary should be allowed to justify breach of duty on that basis.[38]

This is at odds with case law and the weight of legal theory on fiduciary duties. Flannigan makes this point very strongly when he says:

> "It has been understood for more than two centuries that fiduciary liability is strict. No excuse or justification, other than consent, is acceptable. The strict application continues to be regularly affirmed in the courts. Judges understand the necessity of a firm discipline for the self-regarding impulse."[39]

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[36] Langbein, J; "The Contractarian Basis of the Law of Trusts" (1995) 105 Yale LJ 625 and Langbein, J; "Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?" (2005) 114 Yale LJ 929.
[37] *Ibid.* (1995), p626
[38] *Supra* n36, (2005) p934
[39] Flannigan, R; "The Strict Character of Fiduciary Liability" [2006] *New Zealand Law Review* 209

This asserts both the legal precedent on the subject and the necessity of strict application to counter the incentive fiduciaries have to exploit their trust. Flannigan further criticises the theory by emphasising the evidentiary need for fiduciary duties to be strict in character. As a fiduciary will often have control over the information which documents his actions, without the strict character of the duties, it would often be impossible to prove wrongdoing.[40]

However, the Law Commission concluded that commercial parties were free to specify in a contract whether or not their business relationship was a fiduciary one if it fell outside the recognised fiduciary offices.[41] They have built on this approach[42] stating that it gives strong support to a “contract first” approach to fiduciary duties in a situation where the relationship is governed by both a contract and the fiduciary obligation.[43] At one point even stating that, “[fiduciary duties] are only default rules out of which the parties may contract”.[44] The Commission claims legal authority for this position from *Kelly v Cooper*,[45] *Henderson v Merett Syndicates Ltd*[46] and *Fattal v Walbrook Trustees (Jersey) Ltd*[47]. This approach is questionable both conceptually and as a matter of authority. It cannot be denied that following *Kelly v Cooper*[48] the English courts will look to a contract, where one exists between parties, to establish the nature of a relationship and the extent and content of the fiduciary duties in that relationship. This is affirmed in *Henderson v Merett*[49]. However, to describe this as authority for the proposition fiduciary duties constitute default rules is misleading.

Both cases involved contracted representatives who acted from the outset in a manner which would constitute a breach of the fiduciary duty to avoid conflicts of interest if they were subject to the duty as a trustee would be subject to it. However, because of the nature of the contractual relationship they were not found to have committed such a breach. The situation is clearest in *Kelly* which involved an estate agent who acted for the sellers of 2 adjacent properties sold by the agent to the same buyer at the same time. The sellers sued on the basis of a conflict as each could potentially have achieved a higher price had they known the buyer was purchasing the other. The judges reached the sensible conclusion that it was an implicit

[40] *Ibid.* pp 235
[41] Law Commission Report No. 236; *Fiduciary Duties and Regulatory Rules* (1995) HMSO Cm 236, Part VII p42 et seq.
[42] Law Commission Report No. 350; *Fiduciary Duties of Investment Intermediaries* (2014) HMSO Cm 350
[43] *Ibid.* p197 at 10.50
[44] *Ibid.* p196 at 10.49
[45] [1993] AC 205
[46] [1995] 2 AC 145
[47] [2010] EWHC 2767 (Ch)
[48] *Supra* n45
[49] *Supra* n46, p206

part of the contract that the agent would act for many different sellers and buyers and that he would not be subject to a duty to avoid conflicts of interest which prevented him doing so.

However, this is not authority for the idea fiduciary duties are default rules. The case can be analysed in two distinct ways which are more consistent with prior authority. Firstly, the contract may be capable of modifying the fiduciary duty to avoid conflicts of interest by excluding the conflict created by representing multiple sellers. This would not make the obligation, or the imposition of the fiduciary duty a default rule. The obligation is still applied by law, and there would be strict consequences if the agent had sold the house to himself or a company of which he was a director. The duty was modified by the contractual relationship but was not merely in a default position to it. Nothing in these cases is authority for the principle that a contract can exclude or limit the fiduciary obligation if the nature of the relationship remains fiduciary after the contract is made. Secondly, either alongside the first analysis offered or instead of it, the contract may change the nature of the relationship, which in turn changes the fiduciary duty. The fiduciary obligation is not imposed on non-fiduciary relationships. It is perfectly possible for a relationship which would otherwise be fiduciary in character to be made non-fiduciary, or fiduciary in only some aspects, by the existence of a contract between the parties which moves the relationship out of the normal bounds of fiduciary obligation. This means fiduciary duties are not default rules, but the behaviour needed to breach the fiduciary duty is defined by the fiduciary obligation, which can tailor itself to the facts of a specific relationship. This idea will be examined in Chapter 2.

The implications of the Contractarian approach have negative connotations for the approach set out in this paper. In seeking to explore the purpose that fiduciary duties have in English Business Law, it is necessary to ensure that this broader analysis of fiduciary duties in no way reduces the normative force, strict character or direct protection of rights they provide. However, the economic theories above present a challenge to classical accounts of fiduciary duties. For some, the imposition of such complex and forceful legal concept requires justification beyond the protection of property rights. The potential for fiduciary duties and their remedies to impact wider corporate behaviour potentially provides such justification.[50]

1.5 Current Case Law and the Imposition of Fiduciary Duties

[50] For further refutation of contractarian theories of the fiduciary duty see Klass, G; "What if Fiduciary Obligations are like Contractual Ones?" and Smith, L; "Contract, Consent, and Fiduciary Relationships" both in Gold, A and Miller P ed; *Contract, Status and Fiduciary Law* (2016: Oxford, OUP)

In English Law there is no definitive case law statement of the test for the imposition of fiduciary duties.[51] The courts have actively declined to find such a test, deciding that is impossible and unwise to attempt to cover all the possible relationships which could give rise to the fiduciary obligation with a single analysis.[52] The decision as to whether a person is subject to fiduciary duties is governed instead by three core concepts. Firstly, that the content of the obligation owed by a fiduciary is the obligation of loyalty. Secondly, that a fiduciary is someone who has made an undertaking to act as such, and thirdly that the fiduciary relationship is based on the need to protect against the vulnerability of the beneficiary. In other jurisdictions the latter two concepts are tests for the imposition of fiduciary duties.[53] In the English courts however, whether or not a particular individual is 'a fiduciary' per se is rarely considered. More commonly the courts find whether or not they were subject to a particular duty based on mixed use of all three concepts.

The most interesting point that emerges from case law and academic commentary is the tension of reconciling the onerous legal obligations arising from fiduciary duties with the need for such obligations to affect a flexible and wide range of relationships. Classic and current usage of the fiduciary obligations discloses a simple purpose for its imposition, particularly in the commercial context. The fiduciary obligation is intended to maintain the level of trust and confidence necessary for any given relationship to function properly as a vehicle for the economic management of property rights vested in a fiduciary via that relationship. To regulate specific relationships in this way is a lofty ambition. The fiduciary obligation seeks to extend the principles of good trusteeship from classic trusts into a wider range of relationships. In doing so the law recognises that fiduciary obligations must be specific to a relationship, as not all relationships require the same level of obligation. Codification of the specific requirements of each relationship would be impossible. Equally, a wholly discretionary approach would offend against legal certainty. Therefore the approach that is taken by the use of the fiduciary obligation is one which adopts ethical standards and thereby aims to create a business or societal culture. This encourages individual actors to adopt the standards of behaviour which best protect the trust and confidence in their fiduciary or quasi-fiduciary relationships, a matter they are best placed to judge themselves. Broad fiduciary standards of behaviour are promulgated by the use of strict fiduciary duties to proscribe and censure activities which severely undermine the necessary trust and confidence in relationships which

[51] For a review of various approaches see Miller, PB; "Justifying Fiduciary Duties" (2013) 58 McGill Law Journal 969

[52] *Re Coomber* [1911] 1 Ch 723 at 728

[53] The 'Undertaking' approach is used as a test in the Courts of Australia, *Breen v Williams* (1995) 186 CLR 71, and vulnerability is used in what is known as the Power and Discretion Test in Canada, *LAC Minerals v International Corona Ltd* (1989) 61 DLR 14, and New Zealand, *DHL International (NZ) Ltd v Richmond Ltd* [1993] 3 NZLR 10

separate property risk from control. The key concept in this process of protecting trust and confidence in the English law is loyalty.

1.6 Loyalty

The pivotal case on the fiduciary obligation and the imposition of fiduciary duties in English law is *Bristol and West Building Society v Mothew*.[54] In it Lord Millett addressed the question of whether the duty of care and skill imposed on company directors and, in this case, a solicitor was a fiduciary duty. In doing so he set out the key principles which govern whether an obligation imposed on an actor is fiduciary:

> "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."[55]

In the same judgment Millett also endorses the view of Finn that a person is a fiduciary because he is subject to a particular rule and is a fiduciary for its purposes. This is as opposed to a person being subject to a rule because he is a fiduciary.[56] The position is defined by the duties not the duties by the position. Therefore the obligation of loyalty, from which flow the duties imposed in any given relationship, establishes the fiduciary relationship. It is the obligation of loyalty which is unique to a relationship in which is found a fiduciary standard of trust and confidence.[57] This trust and confidence is what is protected by the specific duties, imposing ethics not found in other commercial relationships. The separation of ownership and control of property rights requires this kind of fiduciary responsibility to operate safely and effective. The fiduciary obligation is intended to create a fiduciary culture in these relationships, and has broader effect on the behaviour of commercial actors than simply setting out a specific set of rules to regulate individual transactions. In the words of Millett, the obligation requires

[54] *Supra*, n10
[55] *Ibid.* p18
[56] *Ibid.*
[57] Smith, L; "Fiduciary Relationships: Ensuring the Loyal Exercise of Judgement on Behalf of Another" (2014) 130 LQR 608

of fiduciaries “single-minded loyalty”, an ethical value that must permeate their attitude and behaviour towards their trust.

Building on a lecture by Birks questioning the usefulness of the concept of loyalty[58], Conaglen notes the way the definition of the role of the fiduciary and the content of the fiduciary obligation are circular or symbiotic in nature.[59] Both argue that the fiduciary obligation of loyalty cannot be properly understood without reference to the non-fiduciary duties of a fiduciary to act with care and skill in the interests of the beneficiary.[60] Conaglen’s thesis is that fiduciary duties are prophylactic in nature and formulated with the purpose of protecting the performance of the non-fiduciary duties of the fiduciary from any potential self-interested influence.[61] While this is likely true, it does not fully explain the function of fiduciary duties or account for some of the more unusual applications and consequences of the fiduciary obligation. The primary goal of the fiduciary obligation of loyalty is the creation and preservation of an environment in which any relationship built on the fiduciary standard trust and confidence can flourish. The aim is not just protective, it is aspirational. It seeks to promote positive behaviour by the fiduciary.

Conaglen argues from case law that there is clear “protective” and “prophylactic” function for the fiduciary obligation.[62] A key case is *Aberdeen Railway v Blaikie Bros*[63]. This case involved a self-dealing situation whereby a director of the railway firm arranged a contract for the supply of railway chairs[64] from a firm of which he was also a partner. The railway sought to nullify the contract on the ground of his breach of fiduciary duty. Conaglen uses the following passage from the judgment of Lord Cranworth to support his contention of a protective function:

> “[The director’s] duty to the company imposed on him the obligation of obtaining these chairs at the lowest possible price. His personal interest would lead him in an entirely opposite direction, would induce him to fix the price as high as possible. This is the very evil against which the rule in question is directed.”[65]

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[58] Birks, PBH; “The Content of Fiduciary Obligations” (2000) 34 *Israel Law Review 3, p12*

[59] Conaglen, M; *Fiduciary Loyalty: Protecting the Performance of Non-fiduciary Duties* (2010, Hart: Oxford) pp 60

[60] It should be noted that Birks does not refer to this as the non-fiduciary duties of the fiduciary but as an integral part of the fiduciary obligation itself, but one which cannot be distinguished from the obligation of loyalty to create any independent legal obligations or to provide an action of fiduciary negligence. See *Supra* n58.

[61] *Supra* n59, Chapter 4

[62] *Ibid.* p62-75

[63] (1854) 1 Macq 461

[64] Iron ‘shoes’ which attach rails to sleepers.

[65] *Supra* n63, p473

This passage supports the idea that the fiduciary duty to avoid conflicts of interest has a protective function. Cranworth says the fiduciary obligation is designed to negate the 'evil' of the fiduciary being placed in a position where his own interest runs contrary to that of his principle. The same case makes clear that the court is not permitted to investigate whether there were actual negative consequences to the principle as a result of the conflict. It was decided purely on the basis of the conflict itself being a breach of the fiduciary obligation.

Conaglen cites other cases, mostly from the late 19th Century, in support of the prophylactic nature as well as the protective function. He refers to *Keech v Sandford*[66], a case which forms the foundation of the modern legal doctrine of fiduciary duties. Here a trustee was found to be in breach of duty by renewing a lease for his own benefit which was previously held by his trust. This was despite the fact that the landlord refused to renew the lease in favour of the trust as the beneficiary was a minor and under the law at the time this would have meant the lease was not binding. Conaglen quotes Lord King's famous reasoning:

> "This may seem hard, that the trustee is the only person of all mankind who might not have the lease: but it is very proper that rule should be strictly pursued, and not in the least relaxed; for it is very obvious what would be the consequence of letting trustees have the lease,"[67]

Again we see the protective function of the fiduciary obligation of the trustee. He was prevented from having the lease to ensure he was not in a position where his own interests conflicted with those of the beneficiary, but as Conaglen points out we also see the prophylactic nature of fiduciary obligations in that the duties imposed are imposed strictly, with no opportunity to justify a breach on the grounds that there is no harm done to the beneficiary in question.[68]

Conaglen's analysis is mostly sound. The fiduciary obligation and duties do serve a protective function and through strict liability that protection goes beyond the minimum necessary for the protection of common law rights. However, by limiting the role of the fiduciary obligation to protecting the performance of the fiduciaries non-fiduciary duties, Conaglen departs from a more basic rationale evident in the decided cases. In *Aberdeen Railway* the decision is based on the theoretical possibility that the conflict of interest would lead the director to seek a high price on the contract. This was in his own interest but not in the interests

[66] (1726) Sel Cas t King 61
[67] *Ibid.* pp 62
[68] This prophylactic character of fiduciary duties, particularly in the sense of their strict liability and remedial inflexibility is relatively uncontroversial. See Hayton and Mitchell; *Commentary and Cases on The Law of Trusts and Equitable Remedies*, 12th edn (2005 Sweet and Maxwell: London) 6-24

of his company. The judges expressly do not consider whether the contract was made at an artificially inflated price, and it may well not have been, they found against the director on the basis of the conflict alone. The protection of the non-fiduciary duties of the director does not fully account for this decision, as the judges forbade themselves from considering his performance of those duties. This criticism is one which others have offered in different ways in response to Conaglen's thesis, notably Lee and DeMott. Lee argues that if Conaglen is correct about the protective function of fiduciary duties then fully performing the duties protected by the fiduciary obligation should prevent a finding of breach of fiduciary duty, which it plainly does not.[69] Similarly, DeMott states that if fiduciary duties are subsidiary to non-fiduciary ones then it would be expected that a fiduciary would have an affirmative defence of establishing due performance of the non-fiduciary duties.[70] Conaglen responds to these criticisms with an argument to demonstrate the prophylactic, 'preventative of disease', nature of fiduciary duties. In the case of Lee's criticism, Conaglen responds by developing his analysis into one of preventative probability:

> "The point of fiduciary duties is that they seek to enhance the likelihood that non-fiduciary duties will be properly performed by requiring fiduciaries to eschew situations in which that eventuality is put at greater risk by the presence of conflicting interests."[71]

In response to DeMott's criticism he relies on a risk reduction argument which employs a "prophylactic methodology"[72] to fiduciary duties. Breach of fiduciary duty is a problem in itself because it increases the risk of non-performance of non-fiduciary obligations, regardless of the factual outcome of any breach.

Still Conaglen has not fully responded to this point. Why can due performance not defeat the action against the conflicted fiduciary *in any given specific case*? To insist on the prophylactic methodology after the conflict has borne fruit, such as it had in *Aberdeen Railway* and *Keech v Sandford* is, to use an old adage, shutting the stable door after the horse has bolted. After the conflict has occurred the fiduciary duties can no longer affect the performance or the risk of non-performance of non-fiduciary duties in the relationship. The performance of the non-fiduciary duties is either adversely affected or duly unaffected. The fiduciary should at least be given the opportunity to prove his case. It is somewhat perverse to impugn the probity of a fiduciary and then deny him the opportunity to demonstrate exemplary performance.[73]

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[69] Lee, R; "In Search of the Nature and Function of Fiduciary Loyalty: Some Observations on Conaglen's Analysis" (2007) 27 *Oxford Journal of Legal Studies* 327, p334

[70] DeMott, DA: "Disloyal Agents" (2007) 58 *Alabama Law Review* 1049, p1057

[71] *Supra* note 59, p100

[72] *Ibid.* p101

[73] *Supra* n70

The true answer to this challenge is twofold. Firstly, the fiduciary obligation does more than just protect the performance of non-fiduciary duties. It also protects and promotes the ongoing fiduciary level of trust and confidence, ensuring there is objective 'loyalty' in all the acts of the fiduciary.[74] Equity regards as done that which ought to be done. Secondly, in doing so the fiduciary obligation is not designed solely to protect the specific relationship in which it arose. The protective function extends, through the prophylactic methodology, to protecting the trust and confidence in all fiduciary relationships, and perhaps even beyond, through widespread deterrence and the 'soft-law' promotion of a fiduciary culture of behaviour.

In the history of equity, trusteeship and fiduciary obligation, fiduciary concepts have often been understood as quasi-moral in character. The law has sought to reign in and at times expressly reject this aspect of the equitable jurisdiction for fear of creating uncertainty and undermining the legality of its rules.[75] However, this history is not so easy to escape. The development of the fiduciary obligation, for better or for worse, still owes a considerable amount to ideals of 'morality' and 'good trusteeship'. A system of legal rules in which it is safe to hand over the ownership and control of property rights to another, will always be subject to some agency cost risk. How much is dependent on the good character of the individuals in whom responsibility, trust and confidence is placed. The role of fiduciary duties is to legislate for the promotion of this good character throughout the system of equity. It is only possible to achieve such a difficult goal by ensuring that the standards are widely accepted by the majority of affected individuals, and carry with them a social pressure, or 'soft law' normativity. In addition, a strong deterrence pressure is required in their enforcement to emphasise the quasi-moral character of the rules and properly censure non-compliance.

The case law on the fiduciary obligation accords with this account. In *Aberdeen Railway* the "evil" against which the rule was directed was a conflicted director, not an inflated contract price. The implication is the intention of the rule is to eliminate conflict of interest itself, not its consequences.[76] In *Keech v Sandford* the trustee was the only man in existence who could not have the lease. The case expressly turned on a point of broader policy and the implications for other trust relationship:

> "I must consider this as a trust for the infant; for I very well see, if a trustee, on the refusal to renew, might have a lease to himself, few trust estates would be renewed to cestui que use"[77]

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[74] Millett, P; "Bribes and Secret Commissions Again" [2012] 71(3) CLJ 583
[75] See for example *Bray v Ford* [1896] AC 44 and *Re National Funds Assurance Co* (1878) 10 ChD 118
[76] *Supra* n63
[77] *Supra* n66

The point being that whatever the justice of allowing the trustee to renew the lease for himself in this case, the effect on the behaviour of trustees in general and on standards of behaviour in the system as a whole would be so negative that it could not be allowed.

Modern cases disclose similar considerations. *Bristol and West Building Society v Mothew* was decided on the basis that the conflict of interest the solicitor had in representing both the mortgagor and the lender was consented to and requested by the lender. As such it would not be fair to subject him to duties of negligence which were fiduciary in character rather than common law. The solicitor had not violated the fiduciary trust and confidence of the relationship merely due to a mistake. The court decided not all breaches of duty by a fiduciary were breaches of fiduciary duty, as this would create an unnecessary and undesirable burden.[78]

In *Boardman v Phipps*[79] a solicitor engaged by an estate trust, along with one of the beneficiaries, bought out and restructured a company which was part-owned by the trust in circumstances where the trust could not purchase itself. Despite finding honesty on the part of the two appellants and that they had invested substantial time and effort into the company, the court decided the company was held on constructive trust for the estate. Lord Cohen and Lord Hodson base their judgments on two important points. Firstly, the solicitor and the beneficiary obtained the information relevant to the purchase of the company and conducted much of the negotiation while holding themselves out to be acting for the trust. Secondly, the solicitor could not provide un-conflicted advice to the trust on purchasing the company while negotiating to buy it for himself. The judges make plain that the case was decided on its specific facts and because the fiduciary obligation of loyalty was present at the key moments of the transaction. The conflict of interest breached this obligation and the fiduciary duties. Performance of non-fiduciary duties was not an issue, the honest actions of the two made profit for both themselves and the trust. The important point was that the actions of the parties created a relationship which was predicated on certain standards of behaviour to ensure honesty and loyalty. Once that was established it gave rise to strict rules proscribing potentially disloyal behaviour, regardless of whether the outcome was actual disloyal.

This case neatly illustrates the true operation of the fiduciary obligation and fiduciary duties. The fiduciary obligation allows for a fact sensitive analysis of when the threshold of trust and confidence which gives rise to the obligation of loyalty is reached, even in a nuanced situation. Once the threshold has been reached, the imposition of the duties is extremely strict and the remedial response very strong. These factors ensure the integrity of the fiduciary

[78] *Supra* n10
[79] HL [1967] 2 AC 46

obligations of loyalty and trust and confidence, as well as providing a significant deterrence effect for other fiduciaries. This is designed to promote a culture of fiduciary behaviour which prompts fiduciaries to act positively in the interests of their beneficiaries. The fact-specific approach to the imposition ensures that the aims and influence of the fiduciary obligation can spread throughout the legal system flexibly, without creating a sense of injustice and arbitrary decision making.

1.7 Vulnerability and Undertakings

There have been attempts to devise tests which elucidate the rules governing the imposition of fiduciary duties. Principal amongst these are the vulnerability or power and discretion test and the fiduciary undertaking test. Both are worth mention but do more to clarify the law than create fixed rules on the use of fiduciary duties.[80]

The Law Commission[81] referred to both of these tests in commenting on how to identify a “fact-based” fiduciary relationship:

> “However, it was still considered that the presence of certain factors in a relationship would give rise to fiduciary obligations. The factors included an undertaking by the fiduciary to act on behalf of or for the benefit of another person, a discretion or power which affects the interest of that other person, and the peculiar vulnerability of that other person to the fiduciary. This vulnerability can be shown by factors such as dependence upon information and advice, the existence of a relationship of confidence and the significance of a particular transaction for the parties. This test is based on discretion, power to act and vulnerability.”[82]

The Law Commission state that there is no fixed test for the imposition of the fiduciary duty in English law, but there are a variety of relevant factors which derive from tests adopted in other countries.

The Supreme Court of Canada in *Frame v Smith*[83] adopted a 3 stage power and discretion and vulnerability test:

[80] For a proponent of the view that the English law is already based on a ‘power and discretion’ test see Miller, PB; "Justifying Fiduciary Duties' (2013) 58 *McGill LJ* 969 and Miller, PB; "The Fiduciary Relationship' in Gold, AS and Miller, PB (eds); *Philosophical Foundations of Fiduciary Law* (Oxford University Press, 2014)
[81] Law Commission Consultation Paper No. 124, *Fiduciary Duties and Regulatory Rules* (1992) HMSO Cm 124, p2.4.3 et seq.
[82] *Ibid.*
[83] (1987) 42 DLR 81

(1) The fiduciary has scope for the exercise of some discretion or power.
(2) The fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests.
(3) The beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power.

This test is general and broad in its application. In Canada it has led to a considerable widening of the list of fiduciary relationships. The third limb has caused particular problems as the potential list of relationships which could satisfy this requirement can be enormous depending on how you understand vulnerability.[84]

The English courts have generally avoided trying to establish a fixed test for a fiduciary relationship.[85] The only authority which has attempted any similar to a multi-stage test is the Court of Appeal judgment in *Reading v A-G.*[86]. Two situations which gave rise to fiduciary obligation were identified. The firstly was any situation in which a beneficiary hands property rights to the fiduciary to control. The second was those situations in which the beneficiary gives the fiduciary power to act to fulfil a particular purpose and get the best possible deal. A "job to perform" in the words of Asquith LJ.[87] These findings were endorsed by the House of Lords judgment in the case[88] however none of the judges in the highest court felt that such an analysis was required on the facts of the case.[89] As a legal test the two situations described by Asquith LJ are rather obvious and limited criteria for fiduciary status. These examples arguably are slightly clumsy attempts to codify and simplify the difficult concept of fiduciary 'loyalty', justifying why it might be present and necessary. This is an impossible task as the fiduciary obligation is in its essence highly flexible and must retain the potential to be applied in varied circumstances to maintain consistent effectiveness.

The undertaking test is present in English Law through regular use of the word in case law. In *Bristol and West Building Society v Mothew*[90] the word identifies a person who has undertaken to act on behalf of another in a relationship giving rise to trust and confidence. However in that case, Millett clarifies the meaning by reference to loyalty as the distinguishing feature of the relationship. This renders this test less helpful. Particularly since in English

[84] See *LAC Minerals v International Corona Ltd* (1989) 61 DLR 14
[85] *Supra* n10
[86] [1949] 2 KB 232, p236
[87] *Ibid.*
[88] [1951] AC 507
[89] A soldier had used his position to participate in profitable criminal activity. The House of Lords ruled that the abusive use of the position given to him by his employer was the sole reason for the profit and that this alone gave rise to a constructive trust in favour of the Crown. *Ibid. p516*
[90] *Supra* n10

cases the undertaking is judged to have occurred by an objective rather than subjective standard. Fiduciaries can easily become so by virtue of their actions without intending to undertake the role. Such was the case in *Boardman v Phipps*,[91] and in many other cases. Haley and McMurtry suggest that the fact sensitive nature of the fiduciary undertaking flows from its relationship to some "property" of the beneficiary, broadly defined.[92] They go on to give examples such as the contracts in joint venture operations and the control of a company by shadow directors. This thesis contends that the enquiry the court must make is actually into the loyalty owed by the fiduciary in the context of the specific relationship. While this could be described as an undertaking on the part of the fiduciary, the use of this word does little to expand on the concept of loyalty. If a fiduciary is found to owe an obligation of loyalty, he will be said to have undertaken to act in a loyal manner.

These two tests do not do a great deal to expand on the fact sensitive approach provided by the concept of loyalty. The flexibility of the fiduciary obligation is one of its great strengths. It has a particularly significant role in achieving the broader 'soft law' effects and deterrent purposes set out in this thesis. The flexibility serves to keep potential fiduciaries and commercial actors in general 'on their toes' ensuring fiduciary standards of behaviour disseminate more widely through the legal and business community.

1.8 Conclusion

This thesis suggests embracing some of the traditional aspects of the fiduciary obligation and fiduciary duties in order to attempt to fulfil a very modern and wide reaching function. Equity has its roots in promoting an ideal of the 'moral-man' and the standards of behaviour that entails. Fiduciary duties have a key role in that project, especially in carrying it into corporate governance more generally. They can serve as a means to spread standards of behaviour into all kinds of different relationships, imposing on each the necessary rights and obligations for that relationship to function with trust and confidence. Fiduciary trust and confidence is promulgated and promoted by fiduciary duties in three distinct ways. Firstly, its integrity is ensured in specific cases by a strict approach to the fiduciary duties and strong remedies which 'look on as done that which ought to be done". Secondly, the same strict approach and remedial force creates a significant deterrence effect across all fiduciary and quasi-fiduciary relationships. This discourages negative, self-interested behaviour and promotes diligence and vigilance to the fiduciary consequences of certain relationships. Lastly,

[91] *Supra* n79
[92] Haley, M and McMurtry, L; *Equity and Trusts* (2014, 4th ed: London, Sweet & Maxwell) p501

the flexible application and quasi-moral character of the fiduciary obligation built on loyalty in relationships of trust and confidence has a 'soft-law' effect in promoting fiduciary standards of behaviour more widely in legal business culture. This contributes to mitigating the problems of self-interest and agency costs in many commercial relationships where these can be detrimental.

Clearly this is a lot to expect of the fiduciary obligation and fiduciary duties and may go beyond the current scope of the doctrine. However, some comparisons with other jurisdictions and with the business regulation in developing jurisdictions later in the thesis may shed more light on this. In particular, there may be issues surrounding awareness of fiduciary obligations and fiduciary standards and there is undoubtedly great uncertainty in the law relating to fiduciary duties and the related remedies which is likely inhibiting their potential impact. However, a proper understanding of the broader purpose behind the use of fiduciary duties may allow for a more practical approach to some of the controversies and may point the way to answering some of these difficulties. To some this thesis may also offend against the narrow, private property rights focus of the equitable jurisdiction. However, given the challenge of law and economics theory it is necessary to justify the role the fiduciary obligation plays in commerce. If it is merely an archaic doctrine, which inhibits free contracting and efficient business then it is hard to justify given the fact it is also shrouded in legal uncertainty and highly technical legal disputes.

Recent socio-political developments and shifting attitudes to commerce, particularly in the financial sector, have given the fiduciary obligation and fiduciary duties new relevance. Regulatory approaches to big business, emphasising soft law techniques and 'gold-standard' codes of conduct are demonstrating a desire to see a return to more traditional models of corporate voluntary responsibility. The fiduciary obligation and fiduciary duties, have the potential to be a mandatory legal vehicle which can exist comfortably alongside and even promote voluntary standards of fiduciary behaviour such as stewardship and fulfil the wider role envisaged by the Kay Review.

Chapter 2

The Content of Fiduciary Obligations

2.1 Introduction

Chapter 1 set out the current theoretical understanding of the fiduciary obligation. It analysed fiduciary duties as proscriptive legal concepts designed to protect the integrity of relationship based on the obligation of loyalty. It also noted that the status of an actor as a fiduciary cannot be separated from the content of his fiduciary duties. This logically leads to the question of when an actor should be subject to fiduciary duties. Chapter 2 will take a different perspective analysing fiduciary duties from the point of view of the behaviour which is proscribed.[1] It will show that those same fundamental concepts of trust, confidence and relationship remain essential to understanding fiduciary duties and their role in existing law. This chapter will further advance the proposition that the character of those concepts makes some uncertainty an inevitable consequence of the imposition of the fiduciary obligation but that this is justified by a corresponding benefit in the advancement of valuable legal objectives. The original contribution of this chapter to existing research is to demonstrate that equitable rules are aimed at addressing particular equitable concerns. There is what might be called a legal ethic behind them. This assessment builds on the functional approach identified in Chapter 1. By identifying and focusing rules on those deeper legal principles they can be improved and given greater analytical coherence.

The necessity of a second analysis of fiduciary duties which takes the content as its starting point is demonstrated by a discussion of an extended analogy used by Sarah Worthington to explain the entire equitable jurisdiction. In Chapter 1 of *Equity* the history of English law is liken to a kindergarten game with two referees.[2] As the rules of the game develop and are modified to address new styles of play, the presence of two arbiters presents increasing problems. The two referees develop rules which can be contradictory and interact in inconsistent ways when judging infractions, leading to different decisions on similar facts. Worthington asserts that a system of rules is developed more effectively in a single arbitration system. She therefore advocates for unification of Equity and Common Law.

[1] Flannigan has described this as central to understanding the fiduciary duties. See Flannigan, R; "Compound fiduciary duty" (2017) 23 *Trusts & Trustees* 794

[2] Worthington, S; *Equity* (2nd Ed 2006; Oxford: Oxford University Press), p3 et seq.

However, it is not possible to say whether there should be two referees until you know why there were two in the first place. What does each referee do that is of value to the game as a whole? In the same way, what is it that Equity does which is of value as opposed to Common Law? Taking a modern sporting example: on the two large tennis courts at Wimbledon there are two sets of referees enforcing the same set of rules in different ways to pursue different objectives during a match. The umpire ensures broad compliance with the rules with the naked eye but without disrupting play, slowing the game and making it unenjoyable for players and spectators. The computer system 'Hawkeye' provides perfect accuracy when it makes a call but could not be used in every point because the game would become unplayable. In the same way, Equity was established as a 'court of conscience'. In the words of Lord Selborne, it is designed to "do more perfect and complete justice than would be the result of leaving the parties to their remedies at common law."[3] It is perhaps not as swift and certain as the Common Law but it is more accurate.

This analogy of law to the rules of tennis raises a question of philosophy of law. Worthington's example of two referees might pose problems of legal positivism. Applying Hart's 'Rule of Recognition'[4] every society with the rule of law will have some means of creating, arbitrating and developing that law. The presence of two referees makes the essential characteristics of law harder to identify for members of that society. Inevitably two arbitration systems will sometimes clash on the proper outcome of a dispute. This harms clarity and certainty. Dworkin's "right answer thesis", might offer a solution to this problem.[5] For him the law is a synthesis of rules and principles which cannot provide a clear answer to every societal dispute. The key objective for the perfect judge is the pursuit of legal integrity and the outcome most consistent with the seamless web of law. Inconsistency may be more likely in a dual system of arbitration, but inconsistency is not judged purely by the question of whether every judge decides every same set of facts the same way. Inconsistency is also judged by the conformity of the law to the morals, principles and objectives of the society which is seeking to make and maintain law. Therefore parallel systems of arbitration which encompass a greater range of norms and objectives with greater flexibility than can a single system can still be justified, provided the system offers greater integrity to the law as a whole.[6]

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[3] *Wilson v Northampton and Banbury Junction Railway Co.* (1874) LR 9 Ch App 279

[4] See Hart, HLA; *The Concept of Law* (2nd Ed 1994, Oxford: Oxford University Press)

[5] See Dworkin, R; *Law's Empire* (1986, Cambridge MA: Harvard University Press)

[6] Going further still, there may be still a few near-extinct creatures like your author with natural law sympathies. Natural Law theory probably accounts best for the reason why the English law has a Court of Conscience in the first place, a point that will be developed in a small amount more detail later in the chapter. The key point being that if just outcomes are viewed as the inalienable right of the petitioners in a legal case, then a system to "do more complete justice" becomes a necessity unless the primary system of law can be guaranteed to reach near perfect outcomes.

I do not attempt to decide between the theses of Dworkin and Hart on the nature of Law. The point is that there can be a trade-off between having more consistent decision making and having law which is more consistent with societal objectives. What is necessary is that the law by which a set of facts will be judged is clear and recognisable, and that the reasoning why any decision is made is consistent with legal integrity. This thesis suggests that considering the wider objective of the law to advance the principles and moral values of society it is clear why the law operates as it does in regard of fiduciary duties. The outcomes of the significant majority of cases in this area are predictable. Judges do not need to carry out moral analysis to decide a case, rather the law formulates itself in such a way that social objectives are advanced without requiring such enquiry.

2.2 Breach of fiduciary duty

2.2.1 Specific proscribed behaviour

What constitutes a breach of fiduciary duty is relatively straightforward in English Law. The two core fiduciary duties have been known since the end of the 19th Century:

> It is an inflexible rule of the Court of Equity that a person in a fiduciary position […] is not unless otherwise expressly provided for, entitled to make a profit; he is not allowed to put himself in a position where his duty and interest conflict.[7]

Therefore the breach of a fiduciary duty involves any situation where a fiduciary, without express and valid authorisation, makes a profit or allows his own interests to run contrary to those of his beneficiary. The lack of authorisation is important to note. Disclosure and consent to conflicts of interests are of particular significance in commercial relationships given the interconnectedness of business and finance.[8] Today fiduciaries are often paid for their services, and may even be authorised to profit from some transactions within their trust. There is ample case law demonstrating this is permitted, quite sensibly, where the fiduciary has made full disclosure of all relevant information and have informed consent for their actions.[9]

[7] Lord Herschell, *Bray v Ford* [1896] AC 44 at p57
[8] See Chapter 4 on 'Chinese Walls' cases *Bolkiah v KPMG* [1999] 2 WLR 215 and *Marks and Spencer plc v Freshfields Bruckhaus Deringer* [2004] EWCA Civ 741
[9] *Parker v McKenna* (1874) 10 Ch App 96; *Phipps v Boardman* [1967] 2 AC 46

Retrospective approval for actions in breach of duty is also possible.[10] Again this requires fiduciary to have obtained approval through the informed agreement of the beneficiary based on full disclosure.

The behaviour which is proscribed by these duties is for the fiduciary to act in a way which is self-interested.[11] More than that, he is expected to act in such a way that it is not even possible that he should have the opportunity for self-interest. He is required to wholly set aside his own interests and pursue those of the beneficiary only. Identifying a single word which completely encompasses this aspect of fiduciary conduct has proved difficult. Some have suggested that "altruism" is what is required[12], but this is not free from criticism[13]. Harding theorised that this obligation is based on "fidelity",[14] that it is in fidelity to the commitment to a set of norms made by entering into a particular relationship that the fiduciary obligation arises on an individual. This approach is close to the undertaking test imposed by some courts, discussed in Chapter 1. Harding infers a motivation on the part of the fiduciary which justifies the imposition of the duty. It is the position of this thesis that the facts of a relationship give rise to a fiduciary obligation of loyalty, and the duties enforce that obligation and motivate fiduciaries to honour its ethical standards. The obligation is an objective standard by which the courts can identify fiduciaries and enforce the necessary duties.

What is required of the fiduciary is not that their internal moral character and intentions conform to the provisions of the law. While a desirable outcome, this would be a violation of personal autonomy and completely unenforceable. Rather what is prohibited is the fiduciary displaying any outward signs that he may not be fully committed to the sole interests of his beneficiary. The conduct which is circumscribed is that the fiduciary should allow to exist any reason, not already known to his beneficiary, why he should serve his own interest above, instead of, or even alongside that of the beneficiary. The requirement is that in outward appearance the fiduciary should be devoted to the interests of the beneficiary. In enforcing

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[10] *Lyall v Edwards* (1861) 6 H&N 337*; BCCI v Ali* [2000] 3 All ER 51. See also acquiescence *Re Pauling's Settlement Trusts* [1962] 1 WLR 86

[11] The loyalty of *Bristol v Mothew* [1998] Ch 1

[12] Birks called fiduciary loyalty the third and highest form of altruism, requiring both negative and positive altruism: Birks, P; "The Content of the Fiduciary Obligation" (2000) 34 Isr L Rev 3, see also Samet, I; "Fiduciary Loyalty as a Kantian Virtue" in Gold, A and Miller P ed; *Philosophical Foundations of Fiduciary Law* (2014, Oxford: Oxford University Press)

[13] DeMott points out that altruism fails to accurately describe both circumstances in which fiduciaries can and do still act with self-interest. She also notes that it is also inaccurate to describe an obligation imposed by law as "altruistic". DeMott, D; "Fiduciary Obligation Under Intellectual Siege: Contemporary Challenges to the Duty to be Loyal" (1992) 30 Osgoode Hall LJ 471. Worthington disputes the use of the word in the sense that she feels it "describes the outcome, not (or not necessarily) the motivation". Worthington, S; *Equity Supra* n2 at p131, n6.

[14] Harding M; "Disgorgement of Profit and Fiduciary Loyalty" in Degeling, S and Varuhas, J ed; *Equitable Compensation and Disgorgement of Profit* (2017, Oxford: Hart)

this by law the fiduciary obligation creates a cultural environment in which actors will routinely hold the desired ethical values, but it cannot enforce them directly.

There may be a danger of overcomplicating the core concept of loyalty. Certainly there is a proliferation of academic commentary on the subject.[15] The attempt to encapsulate the ethic that is promoted and protected by the fiduciary obligation in a single phrase may be futile. However, the central tenants of this concept are well established. There is an ethical, conscience-based intention behind fiduciary loyalty. The intention is that the fiduciary in a relationship based on an equitable level of trust and confidence behaves in accordance with that trust and avoids any actions which call into question either his partiality or single-mindedness in pursuit of the interests of that trust. Instead he should act positively in the best interests of his beneficiary. The proscriptions levelled at fiduciaries cannot be understood in isolation, they are behaviours which are defined by the position of the fiduciary and the relationship which exists between himself and his beneficiary.

This may be an obvious statement, but it is rarely itself considered: it is the interests of the beneficiary, his property rights, which limit the scope of activity that the fiduciary may undertake.[16] The fiduciary must avoid financial activity entirely in those markets or opportunities which are the subject of the beneficiary's interests, except that activity he undertakes on behalf of the beneficiary. He must take no reward except that agreed with the beneficiary. His own interests are subjugated to those of the beneficiary, and his potential success is limited to only those fields where the beneficiary has no interest. The substance of the fiduciary duties cannot be ascertained without an examination of the beneficiary: his interests, his knowledge, his authorisation. While the duties are framed in terms of the active behaviour of the fiduciary, they are in reality by-products of the position of the beneficiary. To remedy the power imbalance created by the power the fiduciary has over the interests of the beneficiary his own interests are required to be curtailed by reference to those of the beneficiary, to such an extent that he becomes a servant of the interests of the beneficiary over which he holds power. The fiduciary duties in the context of the fiduciary relationship are a kind of rope that ties together the two parties and their financial autonomy, such that neither can be fully independent of the interference of the other. At the same time they divide the personal interests of the two actors into separate spheres, such that they cannot conflict.

[15] In addition to those works cited above, see also, Penner, JE; "Is Loyalty a Virtue, and Even If It Is, Does It Really Help Explain Fiduciary Liability?, Smith, L; "Can We be Obliged to be Selfless" and Gold, AS; "The Loyalties of Fiduciary Law", all in Gold, A and Miller P ed; *Philosophical Foundations of Fiduciary Law* (2014, Oxford: Oxford University Press) and Keller, S; *The Limits of Loyalty* (2007 Cambridge: Cambridge University Press)

[16] Finn,P; "Fiduciary Reflections' (2014) 88 ALJ 127

These duties are of an order of legal complexity above that of a basic proscriptive rule such as “do not steal from your beneficiary” or “do not lie to your beneficiary” or “do not cheat your beneficiary”, rather they require a fiduciary to modify his own interests by reference to those of the beneficiary to whom he owes a fiduciary obligation. They defy easy analysis because without factual context, the precise nature of what is and is not is difficult to establish. However, on examination of a specific relationship it becomes straightforward to define what a fiduciary can and cannot do. There is a simple rule to follow: he can have no interest within the scope of his relationship with the beneficiary which is not authorised. He need merely apply that to his own situation. Does he have any such interest without explicit authorisation? If there is any doubt he must eliminate it.

2.2.2 Strict Liability

A distinctive feature of fiduciary duties is that their requirements are strictly applied. A fiduciary who is found to have allowed his duty and his interests to conflict or who has made an unauthorised profit has no defence. He cannot argue that the conflict or profit caused no failure in the performance of his duties nor can he argue that his actions brought benefit to the beneficiary. The case of *Boardman v Phipps*[17] is the classic example. The solicitor and beneficiary who bought out the company part owned by their trust and who invested in improving and increasing its profitability, to the benefit of all involved, were still found to be in breach of fiduciary duty

Some of the practical legal reasons for this strict approach are discussed in Chapter 1 at 1.3.[18] Here the key issue is to identify the legal, moral or social wrong which is addressed by strict liability. Clearly, it is not as simple as the moral and legal wrongs prevented by the content of the duties themselves, namely that a beneficiary should not be cheated or exploited for the gain of the fiduciary. This explains the content of the duties but not the fact they are enforced strictly.[19] Strict liability requires acceptance that a conflict or unauthorised profit is a moral, legal or social wrong without it necessarily causing actual harm to the beneficiary. The corollary of that is therefore that for a fiduciary the lack of any conflict or unauthorised profit is a moral, legal or social good.

[17] HL [1967] 2 AC 46

[18] See also Flannigan, R; “The Strict Character of Fiduciary Liability” [2006] *New Zealand Law Review* 209

[19] See ConaglenM; infra n31, and Langbein, J; “Questioning the Trust Law Duty of Loyalty: Sole Interest of Best Interest?” (2005) 114 Yale LJ 929, and Jones, G; “Unjust Enrichment and the Fiduciary’s Duty of Loyalty” (1968) 84 LQR 472.

Put in positive terms the position is quite straightforward accept. If one were to ask a hypothetical beneficiary, "is it a good thing for your fiduciary to avoid being in a conflicted positions, even if there is no chance he would abuse the position?" The answer would likely be yes. Or to put it another way, would not any beneficiary given the choice choose an un-conflicted fiduciary over a conflicted one, even if he trusts the honesty of both. The value of the un-conflicted fiduciary is extra security and trustworthiness. The strict requirements of fiduciary duties mean that the relationship has extra stability and a stronger sense of the fiduciary subordinating his interests to those of the beneficiary. It is natural to say that a fiduciary who is conflicted, or has acted as a fiduciary while simultaneously serving his own interests seems less trustworthy, whether or not their actions were scrupulous in substance.

This kind of certainty and uncertainty based on rather ethereal values may seem difficult for the law to encompass.[20] However, it has economic and social value in commercial fiduciary relationships. Certainty as to the motivations and interests of business partners and agents will increase the economic potential of those relationships and the willingness of parties to invest in them. A sense of trustworthiness and the requirement to communicate conflicts will also reduce the potential for misunderstandings between parties which, as any lawyer knows, can easily lead to legal disputes. A strength of English commercial professionals, lawyers, accountants, tax advisers, financial adviser, consultants, trustees, directors, or any of many possible fiduciaries, is that the English business environment has a reputation for trustworthiness, professionalism, and technical expertise.[21] This thesis contends that fiduciary duties and the strict enforcement of requirements of selfless behaviour play an important role in this.

2.2.3 Exculpatory Provisions

One notable potential exception to the rule of strict liability for breaches of fiduciary duty is the inclusion in certain key statutes of discretionary exculpatory provisions. In s61 of the Trustee Act 1925 and s1157 of the Companies Act 2006 there is a discretion of the court, worded in the largely the same terms in both cases, allowing a fiduciary to be relieved of liability for breach of trust. These provisions are of relevance here given the weight placed by this thesis on the importance of the strict liability of fiduciary duties, and on the centrality of

[20] As Lord MacNaghten famously said: "It is not the function of a Court of justice to enforce of give effect to moral obligations which do not carry with them legal or equitable rights." *Blackburn, Low & Co. v Vigors* (1887) LR 12 App Ca 543

[21] In 2012/13 over 80% of cases before the English Commercial Court involved a foreign participant. QLT School Blog September 15th 2015, available at http://www.lexology.com/library/detail.aspx?g=c3cfb6e2-cc56-4376-8e40-641b0e2f0d31, last accessed July 2018

trust and confidence to the fiduciary relationship. A right granted to the court to excuse breach of fiduciary duty in certain case might imply that there are circumstances in which the centrality of trust and confidence in the fiduciary relationship must give way to more practical considerations.

The relevant statutes state that where a trustee or company director in breach of trust has “acted honestly and reasonably, and ought fairly to be excused” then the court has the power to do so.[22][23] It is worth noting that there are two caveats when applying such provisions to the fiduciary duties discussed in this thesis, these will each be discussed in turn in this chapter. The first is that it is strongly arguable that breaches of trust which involve breach of fiduciary duty are either strictly or practically outside of the scope of these exculpatory sections.[24] The terminology of breach of trust is a difficult one, especially in relation to the fiduciary duty. In the next section this thesis discusses which duties are fiduciary. This question could equally be addressed under the question of when a breach of trust is also a breach of fiduciary duty. The former term undoubtedly includes the latter, but to what extent the two terms precisely differ is far from a completely settled question in English law.[25] The second caveat is that the practical operation of these jurisdictions does not lend itself to useful application in the context of breaches of fiduciary duty.[26] Usage of these sections has been sparse until recently and has been described as excessively technical and formulaic.[27]

The argument that breach of fiduciary duty is not within the scope of these exculpatory provisions can be approached in a number of different ways. In their 1995 Report the Law Commission stated that the relevant sections did not cover violations of the fiduciary imperative not to self-deal as is a disability rather than a breach of trust.[28] *Tito v Waddell* is authority for this position in relation to s61.[29] On this understanding a ‘duty’ of a trustee is a positive obligation under the trust to behave in a particular manner. A ‘disability’ is an absolute prohibition from undertaking certain activities. In the next chapter this thesis makes the case that the proper understanding of the fiduciary duties is drawn from the disability analysis.[30] Self-dealing, along with other transactions tainted by conflict of interest

[22] Trustee Act 1925, s61
[23] Companies Act 2006, s1157
[24] See Law Commission Report No. 236; *Fiduciary Duties and Regulatory Rules* 1995 HMSO Cm 3049, Chapter 15
[25] *Tito v Waddell (No. 2)* [1977] Ch 106
[26] *Supra* n22
[27] Haley, M; “Section 61 of the Trustee Act 1925: A Judicious Breach of Trust?” (2017) 76(3) CLJ 537, p564
[28] *Supra n22*
[29] *Supra n23*
[30] See below, Chapter 3

and transactions by which the fiduciary makes a profit, will not be countenanced by the courts of equity and so the remedial response will focus on complete reversal of their consequences so far as is possible.[31] Given there is good evidence to exclude self-dealing from the remit of these exculpatory breaches, there is a similarly an argument in relation to all breaches of fiduciary duty.[32]

Even if this strict approach to the classification of duty and disability is too formulaic case law discussed in this thesis suggests that fiduciary duties act to prevent what could be called 'technical' dishonesty which violates the trust and confidence placed in a fiduciary relationship. As can be seen in *Phipps v Boardman,*[33] the courts in the context are quite willing to find a fiduciary has behaved in a subjectively honest fashion but has still acted outside of the necessary level of propriety for a fiduciary. The precise definition of honest and reasonable behaviour necessary to fall within the exculpatory sections is the subject of some dispute.[34] However, it is suggested that even if a breach of duty could pass the honesty requirement, which is by no means certain, it is somewhat difficult to see how it could pass the reasonableness one. It simply cannot be reasonable for a fiduciary to neglect their most central of obligations, that of loyalty.[35] That is the essence of the fiduciary duty.

Further support for the disability analysis which puts fiduciary breaches beyond the scope of the exculpatory sections can be found in the way these provisions have been generally understood by commentators and the courts. The case law on these provisions, in the early years and in recent times has often arisen in the context of positive actions the trustee or director which are impugned.[36] A trustee or director has most commonly sought relief because they have honestly and reasonably entered into a bad investment or transaction on behalf of their trust.[37] Certainly it is possible for these to be dishonest transaction, though that will obviously fall outside of the criteria for relief, but in most cases it was a mistaken transaction or one which was rendered unprofitable by other factors. A paradigm breach of trust is a breach of a duty imposed by the trust document itself, followed by breaches of statutory duties, and then lastly by the general law of trusteeship.[38] Commentators who have written on these exculpatory sections have generally done so in

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[31] *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45

[32] *Guinness v Saunders* [1990] 2 AC 663 held that s727 of the Companies Act 1985, the predecessor to s1157 of the CA 2006, could not apply to conflicts of interest.

[33] *Phipps v Boardman* [1967] 2 AC 46

[34] *Vivendi S.A. v Richards* [2013] EWHC 3006 (Ch), *Labrouche v Frey* [2016] EWHC 268

[35] *Richard Hunt Investments Ltd v Richard Hunt* [2017] EWHC 988 (Ch)

[36] See for example *Marsden v Regan* [1954] All ER 475, or *Nationwide Building Society v Davisons Solicitors* [2012] EWCA Civ 1626

[37] For example a fraudulent mortgage as in *Santander UK Plc v RA Legal* [2014] EWCA Civ 183

[38] *Supra n23*

the context of cases which relate to practical decisions gone wrong, or powers exceeded. For example Haley,[39] Davies,[40] and Kleiner and Harris[41] all focus their articles on recent cases of solicitors who fell victim to mortgage fraud, with Haley concluding that the issue in determining the exculpatory discretion in such case was on the adequacy of the solicitor's compliance with their own professional standards.[42] Textbook writers similarly often discuss these statutory provisions in the context of defences to breaches of the managerial duties,[43] and indeed this is a key part of the reasoning of Megarry V.C. in *Tito.*[44] It is in the context of breach of duties such as these where a discretion to excuse liability makes the most sense, and it is in line with the understanding of breach of duty in relation to investment portfolio to be found in the case of *Nestle*.[45] Such exculpation makes far less sense in the context of breach of the fiduciary obligations. It is against the character of these duties to allow for justification of breaches of the disabilities they impose.

The second caveat mentioned above reinforces this conclusion. In general the drafting and understanding of the exculpatory provisions is regarded as poor. Both Haley and Davies note that use of the discretion by the courts is rare,[46] and pleading of the provisions by defendants had been similarly scarce until the last few years. Haley, as well as Kleiner and Harris, also trace the history of section 61 in particular, demonstrating that the core function was originally to protect amateur trusteeship from the pressures imposed by increasingly complex financial markets.[47] Haley explains that amateur trusteeship was seen as particularly valuable and the integrity of professional trustees was regularly questioned during the 19th Century.[48] In the modern world of commerce such an understanding of trusteeship is rather outdated. In fact the core challenge for fiduciary and other equitable obligations is now arguably in the context of the interaction with professional businesspeople,[49] and that is the focus of this thesis. Furthermore, issues with the application of these sections and their scope were highlighted and criticised by the law commission, such that they felt express extension to fiduciary duties more widely was inappropriate, despite support from respondents to the consultation. Haley in his own review

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39 *Supra* n25

40 Davies, P; "Section 61 of the Trustee Act 1925: Deus Ex Machina?" [2015] Conv. 379

41 Kleiner, G and Harris, J; "The application of section 61 of the Trustee Act 1925: the court's dubious prerogative of mercy?" (2017) 23 *Trusts & Trustees* 215

42 *Supra* n25, p564

43 See for example Hudson, A; *Equity and Trusts* 9th Edition (Routledge: London, 2017)

44 *Supra* n23

45 *Nestle v National Westminster Bank* [1992] EWCA Civ 12

46 Haley *Supra* n25 at p538 and Davis *Supra* n38 at p379

47 Haley *Supra* n25 at p540 et seq, Kleiner and Harris *Supra* n39 at p217 et seq.

48 *Ibid.*

49 See Yip,M and Lee, J; "The commercialisation of equity" (2017) 37 *Legal Studies* 647

concluded that that application of the courts of section 61 was, “overly technical, seemingly, without any element of fairness or merit and fraught with difficulty”.[50] This is, as he notes, a problematic approach to take to an equitable discretion, and arguably demonstrates the hostility of the courts to approaching these provisions as a matter of purely producing a ‘fair’ outcome where the consequences of breach of duty are perceived as harsh or excessive. Therefore it seems unlikely that these provisions will be readily applied to breaches of fiduciary duty, which is recognised for the strict and unyielding nature of its application.

That is not to say that the sections do not provide a useful insight into the proper understanding of the role of fiduciary duties and breach of duty more widely in the promotion of good trusteeship. They contain an express recognition that the position of a fiduciary is a difficult and onerous one. That it is possible to violate the duties of trusteeship in an unintended and, at least subjectively, in a faultless and honest manner. This kind of accountability requires examination and explanation. The history traced by the commentators illuminates the way in which trusteeship was viewed in its early years as a position of quasi-moral responsibility. This informs much of its later development.

It is also informative that the key determinants of exculpation are honesty and reasonableness, when combined with an overall assessment of fairness. These two requirements appear to mirror the two pillars of trusteeship identified by Conaglen,[51] the fiduciary and the managerial duties. The fiduciary duties protecting honesty and the managerial ensuring reasonable conduct of the affairs of the trust. This somewhat implies that the intention of the exculpatory sections is that where someone has been a good trustee, and despite this has breached their duties, they should be excused. This would be contrary to the understanding of fiduciary duties proposed by this thesis. The difficulty of this approach is the lack of clarity in the terms of reference. What truly makes a good trustee is highly context dependent. Honesty appears to be defined in terms closer to genuine subjective honesty in the context of s61 trustees[52] and closer to objective dishonesty in the context of s1157 company directors.[53] It is reasonableness however that seems to be the key criterion and the subject of more extensive discussion.[54] This follows the trend of a judicial preference for tests which carry a greater sense of objectivity and certainty, especially in the commercial context. The question of fairness appears to often be rather neglected, when it has been argued it should be central to the question. The fairness

[50] *Supra* n25, p564
[51] Conaglen, M; *Fiduciary Loyalty: Protecting the Performance of Non-fiduciary Duties* (2010, Hart:Oxford)
[52] *Nationwide Building Society v Davisons Solicitors* [2012] EWCA Civ 1626
[53] *Bairstow v Queens Moat Houses* [2001] EWCA Civ 712
[54] At least in terms of section 61, see Haley *Supra* n25, p552 et seq

question could be seen as an attempt to codify the wider equitable discretion of the courts in relation to all equitable concepts, and encourage them to use it. The danger of course is always that there will then be insufficient consistency in the application of the rules.

Elsewhere in this thesis it has been argued that the inherent flexibility in the application of the fiduciary duty can be is essential to it providing a function which transcends the mere enforcement of proscriptive rules. The thesis has also outlined an interpretive approach that can lead to consistent decision making, but argued that codification will inevitably sacrifice either the consistency or the flexibility. The exculpatory provisions are an example of the difficulties posed by codification in relation to the question of equitable duty. It is debateable whether any of the constituent terms of the existing exculpatory provisions are adequately defined. The law commission in rejecting the idea of proposing a new exculpatory provision for fiduciary duties did so on the basis of the magnitude of the task involved, and the fact it therefore fell outside the scope of their review at the time. It is at least doubtful whether an effective provision in this context could conceivable be drafted.

2.2.4 Which duties are fiduciary?

Another question to consider is which duties arise from the fiduciary obligation and which do not. This is important as the more forceful equitable remedies are only available to enforce true fiduciary duties.[55]

In *Equity and Trusts* Hudson discusses the proper understanding of the fiduciary obligation and its possible expansion to recognise new fiduciary relationships.[56] He outlines two competing interpretations of the fiduciary obligation[57] called the “narrow model”, based on the dicta of Lord Millett in *Bristol and West Building Society v Mothew*,[58] and the “broad model”, following comments of Lord Browne-Wilkinson in *Henderson v Merrett Syndicates*.[59] In *Bristol* Millett LJ identifies four duties in a non-exhaustive list: a duty to act in good faith; a duty not to profit; a duty to avoid conflicts of interest, and; a duty not to act for personal benefit or that of a third party without informed consent.[60] Hudson calls this narrow because he considers all of these duties to be in pursuit of prohibiting dishonesty or promoting loyalty and confidence. In his broad model there are five duties: the no conflicts rule; the no profits rule; the confidentiality rule; an obligation to act in good faith in the best interests of the beneficiary, and; a duty of

[55] By this I mean remedies which mirror specific performance, are fully restitutionary, or which have the power to void impugned transactions.
[56] Hudson, A; *Equity and Trusts* 9th Edition (Routledge: London, 2017) Ch 14
[57] *Ibid.* pp 619-621
[58] [1998] Ch 1
[59] [1995] 2 AC 145
[60] *Supra* n58, p18

care and skill.[61] While this may not appear much broader in practice, the theoretical justification for the inclusion of the duty of care and skill is that Hudson considers the duties arise out of the fact that beneficiaries are dependent on their fiduciaries. Beneficiaries require protection from irresponsible and negligent behaviour as much as they require protection from dishonesty making a duty of care and skill desirable. In *Henderson v Merrett* Lord Browne-Wilkinson held that the duty of care and skill was not a separate head of liability but arose out of the fiduciary agreement to act on behalf of another[62] and elsewhere expressly identified "fiduciary duties of care".[63]

Other commentators have various lists of fiduciary duties. Finn in *Fiduciary Obligations*[64] identified eight headline duties, subdivided into a larger number of specific rules in detailed chapters on each.[65] This is more accurately described as a review of all fiduciary duties which apply to office holders rather than a suggestion of rules which apply in general, but he does not draw that distinction. He includes all procedural duties to which trustees are subject concerning the use of powers and discretions, which are not appropriate in other fiduciary relationships. This may be an expansive view of fiduciary duties which holds all such duties are of equal status and open to application where the specific relationship demands it, even if normally only applied in the context of a particular office holder.

Conaglen in *Fiduciary Loyalty*[66] takes the opposite approach and in reliance on Lord Millett in *Bristol* rejects the suggestion that a duty of care and skill is a fiduciary duty. He questions whether any procedural duties can be so and doubts whether a duty of good faith applied to a fiduciary is a fiduciary duty.[67] I do not propose to repeat Conaglen's recent work reviewing each of these duties in turn, however it is important to understand the criteria he applies in order to determine which duties are fiduciary. In *Bristol* Lord Millett states:

> "The expression "fiduciary duty" is properly confined to those duties which are peculiar to fiduciaries and the breach of which attracts legal consequences differing from those consequent upon the breach of other duties."[68]

Conglen bases his assessment on a strict interpretation of the phrase "peculiar to fiduciaries", and therefore rejects as fiduciary any duty which also arises in a non-fiduciary context. As a

[61] *Supra* n56, p621
[62] *Supra* n59, p205
[63] *Ibid.* p206
[64] Finn, P; *Fiduciary Obligations*, (1977, Law Book Company)
[65] *Ibid*. p15 et seq.
[66] Conaglen, M; *Fiduciary Loyalty: Protecting the Performance of Non-fiduciary Duties* (2010, Hart:Oxford)
[67] *Ibid.* Chapter 3
[68] *Supra* n58, p15

result he considers only the no-profits and the no-conflicts rule are fiduciary. This has the advantage of being neat analysis but it may not capture the full intention of Millett. Millett specifically endorsed the fiduciary duty of good faith doubted by Conaglen on the basis of Millett's earlier words. Millett's meaning is closer to Hudson, regarding duties which arise out of the peculiar nature of the fiduciary obligation as a guarantor of trust and confidence based on an obligation of loyalty. His endorsement of a statement by Justice Ipp to that effect supports this. It emphasises that a fiduciary duty "stems" from the "requirements of trust and confidence".[69] Less supportive of Hudson's analysis is that Lord Millett was also expressly rejecting the duty of care and skill as a fiduciary duty. He states that the fiduciary obligation has no "special legal consequences" for the equitable duty of care and skill and so it is not a fiduciary duty.[70]

Millett endorses the approach that those duties which arise out of the ethic of the fiduciary obligation laid out in this thesis, the protection of the relationship of trust and confidence, are those which are fiduciary. He also states that these can be identified by the fact that they attract different legal remedies, whereas a breach of an equitable duty of care and skill will only attract *in personam* money damages in the form of equitable compensation. A thorough review of the remedial consequences of the different candidates for status as fiduciary duties may be a useful avenue for further research, but time constraints prevent such an analysis here. One of Conaglen's decisions which may thereby be reversed is his approach to many of the procedural duties applied to trustees. As many of these attract drastic equitable remedies such as the voiding of transactions, Finn may be correct to classify them as simply fiduciary duties. This makes it possible that were procedural considerations relevant in a case of an ad hoc fiduciary relationship, a duty could be applied in pursuit of the ethic of the fiduciary obligation, the protection of trust and confidence.[71]

The attraction of Hudson's broader approach is that it creates the potential to use the fiduciary duty in a robust manner to ensure more complete justice is done in a greater range of relationships where there is vulnerability. His suggestions for relationships where expansion

[69] *Ibid.* p17 endorsing comments from *Permanent Building Society v Wheeler* (1994) 14 ACSR 109, p158
[70] *Ibid*. p16
[71] Note however *Paragon Finance v Thakerar* [1999] 1 All ER 400 in which the Court of Appeal reject the suggestion that the procedural duty of an agent to account to his principal is a fiduciary duty for the purposes of avoiding the Limitation Act 1980. They discuss a long line of case law in agency establishing this obligation as arising in a uniquely contractual manner, as distinct from its application in the case of a trust. The judges choose to apply the contractual model rather than a fiduciary analysis on the facts of the relationship. Any question of procedural behaviour by the fiduciary is therefore potentially subject to a factual analysis of whether a duty is fiduciary or not in the circumstances. This is more evidence in support of Millett's analysis of the importance of the availability of uniquely fiduciary remedies. An *in personam* claim for money arising out of breach of duty was not susceptible to analysis as a breach of fiduciary duty.

could occur include mortgagor and mortgagee, a topical subject in the wake of a financial crisis caused in part by irresponsible lending, and abuser and abused, again topical given recent events.[72] While not current law, such developments are worth consideration. Kay,[73] discussed in Chapter 1, also has higher ambitions for the use of the fiduciary duty, discussed in more detail in Chapter 5.

A key driver of expansion may be the duty of good faith, as this is arguably the duty of most general application outside of care and skill. It has the potential to attract the more potent and drastic proprietary equitable remedies. *Item Software v Fassihi*[74] demonstrates the potential of this duty. A director advised the owner of a company to take a hard line in contract negotiations while secretly making preparations to submit a competing bid. Lady Justice Arden stated that while a fiduciary did not owe a separate duty to disclose their own misconduct, in this case the fiduciary was required to do so by what she described as "the fundamental duty to which a director is subject",[75] the duty to act in good faith to promote the interests of the company. In particular she praised the generality and flexibility of this duty which was not dependent on any particular case of context. She also emphasises that good faith is a characteristic duty of loyalty, and it would seem strange indeed if all fiduciaries were not also subject to similar duties. What stands out from *Item Software* is the potential of a duty of good faith to catch behaviour which clearly falls short of the expected standards required in a fiduciary relationship of trust and confidence, but which did not neatly fall within the application of the other duties. More recently in *Shepherds Investments Ltd v Walters*[76] Etherton J called this "a straightforward application of ordinary principles of equity concerning fiduciary duties".[77]

The question of which of the duties of fiduciaries are fiduciary duties is therefore one which still poses problems and would benefit from clear clarification by the courts. It would be simple for the issue to be resolved clearly at the next judicial opportunity, drawing together the various statements made by different judges in a range of different circumstances affected by the fiduciary obligation. The resolution could take the form of a definitive test for when a duty is fiduciary but equally in the cases of some duties a simple yes or no might be advantageous. This review suggests that the correct approach is that the duties which are fiduciary arise as

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[72] *Supra* n56, p622-626

[73] *Final Report of the Kay Review of UK Equity Markets and Long-Term Decision Making* 2012 http://webarchive.nationalarchives.gov.uk/20121204121011/http://www.bis.gov.uk/assets/biscore/business-law/docs/k/12-917-kay-review-of-equity-markets-final-report.pdf, last accessed July 2018.

[74] [2005] 2 BCLC 91

[75] *Ibid.* para 41

[76] [2007] 2 BCLC 202

[77] *Ibid.* 231, this is not to say that the duty of good faith is without its problems. See Chapter 5 for discussion of the cases of *Cowan v Scargill* [1985] Ch 270 and *Harries v Church Commissioners for England* [1992] 1 WLR 1241.

a consequence of the obligation of loyalty which is owed in a relationship of trust and confidence. This includes universal application of the no conflicts, no profits, and confidentiality rules, along with a duty of good faith to promote the interests entrusted or undertaken by the fiduciary, with the caveat that the extent of such a duty and its effect on permissible and impermissible actions is a fact sensitive question. Procedural duties which apply to fiduciary office holders can be applied to ad hoc fiduciary relationships under such a test, but this will depend on their appropriateness to a specific relationship, which is again a mixed question of fact and law to be determined by the judges in individual cases.

Rationale for censure of conduct in breach of fiduciary duty

2.3 Role of Unconscionability in Equity

2.3.1 Equity and morality

The difficulty in the above approach to fiduciary duties is that judges may be asked to make moral or quasi-moral decisions about what conduct is and is not appropriate in any given relationship in deciding the content of the fiduciary obligation.[78] If judges must look to the protection of trust and confidence in a fiduciary relationship as the rationale that explains the imposition of the fiduciary obligation then they may be required to delve too deeply into private affairs and apply standards which may be inconsistent and arbitrary.

However, this is probably an overstatement of the problem. Firstly, because the rationale for the fiduciary obligation proposed here and the manner in which a relationship can modify its content is limited in its application. It will only ever be necessary to ask such questions in borderline cases, which by their nature already involve difficult judicial decision making. In the majority of cases of breach of fiduciary duty, the position will remain straightforward. The rules applicable to established categories of fiduciary will remain largely unaffected. Secondly, the decision is not as vague or as moral as it may first appear. Judges are not required to decide whether fiduciary behaviour was immoral or against social norms, rather they are asked to decide the legal level of trust and confidence placed in the relationship. This decision will normally be based upon the established principles which govern relationships of the same type. It is also not rights and wrongs that fiduciary duties require a judge to decide, rather it is a fixed standard of loyal behaviour which will be strictly enforced.[79]

[78] Peter Birks once said "the lawyer who deals in 'unconscionable behaviour' is rather like the ornithologist who is content with 'small brown bird'". Birks, P; "Equity in the Modern Law: An Exercise in Taxonomy" (1996) 26 *University of Western Australia Law Review* 1, at p16

[79] Millett, P; "Bribes and Secret Commissions Again" [2012] 71(3) CLJ 583

The starting point will always be the total avoidance of conflicts of interest and unauthorised profits.[80] However, the needs and expectations which govern a complex commercial relationship may modify that basic position where the conscience of the parties is affected differently from the normal standard. The likely modifications to the fiduciary duties themselves should generally be plainly apparent. The fiduciary can ask themselves a simple question to avoid censure: could my behaviour be said to call into question the trust and confidence that has been placed in me by virtue of my position? If the answer is yes the fiduciary can avoid such behaviour and will never fall foul of this legal regime.

This may still leave a gap in certainty for a fiduciary, and a potential discretionary sphere that could lead to judicial decisions on moral issues. There is a limited range of behaviour which in impinges minimally on the trust and confidence of a relationship but which could also be said to be rational and valuable economic behaviour in the context of that relationship. In *Kelly v Cooper*[81] the difficult question is how much further the fiduciary estate agent could have gone in putting themselves in a position of marginal conflict before it could be said their behaviour offended against the trust and confidence of the relationship and was a breach of fiduciary duty. It is clear that merely selling two adjacent houses to one buyer did not offend. It would be equally clear that taking a commission from the buyer for finding him a deal to buy two houses together, without informing the sellers, would offend. But would a breach have occurred if the buyer had approached the estate agent to find 2 adjacent houses without offering any incentive other than the prospect of a double sale? My sense of the duty is probably it would. The instruction of the agent to find two properties would predate the relationship with the sellers and so would require disclosure or the contracts with the sellers would be based on a conflicted interest. The estate agent would in some senses be acting for the interests of both the seller and the buyer. However, it is perfectly conceivable that others might conclude differently given that set of facts, and so there is an inherent uncertainty and discretion. While this certainty gap remains, over time the decided cases will establish more principles and guidelines which govern these difficult cases, and answering them will become easier.

This situation is no great cause for concern. It is not necessary or possible that the law should be so certain in advance that every detail of every case can be predicted. It is also unnecessary to take such a positivist approach to fiduciary duties given that they are a requirement placed on actors at Equity. It is an uncontroversial fact that the Court of Equity began as a court of conscience and evolved into a form of legal conscience, governed by legal

[80] *Bristol West & Building Society v Mothew* [1998] Ch 1
[81] [1993] AC 205

norms and not moral ones. It is still designed to mitigate against harsh and unjust outcomes in the Common Law.[82] The approach set out here to fiduciary duties is quite consistent with the general approach taken by Equity to complex legal problems and is effective as a result.

2.3.2 Equity and Unconscionability

Halliwell in *Equity and Good Conscience*[83] takes this further and explains all of the jurisdiction of Equity in terms of legal provisions to restrain unconscionability. For her, unconscionability is a unifying concept which could underpin the jurisdiction.[84] All of its provisions and rules are a means of protecting legal conscience, not merely by sanctioning wrongful and illegal behaviour but also by preventing unconscionability. Halliwell states that unconscionability enforces a minimum standard of behaviour in the legal relationships governed by the equitable jurisdiction.[85] This allows for expansion and development of the law on the basis of social norms. She rejects the idea of defining the criteria which govern unconscionability favouring instead the view that unconscionability is a matter of any conduct which falls short the minimum conscionable standard of behaviour in each context where the question arises.[86] She believes that this approach has served to "rejuvenate" equity[87] by allowing it to expand its horizons into new areas of law and to provide innovative solutions which do greater justice than the common law.

Unconscionability has been at the forefront of recent developments in the equitable jurisdiction. In *High Trees*[88] the concept of promissory estoppel was developed to restrain behaviour which would break a promise of legal character in a manner which the courts deemed unconscionable. In *Barclays Bank v O'Brien*[89] unconscionable exploitation of the vulnerable through undue influence developed into a fully-fledged legal doctrine. Situations of duress have long been subject to equitable relief on the grounds that such behaviour is unconscionable in a commercial and wider legal context. Halliwell argues that the decision in *Westdeutshe*[90] is a compelling example of the primacy of conscience in the equitable jurisdiction. It was decided that no constructive trust arose in the case as that would have

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[82] *Supra* n3
[83] Halliwell, M; *Equity and Good Conscience* (2nd Ed 2004, London; Old Bailey Press)
[84] *Ibid.* p152 et seq
[85] *Ibid.*
[86] *Ibid.* p10-21 and p152
[87] *Ibid.* p158
[88] *Central London Property Ltd v High Trees House Ltd* [1947] 1 KB 140
[89] *Barclays Bank v O'Brien* [1993] 4 All ER 417
[90] *Westdeutsche Landesbank Girozentrale v Council of the London Borough of Islington* [1996] AC 669

required the conscience of the local authority to be affected.[91] It could not have been affected because their receipt of money only became erroneous as a result of a subsequent judicial decision invalidating a widespread commercial practice of interest rate swapping. At the time of receipt their actions were innocent.

Halliwell's difficulty is that unconscionability in each of these examples operates a different way and the word itself has little fixed meaning. In promissory estoppel the unconscionability occurs when the defendant unexpectedly goes back on their legal but non-contractual word. In undue influence it occurs when an actor uses a personal relationship or the vulnerability of another to gain financial advantage. In recipient liability the conscience requirement is that an actor is objectively said to be aware they have received a mistaken or fraudulent payment and it would be unconscionable for them not to be a resulting trustee. Little unites these ideas except that each outcome is wrong and unjust. Halliwell confronts this criticism with the point that each individual example is not itself uncertain in its application. As the law develops the use of unconscionability will become more defined and clear for different sets of factual circumstance.[92] Her argument is that the examples are all unified by the idea of unconscionability because Equity is a court of conscience and each example requires more perfect justice than is done by the common law.

A similar approach to conscience in Equity, in the form of the legal concept of unconscionability is set out by Hudson.[93] He asserts that conscience itself is "objectively constituted"[94] in that it is a common virtue of mankind to have an internal voice which guides us as to right and wrong.[95] He considers this justifies using unconscionability to make the law more just and flexible in novel situations, alongside a careful reading of case law to define the term in the context of any given set of facts.[96] *Cobbe v Yeoman's Row* offers some support for this approach. Lord Walker argued that unconscionability "should always be used … as an objective value judgement on behaviour".[97] This endorse Hudson's approach to a degree but not his more radical conclusions.[98]

This thesis sets out the view that there can be identified a clear 'ethic', an issue of conscience, which underpins the legal rules which are applied to the fiduciary obligation. Once

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[91] *Supra* n46 Chapter 5, reaching a conclusion to this effect at p144
[92] *Ibid.* p147 - 152
[93] Hudson, A; "Conscience as the Organising Concept of Equity" (2016) 2(1) CJCCL 261
[94] *Ibid.* p264
[95] *Ibid.* p277 - 279
[96] *Ibid.* p264 and p279 et seq.
[97] *Cobbe v Yeoman's Row Management Ltd* [2008] 1 WLR 1752 p92
[98] *Supra* n93 p297 – 298 Hudson appears to express support for the use unconscionability as an independent cause of action.

the court has identified this ethic it can be analytically applied to the facts of the case to determine whether or not the actions of the fiduciary in question are within the conscience of the court to uphold or must be dis-applied due to unconscionability. In a sense this does make unconscionability an organising concept. Not because it is a concept which itself has particular content, but because it is a guide which points judges towards the relevant questions that must be answered in order to decide cases in a just and consistent manner. Specific examples of this approach are examined and developed in Chapter 3 and 4 of this thesis, focusing on the case law on secret profits and bribery and then on a number of different analytical controversies which have developed at the boundaries of fiduciary law in a business context.

2.3.3 A functional approach to Equity

Worthington proposes a more functional approach to Equity, unconscionability and consequently also fiduciary duties.[99] To Worthington Equity is composed of legal rules which are no different in character to common law rules and that the mysticism surrounds the jurisdiction is simply uncertainty and inconsistencies resulting from absence of a sound analytical basis.[100] For her the function of Equity historically was to distinguish certain types of rights which required greater protection. It allowed the law to give special attention to property rights and to protecting those vulnerable to exploitation by more powerful interests.[101] Equity produced rules which overcame the developing complexity of property law by creating flexibility and the ability to separate beneficial ownership of property from possession and legal ownership. It stimulated social and economic advancement by ensuring security for the beneficial owner and efficient use by the legal owner.[102] Worthington says that these rules could have been developed either at Common Law or at Equity. That it is only by an accident of design these developments were made by the court of conscience, because it was more flexible to changing social and economic institutions. Her conclusion is that Equity should be subsumed into the Common Law and those valuable and analytically justifiable rules of Equity will become Common Law rules where appropriate.[103]

Worthington contends that unconscionability is similar in function to *Wednesbury*[104] unreasonableness in public law. Describe unconscionability as a standard of conduct but regarding it as a means of establishing bad faith by demonstrating no reasonable trustee

[99] *Supra* n1
[100] *Ibid.* p17 - 21
[101] *Ibid.* Chapter 2
[102] *Ibid.* Chapter 3 and Chapter 4
[103] *Ibid.* p17 – 19 and throughout.
[104] *Associated Provincial Picture Houses v Wednesbury Corporation* [1948] 1 KB 223

would have taken such a decision. It demonstrates an abuse of power so stark that it does not require any moral analysis by a judge to investigate, he can simply apply the relevant equitable rules to achieve its resolution.[105]

Worthington would not claim this is an accurate picture of the Law of Equity as it stands today. It is a route that could be used to simplify and streamline the law. However, my thesis is that equity accomplishes far more if the conscience element of the jurisdiction and its independence from the common law are maintained. In a way Worthington has actually demonstrated the reason for allowing conscience to play a role in the development of the law. Society has not ceased to evolve, and there continue to be challenges to the justice and flexibility of the Common Law by complex sets of facts. Equity and conscience provide a means to ensure the law keeps pace with these developments. Taking unconscionability in relation to promissory estoppel as an example, the unconscionability requirement on a *Wednesbury* unreasonableness standard is clearly satisfied by the change of financial position and the severity of the consequences of the outbreak of war for the tenant in *High Trees*[106]. However, the requirement is much less likely to be satisfied in the case of *Collier v Wright*.[107] A man agreed to keep repaying his share of a debt for which he was jointly and severally liable, on the understanding that he would not have to repay the share of his partner who had gone bankrupt. Here the unconscionability may not meet the criteria of *Wednesbury* unreasonableness as it is debateable whether he suffered any detriment on being forced to repay the full amount. However on a standard understanding of unconscionability which can encompass the relevant circumstances of the relationship the injustice is clear. There is a power imbalance between the customer and the commercial creditor. Providing no protection to the debtor from dishonest assurances that his debt will be discharged if he pays a little more encourages unethical business practices and exploitation. There is a clear legal wrong and a straightforward resolution; hold the creditor to their word. The law is certain enough to reach a clear and analytically coherent result at the same time as providing a more just outcome and producing valuable social consequences.

Similarly, fiduciary duties founded on equitable principles that can countenance both a higher ethical standard of behaviour and a relationship specific flexibility can do a lot of good. They have the potential to not only enforce the avoidance of self-interest, but also to enhance the security and trust and confidence in commercial relationships. Kay suggested they may

[105] *Supra* n2, p144
[106] *Supra* n88
[107] [2007] EWCA Civ 1329

assist in spreading fiduciary standards of behaviour into the wider business environment not strictly encompassed by the rules themselves.[108]

2.4 Conclusion

The law on the fiduciary obligation is complex because it serves very many legal objectives. On a simple level it prohibits certain types of behaviour, providing a strong remedy in cases of obvious wrongdoing. A fiduciary claim provides a simple action and a strong remedial response when a dishonest fiduciary appropriates trust property. The fiduciary will be held strictly liable for the missing property, the remedy against the wrong will be proprietary, not merely personal, and will be against not just the stolen trust property itself but also effective against any assets which were bought with the property. The beneficiary can also claim for the disgorgement of any profits made by the fiduciary or to pursue a personal claim against him if the property is lost or depleted. From a more complex perspective the fiduciary duty has the potential to increase the trust and confidence in the relationship and make the instance of dishonesty by fiduciaries less likely. It also has the potential to introduce fiduciary concepts and promote fiduciary standards in the wider commercial environment by exercising soft law power in number of different ways.

Fiduciary duties, like any aspect of Equity, are designed to produce law which is more just by mitigating against harsh results imposed by the strict application of Common Law and by ensuring there is a remedy where wrongdoing has avoided censure. Contrast for example the function of Equity in *Pennington v Waine*[109] where the principles of Equity and fiduciary responsibility intervened to complete a gift which otherwise would have been defeated, contrary to the intentions of the settlor and proper justice, with *AG for Hong Kong v Reid*[110] in which a dishonest official was stripped of land and profits obtained through accepting bribes while holding public office, through an expansive use of fiduciary concepts. It is a high demand placed on this area of law to provide just outcomes to varied and complex facts, and also provide a backstop against injustices occurring at both ends of the legal spectrum.

One of the functions of fiduciary duties which it is clear is present but which is difficult to fully rationalise and analyse is the ability of the fiduciary duty to operate as a deterrence to behaviour which is dishonest or exploitative by the fiduciary. Clearly since the duty is enforced

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[108] *Final Report of the Kay Review of UK Equity Markets and Long-Term Decision Making* 2012 http://webarchive.nationalarchives.gov.uk/20121204121011/http://www.bis.gov.uk/assets/biscore/business-law/docs/k/12-917-kay-review-of-equity-markets-final-report.pdf, last accessed July 2018.
[109] [2002] EWCA Civ 227
[110] [1993] UKPC 36

strictly and no excuse can be given or evidence produced demonstrating benefit to the beneficiary, a dishonest fiduciary knows there is little room for manoeuvre in attempting to extract any unauthorised rent by virtue of his position. The deterrence effect of fiduciary duties is not straightforward, because it is debateable whether deterrence can be easily achieved through duties which target specific relationships and indeed it is questionable whether the greatest problem with dishonest fiduciaries is holding them to account or is more a matter of detection and evidence. Part of the value of having fiduciary duties formulated on a basis where the concepts which govern the standards of behaviour are not overly detailed, is that the detail cannot be exploited in order to avoid the law through innovative non-compliance. Since a fiduciary knows that the relationship in which he operates will form an important part of the enquiry into whether he has breached his duties, it is difficult for him to avoid the effect of the rules. Fiduciary duties provide an ingenious way of making compliance with merely the letter of the law and not the spirit difficult. Both in that the fiduciary duties are generally strict in their application, and in that they still retain some flexibility.

This Chapter has shown that the fiduciary obligation and fiduciary duties provide a remarkably coherent response to the issue of the power a fiduciary has over the beneficiary and the potential for him to abuse that power. They focus on the wrong which is created merely by a fiduciary's behaviour undermining the trust and confidence in a relationship, as well as all the consequences that may flow from that. By this fiduciary duties create a tightly controlled system of loyalty while still retaining the necessary flexibility for such relationships to operate in both private and commercial contexts. This is quite consistent with the approach taken by Equity in protecting the conscience of the law. Judges are not required to make moral decisions but rather need only apply ethical legal reasoning to the relationship between the relevant parties. This clarifies which of many possible equitable rules should apply to promote just outcomes in difficult factual scenarios.

Chapter 3

The Question of Remedy for Breach of Duty by Secret Profits and Bribery

3.1 Introduction

One of the foremost issues in recent case law concerning the fiduciary duties in a commercial context has been the question of when a breach of duty which results in an economic benefit for the fiduciary gives rise to a proprietary remedy. It is uncontroversial that when a fiduciary acquires property which should properly belong to his trust he holds that properly on behalf of the trust. The more difficult question is when property should properly be said to belong to the Trust. Obviously any economic benefit which is derived from the misappropriation of existing trust property belongs to the trust, as do any profits generated by the use of that property. However the early 18th Century case of *Keech v Sandford*[1] gives rise to another important circumstance where property acquired in breach of fiduciary duty is held on behalf of the trust. In that famous case a trustee of an estate held for a minor took a lease on commercial property that had previously been used for running a business belonging to the estate as a new lease could not be granted to the minor. The court held that despite the fact it would have been impossible for the minor to acquire the lease for themselves, that the fiduciary held the lease on trust for the estate. This case established that a proprietary remedy is also available where a trustee has acquired a benefit which came to his attention or became available as a result of his fiduciary position.

The application of this principle has proved highly controversial, and resulted in significant contradictory case law, as it has proved hard to establish what the correct limits are in application of the idea of a benefit which is acquired by a fiduciary as a result of his position. At the heart of the matter is the question of what benefits it is right for the law to find belong to the trust; why is it that a particular piece of property, acquired in breach of fiduciary duty, should belong to the trust?

It should be noted that there is no dispute over the fact that in any case of fiduciary duty, the beneficiary has a personal remedy against the fiduciary who is in breach. They are entitled to an account of the trust. If losses have resulted to the trust as a result of the breach of the fiduciary, the fiduciary will be liable for their restoration, and if the fiduciary has acquired and benefit as a result of their breach of fiduciary duty then they are liable to account for that profit and to pay it over to the beneficiary. The question which is controversial is simply the

[1] [1726] Sel Cas Ch 61

issue of when the benefit is in fact held by the fiduciary as trust property, when through a constructive trust, the law treats that property as belonging to the beneficiary from the time it is acquired by the fiduciary onwards.

The main factual scenarios in which this issue has arisen in the case law are in claims which involve a fiduciary who has taken a bribe or made an unauthorised or secret profit by virtue of his position. A classic example of this would be the facts of the recently decided leading case on this issue *FHR European Ventures LLP v Cedar Capital Partners LLC*[2] (also referred to here as "*Mankarious"* after one of the parties in the Court of Appeal[3]). In that case an agent for a company buying a hotel also took a finder's fee from the seller as a result of the transaction. In this case, reversing the judgment of the Court of Appeal, both in this case and in a case from just three years earlier[4], the Supreme Court held that the secret commission was held on trust for the beneficiary, in this case the hotel purchasers. As stated above, the core dispute is not whether the beneficiary should be entitled to a remedy to take the profit made in breach of fiduciary duty, but whether this profit should be treated as held on trust for the beneficiary as soon as it is received. To answer this question in the affirmative it must be justified why the property should rightly belong to the trust when it is not a benefit or potentially is not even a benefit which arises from an opportunity which is available to the trust or beneficiary themselves. This is not an easy question to answer either in theory or in practice.

This question of when a proprietary remedy should be available, when property acquired in breach of fiduciary duty should belong to the trust strikes right at the heart of the complexity which surrounds the English law relating to the fiduciary duty. In *Bristol and West Building Society v Mothew*[5] Millett LJ said that the relief accorded by equity is "primarily resitiitutionary or restorative in nature rather than compensatory".[6] If we take this to be the case then the application of a proprietary response in a case of breach of fiduciary duty should be a means of restoring something which otherwise might be lost, of using the remedy to allow equity to look on as done which ought to be done, as the maxim goes. Immediately this seems to pull in both directions in deciding the key question. On the one hand the proprietary remedy in the case of bribes or secret profits does not merely restore, it treats as property of the trust something which could never have been so, it actually seems to generate rights in the property in question out of the air. The rights appear to come from the wrongdoing of the fiduciary, not the existing property rights of the beneficiary. On the other, not to find that that the fiduciary holds the property on trust fails to hold the fiduciary to the highest available standard in the

[2] [2014] UKSC 45
[3] [2013] EWCA Civ 17
[4] *Sinclair Investments Ltd v Versailles Trade Finance Ltd* [2011] EWCA Civ 347
[5] [1998] Ch 1
[6] *Ibid.* para 18

very cases where their breach of trust is most egregious. It does not look on as done as ought to be done in that it fails to restore an outcome which is consistent with reputable behaviour by the fiduciary.[7] How the law chooses to resolve this clash has important implications for fiduciary duties more widely and their role in the law. If a model of fiduciary duties which draws them as a limited legal instrument which is designed merely to protect beneficiaries against losses which result from the behaviour of their fiduciary agents then there are good reasons why from an analytical perspective it could be a mistake to extend the use of a proprietary remedy to cases which do not result directly from the use of trust property or trust opportunities.[8] If the role of fiduciary duties is seen more as part of a legal framework which creates a safe environment for the use of property agents and trustees then there are equally good reasons why a proprietary remedy should be preferred in a wider range of cases where fiduciaries benefit from breach of their duties.

This Chapter advances scholarship in this area by providing a detailed and analytical history of the case law which led to the decision by the Supreme Court in *FHR European Ventures*[9]. It demonstrates the way in which conflict between two different types of analysis, examples of which have existed in case law since the earliest decisions, have created controversy and uncertainty. This in turn has led to a long and potentially irresolvable conceptual dispute over the proper application of the proprietary remedy. This dispute provides the opportunity for the new approach to fiduciary duties proposed in the previous Chapters of this thesis to be tested, and it is found to provide a useful way forward.

3.2 The proprietary remedy and the case law history

3.2.1 The Imposition of a Proprietary Remedy for Breach of Fiduciary Duties in Early Case Law

The 19th century saw significant development in the law relating to equity and trusts, and the law relating to fiduciaries was no exception. The interaction between the increase in national wealth, property and commercial activity brought on by industrialisation and the complex social and financial arrangements arising from Victorian ethics led to a plethora of different factual scenarios of agency and trusteeship which might require legal intervention. In the judgments dating to this period there is a clear pattern in the behaviour of the court of equity, demonstrating a strong desire to ensure there was no space left by the law which could

[7] Millett, P; "Bribes and Secret Commissions Again" [2012] 71(3) CLJ 583
[8] Worthington, S; "Fiduciary Duties and Proprietary Remedies: Addressing the Failure of Equitable Formulae" [2013] 72 CLJ 720
[9] *Supra* n2

be exploited by the dishonest agent or trustee. There is also a nearly unquestioned assumption by the judges at that time that where a fiduciary had derived an unauthorised benefit by virtue of his position, then it was clear at equity that he could not have acquired that benefit for himself and therefore must hold it on trust for his principal or beneficiary.

In the case of *Carter v Palmer*[10], a leading House of Lords decision of this time, the court considered the case of a barrister who, having advised a client on the enforceability of certain deeds of debt against his property, later purchased those securities for himself and sought their enforcement. The court of course took it as completely uncontroversial that a legal representative was prevented from using information he had obtained from his trusteeship of the interests of a client for his own benefit, especially as against that client directly. What is most enlightening is the simplicity of the court's reasoning when it came to the use of constructive trusteeship as an available remedy:

> "I am therefore of opinion that Mr. Carter had been incapacitated, by the character of his employment, from purchasing, for his own benefit, these securities upon his employer's property, and that such incapacity continued at the time of his purchase, and consequently that he is to be considered as having so purchased for the benefit of his former employer."[11]

The "no profits" and "no conflicts" rules which together compose the fiduciary obligation in the modern law were understood in practice by Lord Cottenham in *Carter* as constituting legal disabilities. The reasoning makes it clear that in the law as equity as it stood at the time the purchase of the securities by the legal representative, Mr Carter, could not be regarded as a transaction for his own benefit and therefore it must be treated as a transaction for the benefit of his principal. This is quite a radical analysis. The answer to the question of why the beneficiary should have property in the profits of the unauthorised benefit of a fiduciary in this case is simply that the benefit cannot be legally regarded as belonging to the fiduciary at equity and therefore must belong to the beneficiary.

Exactly the same line of reasoning appears in the judgment of Lord Justice Knight Bruce 16 years later in the Privy Council case of *Bowes v City of Toronto.*[12] The Mayor of Toronto, a member of the Corporation of Toronto, had purchased debentures issued by the Corporation to fund the building of a railroad and he had made a considerable personal profit on this purchase. In finding that these debentures were held on trust by Bowes for the benefit of the people of the city, the Privy Council again used the language of "incapacity" in justifying

[10] (1842) 8 CL & Fin 657
[11] *Ibid.* para 707
[12] (1858) 11 Moo PC 463

why it was that the Appellant could not be seen as sole owner at equity.[13] The logic of the position is fairly straightforward. If the fiduciary cannot take the property for his own benefit, and yet he has taken it, then equity will regard the property as taken on trust for the benefit of the principal. Obviously there is a legal fiction at work here, since it is clear that in each case the fiduciary, in fact, did take the property for his own benefit. However, in the 19th Century it was seen as perfectly straightforward for the legal position at equity which was created by the actions of a fiduciary to be different from what was intended.

In the above cases, the court did not go as far as stating that there had been any dishonesty on the part of the fiduciary, such as is the case when a bribe is taken. However, it is clear in those decisions that the reason the fiduciary cannot take equitable ownership of the unauthorised benefits is because it would create moral hazard and would be unconscionable. This is stated quite explicitly in two cases which appear to result from a greater level of dishonesty by the fiduciary and could be termed examples of bribe taking or fraudulent behaviour.

In *Fawcett v Whitehouse*[14] an entrepreneur negotiating on behalf of a new partnership, in which he would be a partner, to take over a mining lease took a large payment from the previous tenants for ensuring that an assignee could be found to take over the lease without the knowledge of his fellow partners. In the bill pleading the case on behalf of the plaintiffs it is interesting to note that it was charged and was accepted by the court that accepting this payment must have deprived the partnership of an equivalent amount which could have been negotiated in taking over the lease.[15] In his judgment Lord Chancellor Lyndhurst stated that the transaction by which the respondent was paid the money was one which it would be "impossible for this Court to sanction".[16] The clear implication of this reasoning is that in deciding such a case the Court of Equity is acting as arbiter of the legality of the transaction by which the fiduciary receives the unauthorised benefit. On finding it unconscionable in the eyes of Equity the Court instead finds that the transaction was conducted on behalf of the principal.

This quasi-moral judgement on the legality of the transactions of the fiduciary is even more apparent in the case of *Barker v Harrison*,[17] which concerned a land sale agent who received a payment from a purchaser to arrange a preferential sale. In a relatively brief and scathing judgement on this behaviour the Vice-Chancellor, Sir Knight Bruce states that:

[13] *Ibid.* para 518
[14] (1829) 1 Russ & M 132
[15] *Ibid.* para 134
[16] *Ibid.* para 148
[17] (1846) 2 Coll 546

> "If this view of the facts is, as I believe it to be, correct, it would indeed be a disgrace to a Court of Equity were such a transaction to be tolerated."[18]

It is clear that once again the emphasis is on the transaction conducted by the fiduciary and its unconscionability according to the law at Equity. In fact here the reasoning centres on the reputation of the court itself as a place which delivers justice according to conscience. In such a venue it is impossible to find the transaction of the fiduciary as legitimate and therefore in its place is substituted an effective transaction, conducted on behalf of the beneficiary, in which the unauthorised profit is held on trust by the fiduciary.

The legal analysis found in these 19th Century cases regarding the imposition of a proprietary remedy is in some ways quite different from the focus of modern literature. The latter tends to concern itself mainly with the question of why it is that the beneficiary acquires rights in property which was obtained apart from his interests or abilities to acquire, sometimes even illegally or through fraud. It searches for a difficult technical justification for why the law should behave in this way with regard to the property rights of the beneficiary. In these early cases the analysis is much more basic. Starting from the position that transaction by which the fiduciary acquires the benefit is unconscionable and therefore, perhaps illegal, perhaps void, perhaps simply not countenanced at Equity, it is unclear, these justices simply substitute a new transaction which would have been, if not perfect, at least more consistent and conscionable for a person in the office of the fiduciary by holding the transaction occurred for the benefit or their beneficiary. In doing this it is arguable that the Courts in these cases seem more concerned with issue of justice and conscience in fiduciary activities than they are with the strict confines of the law on acquisition and disposal of property rights. However, what is clear is that a trusteeship arises at law immediately a fiduciary completes a transaction from which they derive an unauthorised benefit, such that they hold that benefit on behalf of their beneficiary.

3.2.2 The Exclusion of Bribes from the Rule in *Lister* and Other Cases

As the law of Equity, trusteeship and fiduciaries developed further towards the end of the 19th Century, judges in these cases began to embark on a more advanced analysis of the law relating to constructive trusteeship. They begin to analyse in greater depth why it is that certain situations give rise to a situation where a fiduciary is found to hold property he attempted to acquire for himself on trust. This more technical analysis eventually led to the current debate surrounding the proprietary remedy as it is at this point that we find the first

[18] *Ibid.* para 554

cases which held that a fiduciary who took a bribe was a debtor to his principal under a personal duty to account for his dishonest gain and was not a trustee of that bribe, and thus the principal did not have property rights in the bribe or in items or profits into which that bribe was converted.

The more famous of these cases are two judgments involving Lord Justice Cotton in the Court of Appeal, *Metropolitan Bank v Heiron*[19] and *Lister & Co v Stubbs*.[20] In the former case a debtor had secretly paid a sum of £250 to a director of a bank to which he owed £3800 to engage that director to make representations to the other directors of the bank that the debtor was virtually insolvent, thus persuading them to accept £50 in settlement of the full amount of his loan. The defendant resisted a claim by the bank on the grounds that it was a debt action barred by limitation, more than six years having elapsed since the bank first became aware of his actions. However, if the director had become a trustee of the money then no such limitation could apply and the money would belong to the bank. In deciding that the money was held in the manner of an equitable debt, and that the claim therefore failed due to limitation, the judges in the case express their belief that there was no previous authority for a finding that the property would be held on trust. None of the cases discussed in the previous section of this chapter had been cited.

Essentially the argument was that since the property which the defendant acquired via the bribe was wholly separate from the property of the cestui que trust, no property rights could be carried over from the beneficiary into the secret payment, whether or not it was a bribe. Cotton LJ affirms this argument in direct terms when he states that:

> "Here the money sought to be recovered was in no sense the money of the company, unless it was made so by a decree founded on the act by which the trustee got the money into his hands. It is a suit founded on breach of duty or fraud by a person who was in the position of trustee, his position making the receipt of the money a breach of duty or fraud."[21]

Lord Cotton and the other justices found that no property rights for the beneficiary could arise in respect of a bribe paid to a fiduciary as the transaction by which the fiduciary acquired the property was one which was wholly separate from the subject matter of the trust.

In *Lister*, which has been most commonly cited as authority for the principle that a bribe paid to a fiduciary does not give rise to a proprietary remedy, Cotton LJ led the court and affirmed his earlier decision in *Metropolitan Bank*. He took the view that he was correct in his

[19] (1880) 5 Ex D 319
[20] (1890) 45 Ch D 1
[21] *Supra* n19, p325

earlier decision that an action lies against the dishonest fiduciary but that the proper action is an equitable account and that the resulting relationship is equitable creditor and debtor, not cestui que trust and trustee.[22] He was supported in this by Lindley LJ who agreed that there can be no trust. His reasoning is more interesting, as he stated that this is clear as a position of logic when one considers the consequences of the bribe being held on trust. He stated that the potential effect on third party creditors arising from the right of the beneficiary to acquire any profits which were generated from investment of the bribe "startle[d] him" and that therefore logic and practicality demonstrate that there can be no proprietary remedy in the case of a bribe.[23]

The reasoning in these cases has much in common with the modern debate. The difficulty of reconciling why it is that a beneficiary should acquire a beneficial interest in property acquired illegally which is not and could not be part of his trust is still a significant problem on an analytical level. The practical consequences identified by Lindley LJ are still considered to be some of the more pressing policy arguments against the imposition of a proprietary remedy in such cases. However, the reasoning is also arguably significantly flawed. First of all it would appear from the history of cases in the 19th Century that far from these cases being a continuation of the established principles of Equity, they in fact departed from previous decisions. Secondly it also appears that in their reasoning the justices stated their case with a little bit more force than was strictly accurate, even on the law as it stood at the time. They had not grappled with the clear principle of *Keech v Sandford*[24] that it was possible for a constructive trust to arise in a case where a fiduciary acquires property which came to his attention as a result of his trust, regardless of whether that property could be acquired by the beneficiary. Nor did it matter in that case that the transaction had not used or concerned trust property in any way. Thus Lord Cotton appeared to over-reach himself in his reasoning when he appears to find that a proprietary remedy can only be available where trust property is involved directly in the dishonest transaction. Lord Lindley is right to identify practical problems with the use of the proprietary remedy, but is not correct to find that this alone constitutes a reason why it cannot be used in this specific case above others. He does nothing to distinguish a constructive trusteeship which arises from the bribery of a fiduciary from one in which the fiduciary misapplies trust property directly for his own benefit.

In some ways the most interesting case from this period is the earlier and often overlooked case of *Tyrrell v Bank of London*[25]. This case has complex facts and hits more

[22] *Lister & Co v Stubbs* (1890) 45 Ch D 1 at pg 13
[23] *Ibid.* pg 15
[24] (1726) Sel Cas Ch 61
[25] (1862) 10 HL Cas 26

directly at some of the difficulties in drawing a clear distinction over what should and should not be considered to be held on trust for a beneficiary where a fiduciary has acted for their own benefit in breach of duty. A solicitor, Tyrell, was acting for a new Bank which was looking to buy property. He was approached by a man named Read with an offer to sell the bank a premises known as the Hall of Commerce. Read had acquired the right to buy this property along with a syndicate of nine others, who had paid a deposit of £1000 to secure the property at a purchase price of just under £50,000. They had also bought some of the surrounding land in this transaction. Read persuaded Tyrell to help him buy out the syndicate and help him sell the property to the Bank. They each took a 50% share in this venture but Tyrell kept his interest secret. Negotiating on behalf of the Bank Tyrell arranged the sale at a price of £65,000, excluding surrounding land worth £5000-£8000. Therefore he stood to gain a 50% share of profit of £15,000 and retained 50% ownership of the extra land. He even handled the transfer of the money from the Bank to himself and Read. When the Bank eventually became aware of Tyrrell's interest in the transaction, it sued him for breach of duty, alleging that he held his entire 50% interest in the property on trust for the Bank, both that which he and with Read had sold to the bank and the surrounding land they still owned.

In attempting to decide such a complex case the reasoning of the judges becomes equally complex and at times obscure. The end result can be straightforwardly explained. The court ordered that Tyrrell had held his interest in the main property on trust for the bank, and therefore also held the profit he had made from that transaction, likely around £7000, on trust for the bank. However, it rejected the order of the first instance judge that he also held his interest in the surrounding land on trust. Instead the judges ruled that as the transaction was dishonest, the Bank had the right to a money amount representing the profit Tyrrell had made on the sale contract and the profit he stood to make on the sale of the surrounding land. As the sale to the Bank had already covered the purchase price paid by Read and Tyrell this would be the full value of the surrounding land minus costs.[26] Lord Chelmsford noted that therefore the practical result of what was ordered was likely the same as if a proprietary remedy had been awarded as Tyrrell was solvent and able to repay the money.

This decision represents a subtle distinction between unauthorised benefits which do give rise to trusteeship and those which do not. Lord Westbury sets out the main line of reasoning as to why it was the case that the proceeds of the sale of the Hall were held on trust by Tyrrell but the proceeds of the surrounding land were not. He argues that the agency and control of Tyrell only extended so far as the main contract, that the property rights of the Bank could not be extended beyond that contract and that therefore the property in the surrounding

[26] *Ibid.* para 61

land fell entirely outside of the scope of his fiduciary obligations to the Bank.[27] Lord Chelmsford agrees but at times takes a more direct approach, he considers bribes directly and states that they cannot give rise to a proprietary remedy.[28]

In this case then there is a quite concerted effort to rationalise and keep consistent the expansion of property rights which can accrue to a beneficiary as a result of the misdeeds of his fiduciary. In places the reasoning rather breaks down. It is not at all clear why the surrounding land cannot be said to be an opportunity which Tyrrell should rightly have acquired for his principle. Especially given it was accepted to be the case that the profit he made on that land was dishonest and he was held liable to account for it. It could also be argued, given the way the judges lay out their view of the property transaction, that since the judges accepted that Tyrrell had in effect purchased his share of the Hall with money he held on trust, the Bank's purchase price, then he arguably also purchased his share of the surrounding land with the Bank's money, as Read and Tyrrell did not in fact complete payment on the land until they sold it to the Bank, at which time the original seller was paid. In fact, in the modern law, even prior to the decision in *Mankarious* it is arguable that such a case would give rise to a trusteeship of the surrounding land, even on a narrow interpretation, which would not apply a proprietary remedy in the case of bribes. It appears that the case could be analysed as a joint venture in breach of duty by Tyrrell and Read, or that of a bribe paid by Read to Tyrrell depending on the preferred interpretation of the facts.[29]

What is most relevant from a historical perspective is how in examining this set of cases, the style of the reasoning differs substantially from the reasoning in the case in the previous section in which a constructive trusteeship did arise. While condemnation of the behaviour of the parties is found in these three cases, and dishonesty is alleged or strongly implied on the part of the fiduciaries, this clearly forms no part of the reasoning. The questions of the conscience of Equity are almost entirely absent, save a few references by Lord Chelmsford in Tyrrell. Instead we find a concerted attempt to rationalise how a bribe could be held on trust for a principal as a matter of property law, with no answer being found, the trust is rejected. The focus clearly falls on the outcome as a matter of the strict legal rights of the parties, not as a matter of what is required by the nature of the relationship and the demands of Equity. This is a dichotomy which persists in the debate over the availability of a proprietary remedy right into the modern era.

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[27] *Ibid.* para 45-46

[28] *Ibid.* para 52-53

[29] For useful further reading on *Tyrrell* see Watts, P Q.C.; "Tyrrell v Bank of London - an inside look at an inside job" (2013) 129 LQR 527

3.2.3 The Continuation of the Exclusion in Modern Case Law

3.2.3.1 Secret Profits

In 20th Century case law the ratio for the imposition of a proprietary remedy in secret profit cases develops further and become more complex. No longer is the issue decided purely on the basis of the conscience of Equity and the fact that the fiduciary could not in good conscience enter into the transaction for his own benefit. This approach evolves into one which considers the fiduciary a kind of agent who safeguards the interests and acts on behalf of his beneficiary. Therefore all transactions in the purview of this agency must be for the benefit of the beneficiary.

The first shoots of this analysis can be seen in the Privy Council in the case of *Cook v Deeks*.[30] The facts of the case were summarised by Lord Buckmaster LC. A group of four businessmen, including the two Deeks brothers, formed a railway construction company in Canada ("the first Company"), of which all were directors. They repeatedly obtained lucrative contracts from the Canada Pacific Railway Company ("CPRC") to build new rail lines, and worked almost exclusively for this larger company. At some point there was a falling out between Mr Cook and the rest of the group and the other three planned to split from him. To this end they pursued a tender on the latest CPRC contract exclusively on their own behalf and set up a new company ("the second Company") to secure this contract. During this negotiation Mr Cook was not warned of their intentions. Once the contract was signed on behalf of their new company the three directors used their voting power in the 1st company, of which Cook was still joint owner and director, to ratify their actions and to put that company into voluntary liquidation. They then planned to buy its construction assets and use its expertise and infrastructure for the second company.

Lord Buckmaster when setting out these facts is at pains to emphasise that the three respondents in this case used their long relationship with CPRC as directors of the first Company in order to negotiate for the contract which was at the foundation of the second Company. He also noted how they used their power and influence in the first Company, whose rights they were bound to advance and protect, to exclude that very company from their lucrative business. The Court of Appeal in the case, even though it essentially decided to accept they had the power to ratify their actions, spent much time considering hypotheticals as to whether the respondents had deprived the first Company and Cook of an opportunity to

[30] [1916] 1 AC 554

obtain the contract.[31] The rationale which the Privy Council then adopts in allowing the appeal, as set out by Lord Buckmaster, follows naturally:

> "men who assume the complete control of a company's business must remember that they are not at liberty to sacrifice the interests which they are bound to protect, and, while ostensibly acting for the company, divert in their own favour business which should properly belong to the company they represent"[32]

This analysis is one of obligation mixed with agency. The Directors are acting as agents for the company and the benefits of their actions must be for the company. The reasoning of the earlier cases is still present, the learned judge also states that the key question is not the ability to ratify the decision but whether the Directors were at liberty to enter the contract for their own benefit in the first place.[33] However, it is mixed with a more technical analysis which attempts to rationalise and develop a 'chain of property' which justifies why the first Company has a proprietary interest in the contract. It was an opportunity the Directors should have taken for the company, they were able to acquire it due to their position as Directors of the 1st company and the relationship it had given them with the CPRC.

The outcome of this case is quite uncontroversial. The second Company was set up deliberately to divert the benefits of the first. It is straightforward that this is a case of a significant conflict of interest and that the contract with the CPRC should be held on trust for the benefit of the first company and therefore for Cook. What is interesting is that the rationale set out by Lord Buckmaster advanced significantly beyond that in earlier cases, increasing in technicality. This is a sign both of increasing analytical structure and scholarship in English law and also a response to the challenge posed by *Lister* and similar cases. Lord Buckmaster in *Cook v Deeks* recognised the need to place the proprietary remedy on a sure logical footing. Ironically, in some ways it is this agency analysis that becomes the most problematic part of attempting to justify the proprietary remedy in the case of bribes. It is stretching the idea of agency to suggest that the bribe-taking fiduciary is taking a bribe to advance the interests of the beneficiary. He is in fact doing the opposite of that. The much simpler approach is to take the view that the transaction is one which the fiduciary by reason of his duties cannot enter into, and therefore the transaction or bribe is an aberration. This is remedied by Equity looking on as done that which ought to be done, and assigning the transaction to the property of the beneficiary. Clearly what ought to be done is the bribe should not be taken, but given that the

[31] (1915) 33 Ont. L. R. 209
[32] *Supra* n30 at p563
[33] *Ibid.*

transaction has occurred, the law of Equity treats the transaction as having occurred in the way which is as far as possible consistent with its rules and legal ethics.

The difficulty and complexity of the reasoning in justifying a proprietary remedy in the case of secret profits, and therefore bribes, develops still further in the mid Century cases of *Phipps v Boardman*[34] in which the majority apply, with modifications, much of the reasoning of *Regal (Hastings)*.[35] These two cases are complex, especially the influential case of *Phipps*, which contains two dissenting judgments. It is worthwhile looking at the reasoning of each justice individually, as each disclose subtly different reasoning when it comes to the proprietary remedy.

Regal was a case involving a cinema company which wished to expand its assets. The directors decided to purchase the leases on two smaller cinemas in the Bristol area, and to do so set up a new company. The new company required share capital of £5100 to complete the purchase but the directors felt they could not justify spending more than £2000 of the main company's money. So each of the directors purchased £500 of the share capital for themselves. Eventually these shares were sold at considerable profit and the new board of Regal sued these directors for the profits they had made. Throughout the reasoning in this case the judges place a considerable amount of emphasis on the fact that the shares had been acquired because of and in the course of the directorship of the respondents.[36] While previous authority is also cited for the proposition that fiduciaries cannot enter into a transaction that causes their own interests to conflict with their duty to their principal or make a secret profit, much of the reasoning focuses on agency concepts. The argument is simple enough in the context of the facts of this case. The directors were acting on behalf of the company and to promote its interests when they took the shares. Therefore they must hold the shares on behalf of the company. However, *Phipps* demonstrated why this simple analysis runs into trouble when more difficult facts are considered and the issues of conflict and profit are more oblique.

Phipps concerned the estate trust of a deceased businessman who had built a successful textile company. One of the assets of the trust was a shareholding in another textile company which was experiencing difficulties and the value of its shares were significantly below the estimated asset value of the company. Mr Boardman, a solicitor who was an executor of the will, decided to attend the AGM to try and establish whether the business could be turned round to increase the value of the trust's holding. He sought to have one of the sons

[34] [1967] 2 AC 46
[35] [1967] 2 AC 134
[36] *Ibid.* see judgments of Lord Russell at 144G, Lord MacMillan at 153D, and Lord Wright at 154B.

of the deceased, Tom Phipps, an expert in the textile business, appointed to its board. In letters of advice to the other trustees of the estate Boardman expressed his view that to turn the company round the estate would need to acquire a larger shareholding. However, he agreed with the accountant of the estate that it would be unacceptable for the trust to purchase such shares. To do so would have required court approval.[37] This may not have been forthcoming as the venture was risky. Instead the executors agreed to transfer one share each to Boardman and Tom Phipps in order that they could meet with the company and obtain information as shareholders. It was also agreed Boardman should begin negotiations to attempt to purchase a greater shareholding in the company. However, it was clear from the correspondence that the widow, and after her death, her daughter, were not really aware of the details of Boardman's plans, due to a lack of complete information and due to simply not understanding what was proposed. Boardman and Tom Phipps then began a process of attempting to purchase shares in the company. Throughout these negotiations, to give their proposals greater weight Boardman and Tom Phipps relied on the fact they could command the voting power of the trust holding, some 15% of the company's stock, in addition to anything that they might purchase. Their conduct led the other shareholders in the company to believe they were representing the trust, even though they were negotiating the personal purchase of the company for themselves. Eventually Boardman and Tom Phipps bought the company out, each taking a half share. They worked tirelessly to maximise the value of the company. Boardman negotiated the selloff of an Australian subsidiary for an amount which provided a capital dividend of nearly the full amount the shares had originally been worth. Tom Phipps turned round the business of the UK factories and the shares rose in value despite the sale of capital assets. As a result Boardman and Tom Phipps made considerable personal profits, but had also increased the value of the shares to the trust. However, when the eldest son of the deceased, John Phipps, became fully aware of the scale of the profit his brother and the solicitor had made, he prompted the trust to claim that the purchase of the company had been in breach of fiduciary duty by Boardman. It was argued that the shares in the company were held on trust for the estate.

Lord Cohen delivered the first judgment for the majority in the case.[38] As with many of the judges in this case he quotes two key passages from *Regal*, starting with this passage from the judgment of Lord Russell:

> "The rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of

[37] The will did not grant this power to the executors.

[38] *Supra* n34 beginning at p94

> bona fides, or upon such questions or considerations as 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, or whether he took a risk or acted as he did for the benefit of the plaintiff, or whether the plaintiff has in fact been damaged or benefited by his action. The liability arises from the mere fact of a profit having, in the stated circumstances, been made."[39]

Following this he quotes this passage from the judgment of Lord Wright:

> "That question can be briefly stated to be whether an agent, a director, a trustee or other person in an analogous fiduciary position, when a demand is made upon him by the person to whom he stands in the fiduciary relationship to account for profits acquired by him by reason of his fiduciary position, and by reason of the opportunity and the knowledge, or either, resulting from it, is entitled to defeat the claim upon any ground save that he made profits with the knowledge and assent of the other person."[40]

These passages are treated with approval and in order to make the following legal observations. Firstly, Lord Cohen treats it as clear that the liability to account as a constructive trustee depends neither on dishonesty by the fiduciary nor on the opportunity being one that could or should have been acquired by the trust rather than the fiduciary.[41] Secondly, he states that the key question to be decided is whether the fiduciary is disbarred by reason of their office from making the transaction.[42] Thirdly he makes the point that the mere acquisition of information by a fiduciary as a result of his office does not necessarily mean that he will have to account for the profits of every use of that information.[43] In fact he specifically states that in his opinion had the shares in question in the case been publically traded then the appellants would have been free to purchase them for themselves.[44] In his further reasoning Lord Cohen states that he finds attractive an argument advanced on behalf of the appellants that they were not acting in the course of any agency when they purchased the shares and so should not be liable.[45] However a key part of his reasoning is that this argument understates the significance of the fact that the information, introduction and opportunity to purchase the shares came about because of the fact that the appellants were in a fiduciary position, acting for the trust to increase the value of its holding.[46] In his judgment as a whole there is a strong sense that

[39] *Supra* n35 at para 144G-145A
[40] *Ibid.* pp 154B-C
[41] *Supra* n33, p104
[42] *Ibid.* p100 & p103
[43] *Ibid.* p102
[44] *Ibid.* p100
[45] *Ibid.* p102
[46] *Ibid.* p103

in the mind of Lord Cohen the fact the appellants had used their status as trustees in order to obtain benefits during negotiations to purchase the company was fatal to their case. The connection between their office and their profit making activities was too direct and was to some extent inappropriate without full trustee authorisation. He further states that though the unauthorised profit was sufficient to decide the case, that the resulting position at the time when the shares were purchased represented a conflict of interest for Mr Boardman. He could no longer have given impartial advice to the trust as its solicitor as to whether the trust should seek court approval for the purchase of the shares itself.[47]

This judgment by Lord Cohen is interesting because it illustrates the number of tensions that have developed in the legal reasoning on this subject. There are elements of simple equitable reasoning, the question of the disbarment of fiduciaries from conflicting or profit making transactions for example. There are issues of property rights, and the question both of whether information itself can be rightly seen as trust property or whether the opportunity to purchase the shares was created by the use of trust property. There is the attempt to rationalise the decision as a matter of law by inquiring into the presence of a kind of quasi-agency arrangement, voluntarily assumed by Boardman and Phipps in the case, and there is the obvious recognition of the limitations and dangers of the equitable remedy in this case in that Lord Cohen is at pains to limit its application from having an effect on publically traded shares.

The problems with the approach can easily be seen by contrasting it with that of the dissenting Lord Upjohn. [48] He takes a narrow view of the fiduciary duty, and strongly attacks any idea that information can constitute property except in limited cases, or that use of information can be in breach of fiduciary duty if it is not a breach of confidence. He rejects any suggestion that agency can arise in such an informal fashion. While he seems to envisage the scope of the fiduciary obligation too narrowly, he correctly demonstrates that attempts to answer the case on these grounds struggle to find complete coherence. Property in information is necessarily limited to cases of specific and unique information that belongs to a company, such as intellectual property or specific knowledge or expertise. Agency arises as a result of a clear and legally binding agreement between two parties in respect of some specific business conducted by the agent on behalf of the principal. Thus any reasoning based on these idea must necessarily fail where it is clear that the fiduciary is conducting a transaction that is either impossible for the trust to conduct or which the trustees have express a desire not to conduct, as was the case in *Phipps*. Yet the issue which seems to most define

[47] *Ibid.* p104
[48] *Ibid.* p118

the judgment of Lord Cohen remains. The share purchase by Boardman and Phipps occurred because Boardman was a trustee of the estate. He used that office to manoeuvre, albeit unintentionally, himself and Tom Phipps into the position whereby they bought shares and made a significant profit. The potential for wrongdoing arises. A dishonest man in the position of Boardman could have used the situation, and the rights and property of which he was empowered with fiduciary responsibility, to his advantage.

It is a problem which is hard to annunciate clearly, but which undoubtedly exists in the situation which arose in the case. It is dealt with more easily if a simple approach like that in the judgment of Lord Hodson or Lord Guest is taken.[49] Each initially decides the case as a matter of a simple, strict rule disbarring the fiduciary from any transaction which allows a fiduciary to profit from his office, understood on the facts of the case. Hodson goes as far as stating that to undermine or weaken such a right would be undesirable, holding that the strictness of the rule is of "importance".[50] In the facts of the case it is clear enough that there is a sufficient link between the actions of the fiduciary Boardman, the subject matter of his trust and the profit he ultimately made, that we can say he could not participate in the transaction for his own benefit. Even though it is also clear that in this case there was no intent to be dishonest, and no fraud was committed. Boardman's behaviour calls into question his undivided loyalty to his trust, given the profit he made for himself, and whether the utmost integrity of the relationship between fiduciary and beneficiary was maintained. This is demonstrated by the reaction of John Phipps when the profit was discovered.

In his thoughtful dissenting opinion[51] Viscount Dilhorne analyses with great care the position of Boardman and Tom Phipps and their fiduciary obligations. He concludes that they were in a fiduciary relationship with the trust throughout their dealings, in part because of their past position and in part because of the purpose of their actions and the authority they had held themselves out as having.[52] However, for him the key issue was that ultimately there could be no conflict of interest in their actions or unauthorised profit while the accountant Trustee, Mr Fox, remained opposed to any purchase of the shares by the trust.[53] As the trust was unwilling and uninterested in making the purchase, the appellants were free to do so unencumbered. At this point, on his understanding, they could not be said to have acquired the shares by reason only of their position, nor could it be said to be in the course of an agency

[49] *Ibid.* p105 and p112 respectively, though both later get bogged down in issues over whether information constitutes property of a trust.
[50] *Ibid.* p105
[51] *Ibid.* starting at p71
[52] *Ibid.* p88
[53] *Ibid.* p88

that they made the purchase.[54] Certainly there is some attraction in this analysis, it seems logical and reasonable, that once an opportunity have moved out of the direct purview of the trust, it should then be open to a fiduciary to pursue it. At the same time it fails to address the tension inherent in that reasoning itself. Once the fiduciary relationship is established, it is vital to establish whether activities undertaken by the fiduciary are tainted by self-interest. This is demonstrated by the fact that if the trust does wish to pursue an opportunity, or if the exploitation of the opportunity would cause competition with the interests of the trust, then it would be a transaction which it would be unconscionable for the fiduciary to enter for himself. We impose a proprietary remedy to make good his actions. However, once confined to only transactions the fiduciary should pursue for the trust, the proprietary remedy itself creates an incentive for the fiduciary to limit the scope of his obligation, to the detriment of his beneficiary.[55] Not only this but we leave open cases where the beneficiary may feel aggrieved when he knows the full facts, and mistrustful of his fiduciaries, with genuine concerns that they may have manipulated the scope of the interests of the trust to their own advantage.

Ultimately the majority view in *Phipps v Boardman* has become orthodoxy, that where, on the facts, a fiduciary exploits an opportunity or information which came his way as a result of his office and makes a profit, whether the opportunity is directly in the purview of the trust or not, and even where it is directly rejected by the trust, he will hold that profit for the benefit his beneficiary. It is interesting to note though that at the time the case attracted some controversy and contained some complex, some difficult and more than likely some flawed reasoning. It is also apparent that more often than not, some of the more advanced lines of reasoning attempting to fully rationalise the imposition of a proprietary remedy in such cases were less helpful in explaining the decision than the simpler, more flexible and principled propositions.

3.2.3.2 Bribes

Throughout this period of increased complexity in legal reasoning relating to the secret profit, the exclusion of bribes from the proprietary remedy continued as a simple matter of authority. *Powell & Thomas v Evan Jones*[56] was decided purely on the basis of the decision in *Lister*. *A-G's Ref (No 1 of 1985)*[57] considered whether the constructive trust which came about as a result of breach of fiduciary duty could give rise to a charge of theft. The case

[54] *Ibid.* p99
[55] A point made in *Keech*.
[56] [1905] 1 KB 11
[57] [1986] QB 491

concerned an employed bar manager who had contracted only to sell the beer of the brewery which owned the bar and breached this to make a secret profit which he took for himself. In rejecting the possibility this was theft and finding there was no constructive trust in the case, Lord Lane CJ relied on a flawed reasoning relating to mixed funds and the authority of *Lister*. A simpler explanation would be that it is difficult for the defendant to have the necessary *mens rea* for theft in a case of constructive trust,[58] a fact the learned judge mentions but glosses over.

This division, in which the reasoning in secret profit cases becomes increasingly advanced while the discussion of bribes is dealt with as a matter of authority is interesting. Not least because it draws into question the assertion of some commentators that it is for those who favour a proprietary remedy to justify their position.[59] Sophisticated property law reasoning against the application a proprietary remedy in the case of bribes can usually be extended into many cases of secret profit law. This division is not fully sustainable. As we shall see below, some bribes directly reduce the value of a legitimate transaction for a trust, while as we saw above some secret profits were never available to anyone other than the fiduciary. Instead the case law demonstrates that at its heart the dispute is between those who favour a narrow and technical analysis of proprietary remedies and those who view their imposition as a consequence of the wider duties and obligations of Equity.

3.2.4 Re-evaluation and the Case of the Dishonest Crown Servant

After the decision in *Phipps* the law relating to secret profits and bribes came to be understood in simple terms as two lines of distinct case law. A proprietary remedy could be imposed in the case of a fiduciary who made a secret profit but not in the case where a fiduciary took a bribe. However, while it was accepted to be the law, the decision in *Phipps* became somewhat controversial, and the dichotomy between *Phipps* and *Lister* even more so. A key factor in why these cases remained controversial and the subject of much academic debate were ongoing theoretical and case law developments in the field of unjust enrichment and related legal claims based on restitution. Goff and Jones published the first major text for practitioners on unjust enrichment in the mid-1960s[60] and, with Goff now sitting in the House of Lords, the seminal case of *Lipkin Gorman*[61] firmly established the principles of this field. By the 1990s jurists such as Sir Roy Goode and Peter Birks were applying the strict analytical

[58] Theft Act 1968, s5

[59] See for example, Goode, R; "Proprietary Liability for Secret Profits – a Reply" [2011] 127 LQR 493 and Swadling, W; "Constructive trusts and breach of fiduciary duty" (2012) 18 (10) *Trusts and Trustees* 985.

[60] Goff and Jones; *The Law of Restitution* (1st Ed, 1966: Sweet & Maxwell)

[61] *Lipkin Gorman v Karpnale Ltd* [1988] UKHL 12

principles of this field to many of the complex problems which had emerged in the historical case law at Equity. They were forcefully arguing for a limited approach to the application of the proprietary remedy which relied on a close connection between the property of the principal and the property in which the interest was claimed.[62] On the other side of the argument were those who were arguing equally forcefully that the distinction between secret profits and bribes was insufficient to justify refusing a proprietary remedy.[63]

The issue came to a head in the 1994 Privy Council case of *AG for Hong Kong v Reid*[64]. The case was striking due to the high level of public attention and because of the outrageous behaviour of the defendant. Warwick Reid, a New Zealander, had risen through the ranks of prosecutors in British administered Hong Kong to become the Principal Crown Counsel, in charge of all commercial prosecutions in the jurisdiction. Once in that position he had systematically accepted bribes from some of the wealthiest businessmen in Hong Kong. By the time he was caught he had amassed some $16 million in assets, well over three times his potential salary for the period. The case became even more noteworthy when Reid skipped bail in his criminal proceedings and went on the run in the Macau underworld, before eventually being recaptured and cutting a deal to testify against former associates and other corrupt lawyers. After serving a prison sentence he returned to New Zealand where the AG of Hong Kong sought to trace his ill-gotten gains into properties now owned by Reid, his wife and his solicitor. Initially the claim was rejected by both the High Court and the Court of Appeal in New Zealand, on the grounds that there could be no equitable proprietary interest due to the ruling in *Lister*.

Lord Templeman delivered the judgment of the Privy Council which, citing with approval the writings of Sir Peter Millett,[65] found that not only was the Court of Appeal in New Zealand free to depart from *Lister* if it so wished but also that *Lister* was wrongly decided and that a proprietary remedy was available in the case of a bribe. The main thrust of the reasoning in the case focuses on the unconscionability at Equity if the dishonest fiduciary keeps the bribe. He holds that as soon as it was paid it should have been transferred to the principle. Applying the maxim, “Equity considers as done that which ought to have been done”, the Privy

[62] Sometimes called a “proprietary base” for the claim. See Goode, R; "Property and Unjust Enrichment", in *Essays on the Law of Restitution*, ed Burrows (1991: Clarendon Press) , p215, 230-231 and Birks, P; *Introduction to the Law of Restitution*, 2nd ed (1989: Clarendon Press), p386
[63] See particularly Millett, P; “Bribes and Secret Commissions” [1993] R.L.R. 7 and also some discussion of the issue in Jones, G; “Unjust Enrichment and the Fiduciary's Duty of Loyalty” [1968] 84 L.Q.R. 472, and Hayton, D; “Developing The Law of Trusts for the Twenty-First Century” [1990] 106 L.Q.R. 87
[64] [1994] 1 AC 324
[65] *Ibid.* p337

Council held that therefore a bribe, and any property into which the bribe was transferred and any profits made, were held on trust for the principle.

A particularly noticeable feature of the judgment which gives further insight into the mind-set of the Privy Council in this case is found in a very commonly quoted passage in which Lord Templeman emphasises the moral harm of bribery and the particularly serious wrong done in this case:

> "Bribery is an evil practice which threatens the foundations of any civilised society. In particular bribery of policemen and prosecutors brings the administration of justice into disrepute. […] The amount of loss or damage resulting from the acceptance of a bribe may or may not be quantifiable. In the present case the amount of harm caused to the administration of justice in Hong Kong by the first respondent in return for bribes cannot be quantified."[66]

This passage is important in understanding the ratio of the decision in the case for a number of reasons. It sets the emphasis of the case firmly in the context of delivering justice and enforcing the rule of law. In this case the bribery and breach of duty had been directed at the foundations of law and justice itself and a robust response was required. The passage therefore understands bribery to be a moral evil which causes moral harm and against which the law must provide comprehensive remedy. It also recognises the difficult and insidious nature of bribery. While there is always loss or damage, according to the Privy Council, that loss or damage can be hard to quantify or may not even be of a quantifiable nature at all. In this case the damage caused was to the administration of justice in the whole of Hong Kong. The loss is not as simple as a financial detriment, but the damage to the interests and purposes of the principle is real. This passage also implicitly recognises that bribery is a kind of harm which by its nature is only controllable and discoverable by the fiduciaries themselves. It is not easy for the courts to unpick and clearly establish the detail of what has occurred and the exact harm done. The wrong done by the fiduciary itself obscures any easy solution.

Starting from this position, and this is an early paragraph in the judgment, the imposition of a proprietary remedy seems somewhat inevitable. Later parts of the judgment state that if a proprietary remedy is available where a fiduciary makes a profit through the innocent misapplication of trust funds then *a fortiori* it must also be available where the fiduciary makes his profit dishonestly. There is a natural force to this argument, it was one of the existing criticisms of *Lister* in the literature prior to the case, as it is hard to see how it can

[66] *Ibid.* p330-331

be justifiable to give the lesser remedy in the case of more serious wrongdoing and the stronger one where there is innocent behaviour.

However, it quickly became clear in scholastic commentary that neither of the two central argumentative threads of *Reid*, neither that based on the equitable maxim, nor that based on the apparent *a fortiori* approach to remedies, would satisfy those seeking an analytical approach. Writing shortly after the decision, Gardner set out the reasons why in his view the use of the maxim to support the decision in *Reid* is inappropriate.[67] Starting from historical use of the maxim he states that it should properly be understood as a rule which will hold complete a transaction which, though incomplete, must be completed according to the principles of equity. Thus where a fiduciary acquires property on behalf of his principal, it is already deemed to be held on trust. Gardner's problem with the application of the maxim in *Reid* is that the obligation the fiduciary has is to pay over the bribe, not to acquire it for the principal. So it is not a matter of completion, rather it is one of the acquisition of new rights in new property.[68] David Cowan made a similar argument in criticising the judgment, in a less technical manner, when he said that the maxim was improperly applied because it was being applied to "something which the fiduciary in truth has an obligation not to do."[69] According to these commentators the maxim cannot justify the imposition of a proprietary remedy because in taking a bribe a fiduciary has been dishonest and the transaction is therefore not one which could ever properly belong to the principal. Instead the transaction should not have occurred at all. To make the fiduciary a constructive trustee of such property is illogical and an expansion of the constructive trust which is not justifiable.

This analysis of the case is compelling when you accept the premise that the use of the Equitable maxim in *Reid* is directed towards connecting the obligation to account for profits on the part of the fiduciary to the proprietary remedy. However, this is arguably not the manner in which the maxim is being used, and thus the argument fails. The difference of views on the subject again boils down to a clash between a strict restitutionary or remedial understanding of the equitable jurisdiction in this area and a broader understanding of Equity as founded on principles of more complete justice. If the starting point of the analysis of the proprietary remedy is understood to be the unconscionability of the transaction undertaken by the fiduciary at equity then the analysis is quite different. Equity refuses to recognise the transaction if it took place for the benefit of the fiduciary. At equity the fiduciary cannot acquire ownership of the property in the bribe for himself, it is unconscionable. This means some kind of legal fiction will always be required to reconcile the factual position with the law. The property is in the

[67] Gardner, S; "Two Maxims of Equity" [1994] CLJ 60
[68] *Ibid.* p61
[69] Cowan, D; "Lister & co v Stubbs: Who profits?" [1996] JBL 22, p30

hands of the fiduciary and the beneficial ownership must vest in someone. Clearly, it would also be equally unconscionable for the one that paid the bribe to retain ownership, such that he retains both the property and the benefit of his dishonest payment. Historically, in a line of clear legal precedent beginning with *Keech v Sandford* the answer preferred is that a secret profit or benefit of a transaction which is acquired in breach of the "no profits" element of the fiduciary obligation is held for the principal of the fiduciary, and there is no clear reason why a bribe should be treated any differently on this understanding. This is the outcome that is closest to an honest fiduciary having fulfilled his duty, in that any benefit acquire as a result of the fiduciary relationship, is taken to belong to the principal. In this way the analysis of bribes used by Templeman LJ, based on the equitable maxim, Equity will look on as done that which ought to be done, seem perfectly straightforward. Indeed, writing more recently, Sir Peter Millett has clarified that this is how he intended the maxim to be understood in this context.[70]

From this perspective, the a fortiori argument deployed by Templeman in *Reid*, also seems more reasonable. Cowan criticised this argument as containing a significant leap of logic, as it asserts that the use of position itself by a fiduciary to obtain a secret profit must always give rise to a constructive trust.[71] However, when it is understood that the principle concern of the law in this area is not directly to untangle a dispute as to property ownership, but rather is to rectify a wrong which has been committed against the relationship of trust and confidence between fiduciary and cestui que trust, then the analysis seems far less controversial. The reasoning is not actually concerned with why it is the beneficiary should or should not have the property, but rather is a matter of the consequences which flow at equity from the disbarment, disability or simple unconscionability (whichever term is preferred) of the common law rule that the fiduciary has taken the property for themselves. Gardner himself clearly demonstrates that the root of his criticism is his restitutionary understanding of the property issues around the imposition of the constructive trust. In assessing the idea that the fiduciary cannot have the benefit for himself, he states this must be because they are unjustly enriched,[72] however once again I think this approaches the problem from the wrong direction. It still assumes the purpose of the remedy, or the justification for its imposition, is found only in establishing a valid legal foundation for the beneficiary to make a proprietary claim based on the infringement of his property rights. Rather the process at equity is that the complaint of the beneficiary is one of breach of duty and breach of trust, the beneficiary is asking the court of equity to restore the integrity of the trust. This is why the fiduciary is liable to account, he must lay bare his actions and account to the trust for all losses and profits which flow from his

[70] Millett, P; "Bribes and Secret Commissions Again" [2012] 71(3) CLJ 583
[71] *Supra* n69, p31
[72] *Supra* n67, p63

breach of duty, in order to fully restore the substance of his trust and ensure the perfect completion of his obligation.

The courts in the early 2000s seemed inclined to distinguish *Lister* and follow *Reid*. In the case of *Fyffes Group Ltd v Templeman*[73] the High Court followed the reasoning in *Reid*, finding that equity held it was unconscionable for a fiduciary to make a profit without informed consent and a bribe was no different. In *Daraydan Holdings Ltd v Solland International Ltd*[74] Justice Lawrence Collins took the unusual step of both distinguishing *Lister* and stating that were it not possible to distinguish he would have declined to follow it and followed *Reid* instead. This case concerned the purchase and refurbishment of London properties by a Qatari royal who instructed an agent to oversee the business for him. The agent had demanded and received a 10% kickback on the price he paid contractors to carry out the refurbishments, and the judge found on the evidence that it was clear the prices had been inflated 10% to cover this bribe. On this basis the judge found that *Lister* could be distinguished as that decision relied on the fact that there was no use of trust property in explanation as to why there could be no proprietary remedy.

This line of reasoning is particularly interesting because it demonstrates the extent to which the exception in *Lister* was untenable in the eyes of the courts. It would strip away much of the jurisdiction. Bribes in the form of kickbacks paid for by inflating the price paid by the principal will be a relatively common form of wrongdoing. In fact the bribes received in *Fyffes* also took a similar form. Once this set of facts is included within the scope of the proprietary remedy, the exception will be limited to only those bribes which do not involve money taken from a payment made by the trust. This is highly technical and very narrow. The *Daraydan* approach is also forceful in and of itself. In cases where a judge finds that a bribe was paid out of funds which came directly from the trust the difficulty of a lack of proprietary connection to the trust property is no longer a problem. In fact you could make an argument that this would be a case of unjust enrichment of the fiduciary at the expense of the principal, thus satisfying restitutionary criticisms of the jurisdiction. Regardless though it is interesting to note that despite criticisms directed at the imposition of the proprietary remedy that it is potentially unfair in practice, especially to creditors, the courts showed a strong preference for the straightforward and clear solution in *Reid*, rather that maintaining the *Lister* exception.

3.3 The Present State of the Law

[73] [2000] 2 Lloyd's Rep 643
[74] [2005] Ch 119

Resolution in two key cases

The law in relation to the imposition of a proprietary remedy for breach of fiduciary duty remained in a state of uncertainty from the mid-1980s through until very recently. The failure to resolve this question stemmed not only from the many practical and theoretical difficulties, but also arguably from a lack of a coherent understanding of when and how the fiduciary obligation should be imposed and what the proprietary remedy was intended to accomplish. This is the question at which this chapter and thesis are aimed, and the resolution of this line of case law in two key recent decisions is quite enlightening.

3.3.1 Sinclair Investments Ltd v Versailles Trade Finance Ltd

The first of these significant cases is the Court of Appeal decision in the case of *Sinclair Investments Ltd v Versailles Trade Finance Ltd*.[75] This case concerned a significant corporate fraud, in the manner of a kind of 'Ponzi scheme'. The claimants in the case, *Sinclair Investments*, were an investor in the scheme through a company known in the judgment by the acronym TPL. TPL was a shell used by the perpetrators of the fraud, Mr Cushnie and Mr Clough, to receive moneys from private investors, known as 'traders'. Mr Cushnie ("C") and Mr Clough were both directors of TPL. Once the traders' money was received by TPL, it was transferred to another company, known by the acronym VTFL, a subsidiary of VGP. Both VTFL and VGP were wholly owned and managed by C, and he was a director of these companies. The money received from the traders was circulated repeatedly through a number of shell companies in order to create fraudulent transactions which inflated the book turnover and profits of VTFL and consequently increased the value of VGP. VTFL and VGP also took out large bank loans in order to finance this increasing Ponzi scheme. C then sold shares in VGP on the London Stock Exchange for a sum of around £28 million. He used this money to purchase multimillion pound properties for himself. When the Ponzi scheme was eventually discovered, VGP and VTFL owed something in the region of £20 million to the traders and £70 million to the banks. Not to mention the vast losses they had caused to stock market investors. Administrators were appointed to VGP and VTFL and began attempting to recoup money. They made various settlements with C which involved him selling the property he had acquired and paying back around £8 million to VGP and VTFL. The administrators began quickly distributing this to the banks and other creditors of VGP and VTFL. This meant the traders who had originally invested via TPL were faced with getting nothing back on their investment, as all money received by TPL was passed directly to the insolvent VTFL.

[75] [2011] 4 All ER 335

Therefore Sinclair, as assignee of the traders' claims, claimed that the proceeds of the sale of shares in VGP by C constituted a secret profit made by C in breach of his fiduciary duties as a director of TPL. This was a novel and interesting argument. Sinclair argued that the assets of TPL, the traders' investments, were used by C in breach of fiduciary duty to artificially inflate the value of first VTFL and then VGP, for his own personal gain. This gain was realised in the share sale and so this constituted a profit made by a fiduciary through improper use of the property of his trust. Therefore Sinclair via TPL had a proprietary claim to the proceeds of the sale of shares in VGP and VTFL. The real subtlety of this argument lying in the fact that there could be no competing proprietary claim by VTFL or VGP themselves, as the selling of shares in that group could not be considered a use of their assets. The banks by their own admission were unsecured creditors. TPL alone could assert a proprietary interest in the money received by C from the share sale, and that they could trace the same into the property and subsequently the settlements made by C with VTFL and VGP, and then into distributions made to the banks.

The leading judgment in the case, with which the two other judges concurred, was delivered by Lord Neuberger. His ratio in deciding the case is apparent from quite early in his judgment and the way he sets out the relevant legal principles. He cites the case of *Foskett v McKeown*,[76] quoting a particular passage as authority for the position that proprietary interest is not a matter of discretion but of property rights.[77] He also quotes a passage from *Paragon Finance plc v DB Thakerar & Co*[78] in which Lord Millett states that the cases that justify the imposition of a constructive trust are those in which the transaction of the fiduciary is not impugned but where it would be unconscionable for the fiduciary to deny the beneficial interest belongs to the principal. On the other hand, according to Lord Millett, in cases where the defendant is implicated in a fraud, the transaction is impugned and the perpetrator is liable to account "as a constructive trustee" but really there is no trust at all, it is a confusing turn of phrase.[79]

To understand this dicta of Lord Millett, from a decision written after his Lordship had made it clear he favoured a proprietary remedy in cases of the bribery of a fiduciary, it is important to understand the facts of the case and the question he was deciding. In *Paragon* a firm of solicitors were the fiduciaries of a trust of mortgage advances received from banks until they paid them on to the beneficiaries of the mortgage. The banks claimed this money was obtained by fraudulent representations by the solicitors and sought a constructive trust to

[76] [2001] 1 AC 102, p109
[77] *Supra* n75, p37
[78] [1999] 1 All ER 400, p409
[79] *Supra* n75, p43

replace the express trust on the basis that knowing of the fraud, the solicitors should have returned the money to the banks or held it on trust for them. The reasoning of Lord Millett in the passage quoted by Lord Neuberger is that this constructive trust simply does not exist, and the actions are not alleged as a breach of obligations under the trust. This is because the impugned actions occur before the creation of the trust and the solicitors behaved with the money received by the banks as they were intended, they passed it on to the clients. The banks' position was reducible to a claim that all receipt of money obtained by fraud gives rise to a remedial constructive trust. It is this Millett is rejecting in *Paragon*, demonstrating instead a constructive trust is created when property is acquired as a misuse of existing trust obligations and it is therefore unconscionable for the fiduciary to deny his principle's claim to the beneficial interest. The key difference in the facts of *Paragon* that dictate there is no constructive trust is that the banks were arguing the fraud itself created the trust. Under the resulting trust the solicitors were only obliged to receive money and pass it on, and did so, whether or not that money was obtained by deception has no bearing on that fact.

This becomes relevant later in the judgment in *Sinclair*. Lord Neuberger goes on to find that there can be no constructive trust in that case for a number of reasons, some of which suggest he fell into slight error in his interpretation of *Paragon*. A key reason for his decision is that he states that no trust funds were used to purchase the shares themselves, or the property bought with the shares, and there was no embezzlement of trust funds in these acquisitions.[80] The starting point is that there is no proprietary connection between the trust property and the property over which the proprietary claim is asserted. From this position he states there is no obvious force in the argument that because breach of duty allowed C to make a profit that profit should belong to TPL.[81] If this is based on an interpretation of the dicta in *Paragon* then this is not a sound conclusion. *Sinclair* is an example of the first type of case in *Paragon*. It would be unconscionable for C to deny the beneficial interest of TPL in the profit he made from the share sale. There can be no doubt that at Equity C cannot assert his own claim to the profits he made from dishonestly using the money of which he was fiduciary. He was under a duty to use that money to create profits for TPL and so how can he in conscience deny TPL's claim to the beneficial interest in the profits he made? It is not an example of the second type of case identified by Millett as the claim flows from the fiduciary relationship and C's obligations under the existing trust. It is not claimed that the fraud itself created a new trust in a claim to make good on losses, rather that the profits which were made should properly belong to the original trust. It appears that Lord Neuberger instead understood this principle as requiring a direct chain of property rights where the improper application of trust property

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[80] *Ibid.* p50
[81] *Ibid.* p52

directly causes the acquisition of secret profits, and that situations of fraud which fell outside of this clear chain could not of themselves create a constructive trust. Therefore he rejected the practical argument that discouraging the breach of fiduciary duty is sufficient justification for beneficial interest on its own.[82]

Lord Neuberger did give a number of other reasons why he reached this conclusion. He accepted that the facts of the case were in many ways analogous to bribes in that both involve a dishonesty separate from direct embezzlement of trust property.[83] After tracing the case history, though perhaps not as thoroughly as was subsequently done in *FHR European Ventures*,[84] he decided that *Lister* was the relevant authority.[85] He also stated in a number of places that the effect on other creditors of the dishonest fiduciary was significant and a strong reason not to support imposition of a proprietary remedy in these cases.[86] He also took on the reasoning in *Reid* directly, stating that in his opinion Lord Templeman in that case begs the question he is asking[87] and that he did not make it clear that he was not addressing the imposition of an equitable account rather than a proprietary remedy.[88] Dealing briefly with the second point, I would respectfully disagree that *Reid* can be read in this way. Lord Templeman specifically invites the New Zealand Court of Appeal to depart from *Lister* if they deem it necessary, explicitly because *Lister* found there can be no proprietary remedy in the case of bribes.

Neuberger's first point is one which has been argued extensively in academic literature. I will deal with it in more detail in respect of *FHR European Ventures*, but suffice it to say I believe this argument stems from an extension of the misinterpretation of *Paragon* discussed above and the failure to recognise that the rationale of Lord Templeman proceeds on an entirely different conceptual basis to the one conceived here by Lord Neuberger. Neuberger is looking for what I have called a chain of property rights directly to make a secret profit, whereas Templeman is proceeding on the basis that Equity dictates rules for the valid transmission of property interests based on what is conscionable given the fiduciary relationship and the nature of the trust. On that latter analysis a fiduciary cannot assert against his principle that he holds the beneficial interest in property he has acquired as a result of

[82] *Ibid.* p53
[83] *Ibid.* p55
[84] *Infra* n90
[85] *Ibid*. p77, p84
[86] *Ibid.* p54, p83
[87] *Ibid.* p78
[88] *Ibid.* p79

breach of his duty. It is irrelevant whether such property is acquired via a direct chain of property use or dishonest misuse of his position.

A final interesting comment to make, and one with a significant bearing on the present state of the law is that something which is absent from Lord Neuberger's reasoning in *Sinclair* is any discussion or reference to principles of unjust enrichment or restitution. While Neuberger references academic writings which rely on arguments from these jurisdictions in support of his decision[89] he does not use those arguments directly, with a telling effect on the overall weight of the reasoning in this decision. The reason for this is the case of *Westdeutsche Landesbank Girozentrale v Islington LBC*.[90] This case was a landmark decision on proprietary remedies in English law, and while the facts are not terribly pertinent, what matters is that it firmly and directly rejected the argument that the justification for the imposition of constructive and resulting trusts came from the rules of unjust enrichment.[91] The ripples of this decision were far reaching and they can be felt in the judgment in *Sinclair*. Lord Neuberger falls back on the rather basic assertion that where there is no direct use of trust property to generate the profit in question there is no compelling reason to impose a proprietary remedy. As shown throughout the case history in this chapter, this assertion is only one among competing ideas, and seems at odds with the foundational decisions in the field of secret profits of *Keech v Sandford* and *Phipps v Boardman*.

3.3.2 FHR European Ventures LLP v Cedar Capital Partners LLC

The second key decision which concludes this history of case law is *FHR European Ventures LLP v Cedar Capital Partners LLC*.[92] This case appears, for the moment at least, to have settled the dispute clearly in favour of the grant of a proprietary remedy both in situations of breach of fiduciary duty by secret profits and in cases of bribes or fraud.

The facts of the case are relatively straightforward. FHR European Ventures LLP ("FHR") and the other claimants in the case were a group of investors in the hotel business. The defendant, Cedar Capital Partners LLC ("Cedar") was a business set up by Ramsey Mankarious in order to provide consultancy services to FHR. The consultancy agreement stipulated that Cedar would act for the investors and FHR in the negotiations and purchase of

[89] *Ibid.* p81
[90] [1996] AC 669
[91] *Ibid.* p705. Lord Browne-Wilkinson in his judgment states that the foundation of the legal rules was that "Equity operates on the conscience of the owner of the legal interest" and rejects unjust enrichment as a sound alternative basis.
[92] [2015] AC 250

the long lease on the Monte Carlo Grand Hotel ("the Hotel") and would be paid for this service according to a fee agreement. As a result it is clear that Cedar and Mankarious were acting as agents for FHR and owed them fiduciary duties in respect of the negotiations and the purchase. However, unbeknownst to FHR, Cedar had entered into a contractual arrangement with the sellers that they should be paid €10 million on the completion of the sale to investors they had introduced to the sellers. The contract gave a list of prospective buyers whom Cedar would attempt to persuade to make the purchase including many of those investors who eventually formed and invested in FHR. The contract also made it clear, however, that Cedar would not act in negotiations for the seller, and that they could act for the buyer and would be under no conflict of interest in doing so with respect to this agreement and the sellers. This avoids any question of there being duties owed to both parties to the contract by Cedar. The hotel was eventually sold to FHR for a price of roughly €215 million, negotiated in large part by Mankarious. Cedar was also paid its commission by the seller. While the commission may have been informally mentioned to some of the investors involved in FHR, and the sellers were obviously fully aware of the arrangement, the court at first instance found that this commission had not been validly disclosed to FHR and was therefore a secret profit made in breach of fiduciary duty. The question which reached the Supreme Court in this case was only as to the central issue in dispute in the case law and academic literature, did such a secret profit, having a nature analogous to a bribe, give rise to a proprietary remedy or was there merely an *in personam* remedy available to FHR?

The judgment of the court was delivered, as it had been in *Sinclair*, by Lord Neuberger. It makes interesting reading, and is quite unlike most judicial decisions in that there are passages which suggest that the outcome cannot be clearly determined as a matter of existing law and precedent. Having conducted an extensive review of decided cases beginning with *Keech v Sandford*, Lord Neuberger states that in the view of the Supreme Court the decisions do not, "represent a clear and consistent line of authority,"[93] against the imposition of a proprietary remedy in cases of bribery and similar profits made in secret which do not flow directly from the use of trust property. In addition to the detailed study of the case law the court also references and comments on the wealth of scholarly opinion on the subject, again finding that, "it is not possible to identify any plainly right or plainly wrong answer to the issue of the extent of the rule."[94] Thus the court in this case essentially concedes that there is merit in both lines of case law, and the various analytical approaches on which they are founded and that essentially a decision must be reached one way or the other.

[93] *Ibid.* p46
[94] *Ibid.* p32

In order to make the decision the court turns to the policy considerations. Weighing heavily in favour of the proprietary remedy is the fact that it would seem untenable to hold that innocent behaviour as in *Phipps v Boardman* attracts the more drastic and forceful remedy, while fraudulent behaviour such as bribe taking results in the lesser *in personam* remedy.[95] Additionally, there is noted the consideration that the existence of the bribe strongly inclines an observer to believe that in a practical economic sense there must have been a direct financial detriment to the principal of at least an equivalent amount.[96] There is also a general reference to the fact that, as was noted in *Reid*, bribery is an evil practice that has the potential to cause significant and widespread social harm, in a general sense and particularly in commercial relations. This justifies and even prompts the law to take a particularly strident approach in addressing such wrongs.[97]

All of these are significant and valid practical considerations, however it can be clearly seen that alone they do not constitute good analytical justifications for the proprietary remedy in law. The claim that the remedy is more severe or forceful is true only in a practical sense in that a proprietary remedy provides a claimant with more certainty of recovery and disgorgement through access to the rules of equitable tracing. In a legal sense the *in personam* remedy arguably indicates with greater accuracy the nature of the wrong committed by breach of duty in that it is breach of the legal trust placed in a relationship by one of the parties to that legal relationship. One could therefore claim that the logical approach is that the remedy that should be available against a bribe taker should be against the person and not against the thing. The practical force which weighs against this logical approach is that in fact the ability to claim the thing is that which really addresses the wrong. It ensures the property is stripped from the wrongdoer and handed to the claimant, thus incentivising enforcement of the law by the principal and deterring the wrongdoing. Similarly the assumption of economic harm done by bribery may seem attractive and accurate in the vast majority of cases. However, in a legal sense it denies the need for proper evidence and undermines established rules of property law which dictate that to have an unjust enrichment the relevant property must have at some time belonged to the principal. In the same way the need to protect society, while having very powerful practical force is not what we would conceive of as an orthodox legal approach. As already stated at the beginning of this thesis, it requires the law to use the rules which govern a specific relationship not merely to determine the outcome on that set of facts but also to use outcomes to govern other relationships. This could be seen

[95] *Ibid.* p41
[96] *Ibid.* p37.
[97] *Ibid.* p42

as weakening the nature of property itself, in the sense that the rules governing ownership encompass considerations beyond just personal rights.

Taken together those practicalities do still carry significant weight. Against them the court only counted the practical effect on unsecured creditors, who suffer greater loss when a principal gains priority due to a previously unknown property interest. Though clearly the issue was not seen as drastically as it had been in *Sinclair*, when it had in fact been part of the background facts. It was dismissed with a counter-argument based in law, namely that since the fiduciary had acquired the property in breach of duty, and especially where they had done so by dishonesty, it was property they should not have. Therefore technically the creditors have not lost anything, as it the property was not rightly there to lose in the first place.[98] This is most likely cold comfort to creditors, and perhaps fails to fully grasp the practical effect in a context more like that in *Sinclair*, which involved more commercial investment and institutional finance. In such a case the property improperly obtained will be present, at least for a while, in the assets of the fiduciary and can potentially enable them to obtain credit they would not otherwise be given. Therefore to simply dismiss the loss of those assets as fictional in law is unrealistic in a practical sense. While this is a genuine problem, on its own it is probably not enough to outweigh the practical considerations in favour of the proprietary remedy, as concluded by the Supreme Court in *Mankarious*.

Perhaps the most important part of the rationale of the court was the fact that they felt that the imposition of the proprietary remedy in all cases where a profit was made through breach of fiduciary duty was the simplest, clearest and most certain approach for the law to take.[99] This line of reasoning contained two separate ideas. The first of which was that awarding a proprietary remedy in all cases where a fiduciary makes an unauthorised profit “had the merit of simplicity”.[100] The judges of the Supreme Court noted that the attempts to set out a principled rule on the imposition of a constructive trust in cases of breach of fiduciary duty had all resulted in slightly different exceptions to that rule. The boundary between breaches giving rise to the proprietary and *in personam* remedies would always be controversial, uncertain and case specific. A blanket rule which imposed a constructive trust in all cases of unauthorised profit, even if not analytically satisfying, would be simple and straightforward.

This is undoubtedly true to some degree, the vast majority of cases will be much more straightforward. The basic fiduciary rule that breach of duty is not determined by the honesty

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[98] *Ibid.* p43
[99] *Ibid.* p33-36
[100] *Ibid.* p35

or dishonesty of the fiduciary is carried forward into remedies. The intentions of the fiduciary in making the profit need not be considered. Yet this approach is still not a complete answer. In the case of *Regal* and the shares bought by Directors in the new cinema venture of the company within their charge, Lord Russell notes that he would not have been inclined to find they held the shares on constructive trust had they been traded on the stock exchange and bought in the open market. Indeed Directors are commonly compensated in their remuneration with stock in the companies which they manage in order that they have an interest in its success. To maintain the simple, blanket rule in *Mankarious* in such a case it would have to be concluded that the purchase of shares on the public market by a fiduciary in his own trust or a venture undertaken by his trust was not a conflict of interest or a secret profit. It may be so concluded, but this places a greater emphasis on what is an uncertain area of law in its own right, the scope of the fiduciary obligation itself.

The second argument based on simplicity made by Neuberger in favour of the blanket imposition of the proprietary remedy in cases of secret profits and bribery fiduciaries is that "it aligns the circumstances in which an agent is obliged to account for any benefit received in breach of his fiduciary duty and those in which his principal can claim the beneficial ownership of the benefit."[101] The point here is that if there are claims which are made against fiduciaries for making an unauthorised profit which do not result in a proprietary remedy but instead leave only an *in personam* remedy then the principal has an inconsistent remedy dependent only on the precise actions of the breaching fiduciary. This leaves control of the remedy in the hands of the breaching fiduciary and not the beneficiary. Rather the judges felt it would be better and more consistent with authority if either option were open. The fiduciary can be required to account for the thing or deliver up the thing itself to his principal. Another advantage of this approach is that it addresses a significant concern in the scholastic literature on this issue. Many of the writers who opposed the imposition of the proprietary remedy spoke of the uncertainty which had resulted from the confused use of the phrase, "accountable as a constructive trustee", which was used in *Phipps* and in prior cases. In some cases at Equity it had even been used in wholly inappropriate situations at a time when it was believed there could be no award of damages at Equity and therefore that any wrong committed had to be address in this manner.[102] While in some ways attractive, whether or not this reasoning is strictly necessary may be doubtful. It is undoubtedly possible for a fiduciary to be liable to account without a proprietary remedy being appropriate or even possible. For instance a fiduciary is liable to account for losses resulting from a conflict of interest, or simple to deliver to his principal an account of his trust, to demonstrate the trustworthy and diligent completion

[101] *Ibid.* p36
[102] For some such comments see Swadling, Goode and Worthing at n96, n98, and n99 respectively, below.

of his duties. It could therefore be argued that the *in personam* remedy of an account is actually the default remedy available to a beneficiary against a fiduciary and that the proprietary remedy is an exceptional extension requiring an exceptional and independent justification.

On the whole the decision in *Mankarious* represents a satisfactory settlement to the long line of case law and the controversy which has surrounded the imposition of a proprietary remedy in cases of breach of fiduciary duty. It is now clear that all cases of unauthorised profit will attract the proprietary remedy. This ensures the strongest possible remedial response is available to protect the interests of the beneficiaries of fiduciaries. In doing so it emphasises the primacy of the right of the beneficiary to have complete confidence in the actions of his fiduciary. If they fall short in any way, then Equity will step in to correct the outcome. However, the position perhaps remains somewhat unsatisfactory on an analytical level. In a strange twist of logic, the decision in *Sinclair* was not fully over-ruled in *Mankarious*, though there was doubt cast on its reasoning. *Lister* and its associated line of case law was treated with disapproval. The final line of the case refers to the fact that the Court of Appeal had distinguished the case from *Sinclair* on its facts, as the earlier case turned on a finding there was no use of trust property to make the profit. In *Mankarious* the secret commission appeared to have been funded by the purchase price paid by the principal in the case. The reasoning of the Supreme Court is almost overtly worded as a compromise and therefore the analytical justification for the law in this area, which is now certain in its practical effect, is still open to some interpretation.

In the years following the decision most commentary has therefore been in the form of casenotes and summaries, explaining the clear position which was adopted on the proprietary remedy and its implications for other types of legal dispute.[103] One significant area which has seen further development is the effect of this decision on limitation.[104] In the case of *First Subsea Ltd*[105] the Court of Appeal applied the approach in *FHR* to find that no limitation period would be applied to protect a director who held property on constructive trust as a result of his breaches of fiduciary duty. This in turn led to a similar outcome in the recent Supreme Court decision in *Burnden*.[106] Analytical criticism of the *FHR* decision has tended to focus on practical considerations, either in a supportive direction emphasising the importance of

[103] See for example Gummow, W; "Bribes and constructive trusts" (2015) 131 LQR 21, and Panesar, S;"Breach of fiduciary duty, equitable wrongs and proprietary remedies: implications for commercial agents" (2016) 27 ICCLR 263

[104] See Demetriades, G; "Fiduciaries and the law of limitation" (2018) 39 *Comp. Law.* 176

[105] *First Subsea Ltd v Balltec Ltd* [2017] EWCA Civ 186

[106] *Burnden Holdings (UK) v Fielding* [2018] UKSC 14

clarity,[107] or in a negative one bemoaning the potential effect on third party creditors.[108] Worthington has also recently written of the way in which the decision may have many strengths but that it has failed to completely resolve the lingering analytical questions.[109]

3.4 The Dispute as to Justification

In the intervening period between the decisions in *Reid* and *Sinclair*, a number of academic commentators expressed their view as to the appropriateness and applicability of the proprietary remedy in cases of bribery. Their differing answers to this question were built on similarly different conceptions of the fiduciary duty, and its function.

William Swadling, comments in an article arguing against the imposition of the proprietary remedy in cases of bribery that the situation is "not amenable to unjust enrichment analysis".[110] In fact he applies that argument to all cases of where a secret commission is paid to a fiduciary by a third party as this cannot be said to be an enrichment at the expense of the principal. Thus in his view it cannot give rise to property rights. Rather what is occurring is compensation and disgorgement is used to remedy an 'equitable wrong' which is similar in nature to a tortious or civil wrong, and the claim is *in personam* only. He later argues there is no fundamental difference in approach between common law and equity in such matters.[111] On this approach, the fiduciary duty is a legal obligation with the same basic character as any other legal obligation, breach of which requires a remedial response in the same way a breach of contract would require a remedial response. While efficient, logical and straightforward as an approach, this does leave open to question many of the foundational principles of the fiduciary duty itself. If breach of the fiduciary obligation is merely of the nature of a common law wrong, why is it said that the obligation is one of loyalty, rather than simple obligation itself? Why is it that no defence is allowed to a fiduciary who breaches his obligation of honesty, good intentions, or even no loss suffered on the part of the principal? It even becomes difficult to justify why the fiduciary obligation is imposed as a matter of status on trustees, directors, agents etc., rather than being a subject for specific agreement and negotiation. Such an approach appears to call into question the use and function of the fiduciary duty entirely, what does it do that could not be achieved in simpler terms by contractual provisions between parties?

[107] See for example Ang, T; "All of your bribes and secret commissions belong to me: an analysis of remedies for breach of fiduciary duty" (2016) BSL Rev 52
[108] Houghton, E; "Equity's new darling and the pitfalls of remedial absolutism" (2016) 22 *Trusts & Trustees* 956
[109] Worthington, S; "Four questions on fiduciaries" (2018) 32 Tru. LI 22
[110] Swadling, W; "Constructive Trusts and Breach of Fiduciary Duty" (2012) Trusts & Trustees 18 985, p988
[111] *Ibid.* p998

Sir Roy Goode is similarly against the imposition of a proprietary remedy in cases of bribery, but his reasoning is a little more limited. For him it is simply a question of the fact that he can find no compelling reason in property law or property rights why the principal should have a right to the gain received through bribery by the fiduciary.[112] To him the principal has no proprietary base on which to make such a claim where a bribe has been taken as he can have no expectation of receipt of such a bribe for himself. Such an approach is focused on a straightforward approach to property rights. The default position is that the fiduciary owns the bribe when he receives it. He criticises the approach of Lord Templeman in *Reid* when quoting the maxim that, 'Equity looks on as done which ought to be done', for already assuming the principal has the right of ownership without first justifying that position. However, his own approach in assuming the dishonest fiduciary takes ownership for himself similarly has no independent justification if the Equitable maxim is taken to mean that in the eyes of equity he cannot be treated as the beneficial owner of the property which constitutes the bribe.

Adopting a pragmatic middle ground approach, referenced by the court in *Mankarious* itself, Sarah Worthington emphasises the need for a clear taxonomy of those situations where a proprietary remedy is applicable and those where it is not.[113] Accepting that the fiduciary obligation has a unique character which is derived from the relationship between fiduciary and principal, she proposes a threefold classification where a proprietary remedy would be applicable in the first two classes but not in the third. The first class are situations where the fiduciary makes gains through use of trust property. The second, where they make gains by exploiting opportunities within the purview of the activities they agreed to undertake for the principal. The third class are all other gains, made merely because of the fiduciary position. In such a situation some bribes would fall in the second class and some in the third. Where undertaking transactions on behalf of the principal, a bribe affecting the value of those transactions might fall in the second class. As most likely would the facts of *Mankarious*, *Lister*, *Keech*, *Phipps*, and practically every other case mention in this chapter. Perhaps most surprisingly, according to Worthington *Sinclair* would fall in the first category, leaving only *Reid* as a category three case which would attract an *in personam* remedy. The main attraction for Worthington of this classification does appear to be here belief in its simplicity and practicality. However, I think this arguably turns out to be truer in theory than when actually confronted with factual scenarios. Worthington seems dissatisfied with all existing theoretical justifications for why the proprietary remedy may or may not be applicable. Like Goode, she takes the view that what is needed is a valid justification for why the fiduciary must have the property, but

[112] Goode, R; "Proprietary Liability for Secret Profits: a Reply" [2011] 127 LQR 493
[113] Worthington, S; "Fiduciary Duties and Proprietary Remedies: Addressing the Failure of Equitable Formulae" [2013] 72 CLJ 720

unlike Goode, for her the accusation that the fiduciary has used something belonging to the principal is sufficient to support such a finding. This is a narrow line to tread, especially when the practical outcome is to leave only a tiny lacuna of case which attract only an *in personam* remedy, limited to cases as where there is dishonesty, but which constitutes only a misuse of position with no financial overlap with the property or sphere of influence of the subject matter of the trust. If it were not for the facts of *Reid*, it would be difficult to imagine factual scenarios in which this would be the case. At the same time what is adopted is still a conception of the fiduciary obligation as merely a limited vehicle for remedying wrongs, rather than part of a technically distinct equitable ethic. Though Worthington does take a broader approach to the nature of the wrongs than Swadling, accepting they are governed by the nature of the individual fiduciary relationship, rather than being of a universal and fixed nature.

The true alternative approach is that proposed by Lord Millett and in a slightly simpler form by Lionel Smith. Lord Millett posits his theory of the good man of equity, as discussed in chapter one. The Equitable maxim in *Reid* and the rule that Equity will not allow a fiduciary to deny a proprietary claim by his principal or assert his own where he is in breach of duty, mean that the fiduciary will be looked on at Equity as having behaved properly. The property in question will be treated as having been acquired on trust for his principal.[114] Lionel Smith deems it satisfactory merely to assert that given the relationship between the fiduciary and the principal is one in which rights belonging to the principal are vested in the fiduciary, then all profits and all costs associated with that fiduciary management accrue to the principal.[115] These accounts take a fully equitable approach to the problem, the key is that the nature of the relationship vests legal ownership and power over rights in the fiduciary but the beneficiary remains beneficially entitled to all profitable activity within the sphere of that relationship. This is ensured by the fiduciary obligation which acts in this context to protect the trust necessary for this relationship to function and to channel all gains made by the fiduciary to the principal. The response of the Courts to breach of fiduciary is not a question of remedying an 'equitable wrong' but rather of correcting an aberration in the fulfilment of the functions of the trust relationship.

3.5 Conclusion

Following the case history in relation to the imposition of a proprietary remedy for breach of fiduciary duty by secret profits has served to demonstrate than in its early beginnings

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[114] Millett, P; "Bribes and Secret Commissions" [1993] RLR 7 and more especially in Millett, P; "Bribes and Secret Commissions Again" [2012] CLJ 583

[115] Smith, L; "Constructive Trusts and the No Profit Rule" [2013] CLJ 260

it was clearly understood that a fiduciary was bound to hand over any such gains in specie to his principal. As the law has developed this is best understood as the imposition of a proprietary remedy through the award of a constructive trust in favour of the principal. The exception to this rule in the case of bribes now appears to have been ruled to have been a wrong turn. It is easy to see how the mistake was made. Rather than adopting the simple analysis of automatic equitable ownership from the moment the gain is made by the fiduciary in breach of duty, which is the clearest interpretation of the early law, attempts were made to rationalise what had occurred in specific cases based on a chain of property rights connecting ownership of existing property owned by the principal to the property which was the subject of the gain made the fiduciary. This chain cannot always be linked. When the fiduciary obligation is understood, as proposed by this thesis, as being an integral part of the fiduciary relationship, designed to protect and uphold the loyalty, trust and confidence necessary for that relationship to function, by guaranteeing all property acquired under the purview of the relationship is directed to the principal, then the final decision reached in *Mankarious* seems far more analytically straightforward and satisfactory. When treated as simply a prohibition, breach of which gives rise to a mere ‘legal wrong’ which requires only a basic remedial response, the fiduciary obligation ceases to be subject to completely coherent analysis and indeed its usefulness and function are open to question.

The question of whether or not the remedy is proprietary is a very important one from the perspective of the beneficiary. In making a claim the beneficiary is taking a significant risk, to invest the time and effort into making a claim against his fiduciary. Since the fiduciary has been in charge of the property of the beneficiary or exercising powers on his behalf, the fiduciary will be in control of much of the evidence of his own behaviour. If he is truly dishonest then he may be hard to pursue as he may simply leave the jurisdiction. He will have passed the property through many hands to hide it. He may also be insolvent. From this perspective it is much easier to pursue property than it is to pursue the individual. The proprietary claim opens up to the beneficiary the opportunity to use the more robust equitable tracing rules to recover his property from the hands of the dishonest fiduciary or a thrid party. It also potentially allows the beneficiary to make a more straightforward claim against third parties via accessory liability claims.[116] Once the beneficiary is armed with a beneficiary interest in property that removes at least one layer of facts which he must prove in order to make a successful claim.

Without these stronger remedies the beneficiary may decide it is simply not worth pursuing a claim. This undermines almost all the practical and theoretical arguments for the use of fiduciary duties in the law. If claims are not pursued in the cases of flagrant dishonesty,

[116] See Chapter 5 for more detail on tracing and accessory liability.

then the fiduciary duties are failing to function in the paradigm cases they are meant to regulate. This is far from the core understanding of the duties as guarantors of a fiduciary obligation of loyalty and a relationship of trust and confidence. It also sends the message that if a fiduciary is to breach their duties, then they should do so in the most flagrant way possible to avoid more stringent liability. Imposing a proprietary remedy in both the cases of secret profits and of bribes is perfectly justifiable on the analytical basis laid out in this thesis, and there is very strong policy reason to do so. The decision in *Mankarious* sends the message that the highest obligations of fiduciary duties cannot be avoided on a technicality. Equity is nuanced enough, and considers fiduciary loyalty important enough, to ensure the strongest remedial response is available in all case of breach of duty.

Chapter 4

Issues on the Limits of Fiduciary Liability

4.1 Introduction

Thus far this thesis has advanced the proposition that in order to understand the function and purpose of the fiduciary obligation in the commercial context it is necessary to recognise that its foundations lie in a desire to protect the trust and confidence placed in fiduciary relationships. This is an objective which requires incorporating elements of both the specific relationship in question in any given set of facts and issues of public and commercial policy. We have seen that throughout this discussion a key point of contention has been the issue of how the fiduciary obligation and its associated duties can be properly restricted to appropriate cases. For some this is primarily a question of a proper analytical approach to the use of the fiduciary obligation, while others are more concerned with the practical outcomes. For the former, the key issue is that this equitable jurisdiction not make unjustifiable and incoherent advances into property and contract law. For the latter it is important that the drastic remedies that flow from the fiduciary obligation do not interfere unduly with the free and arms-length operation of commerce. However, it is clear either way there is a significant need to properly define the limits of the imposition of the fiduciary duty.

In a number of areas of the law the issue of the proper limit of the fiduciary obligation has proved controversial in recent years. While each of the specific areas of the law is different, there are a number of recurring themes which unite these difficult cases for the fiduciary obligation. The first theme is the question of the extent to which a commercial party or business person while pursuing their own legitimate economic interest can be required to protect the economic interests of another as a result of fiduciary obligations. This is especially at issue where the relationship is governed by a contractual arrangement between the parties. Allied to this is the issue of to what extent a contractual arrangement or specific agreement can be used to limit the scope of fiduciary obligations and how this limitation takes effect. A second common theme of the difficult, border-line cases is the point at which the pursuit of a tangentially related financial opportunity by a fiduciary is a breach of duty. A third related question is the proper scope and limits of the concept of a conflict of interest in practice. When does a business person cross the line, given that they operate in an environment driven by profits and personal gain.

This chapter will review a number of different areas of current legal controversy to examine how the courts have approached these questions. Firstly this chapter will examine the law on the application of fiduciary duties in so called 'joint venture' situations. In such cases two or more commercial parties agree to unite to pursue a common business opportunity, usually on the basis of a contractual agreement between them. Where one of the parties takes the lead in managing the exploitation of the opportunity, and may even control the corporate vehicle, the finances, and the assets of the venture, there is undoubtedly scope for fiduciary obligations to arise to protect the interests of the other parties.[1]

By way of examining the limits and appropriateness of the application of the fiduciary obligation, the second section of the chapter will focus on the so called '*Pallant v Morgan* Equity'. In such cases a commercial party who makes an informal agreement with a competitor that only one of them will pursue the purchase of a particular piece of property for them to share can be found to hold that property on trust for both.[2] This is not currently classed by the law as a situation which results from fiduciary duty but the alternative approach taken in Equity to these situation adds some clarity to the appropriate scope of the fiduciary obligation.

The next section of the chapter will look at attempts that have been made to modify or exclude fiduciary duties by contract provisions. It appears to now be beyond doubt in English law that a specific contract term can be used to modify or limit the scope of fiduciary obligations.[3] There are potentially valid reasons of commercial flexibility in an arms-length transaction for allowing them to do so. However the position is not so clear when it comes to the content of the obligation, the specific duties.[4]

A similarly nuanced approach can be found in the case law on conflicts of interest in the context of professional advisors, and especially 'Chinese walls' used by large firms to allow them to represent a large number of corporate clients with often competing interests.[5]

Finally the fifth legal controversy that will be discussed is the proper limit of the conflict of interest disability of Directors and other managerial fiduciaries that prevents them from pursuing business opportunities for themselves.[6]

Thus the chapter will move from examples focused on ad hoc co-operative commercial behaviour through to situations in which parties are seeking to pursue their own interests in situations with recognised status-based fiduciary obligations. This will contribute to scholarship by building a more comprehensive picture of the current approach the law takes

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[1] *Ross River Ltd & another v Waverly Commercial Ltd & Ors* [2013] EWCA Civ 910
[2] *Banner Homes Holdings Ltd v Luff Developments Ltd [2000] Ch 372*
[3] *Kelly v Cooper* [1993] AC 205
[4] Law Commission Report No. 236; *Fiduciary Duties and Regulatory Rules* 1995 HMSO Cm 3049 at para 3.29 – 3.32
[5] *Bolkiah v KPMG* [1999] 2 WLR 215
[6] *Regal (Hastings)* [1967] 2 AC 134

in borderline cases. Each of these issues has attracted significant interest but largely in isolation. This Chapter will pull together a number of debates in the law relating to fiduciary duties in a single place and attempt to approach them all with the same consistent analytical method. It is contended that the fundamental aim of the fiduciary obligation is in protecting the integrity of a commercial relationship. This serves to maintain the necessary level of trust and confidence in fiduciary relationships for them to function as an attractive vehicle for investment and economic activity. The pursuit of this objective can dictate with sufficient clarity and certainty the appropriate limits of the application and scope of the fiduciary obligation. This new approach provides a clear way to resolve disputes and place the entire fiduciary jurisdiction on a more sure conceptual foundation.

4.2 Joint Ventures

According to Lord Justice Lloyd in the leading decision of *Ross River Ltd & another v Waverly Commercial Ltd & ors*[7] the term 'joint venture' is "not a term of art either in a business or in a legal context."[8] He referring to the fact that a joint venture is not a relationship with a specific legal definition or which is subject to a specific set of rules. Neither the law nor the business community is seeking to define such a relationship. However, it is not uncommon for business people to enter into agreements which are referred to or even named a 'joint venture agreement' by those involved and in the documentation. Some of these might reach the level of a defined category of legal relationship, a partnership for example, or many private companies. Others remain simply a business relationship governed by contract. In this section the phrase 'joint venture' is used loosely, to mean any relationship between commercial parties which has some kind of legal character and has been created with the intention of pursuing a common business goal or commercial opportunity.

A joint venture situation is one in which the fiduciary obligation does not come about as a result of status, but rather is imposed on the basis of specific facts. Therefore joint ventures are a situation in which the flexibility of the fiduciary duty as a regulatory mechanism comes into sharper focus. In terms of the questions posed in the introduction to this chapter, the key theme that will arise in this context is whether or not a clear line can be drawn between cases which do attract fiduciary obligations and those which do not, especially in a situation which necessarily involves some conflict of interest. A party to a joint venture owes obligations to the other parties but may have the potential to pursue his own interests in preference to those of the joint venture. A clear breach of fiduciary duty if it is owed. The default position

[7] [2013] EWCA Civ 910
[8] *Ibid.* p34

from a common law perspective would be that any contractual transaction would be prima facie negotiated at arm's length and the parties free to pursue any gain that did not breach the agreement. In some cases such an individual may have legitimately reached an agreement as part of the joint venture to allow them to pursue personal gain at the expense of associates. In other cases a party may have too limited a set of obligations to his co-venturers for such a restriction to be justifiably placed upon him by the law of Equity. We are concerned with identifying those cases in which the fiduciary obligation legitimately should be imposed.

Ross River v Waverly[9] concerned a contractual agreement called "The Joint Venture Agreement" ("JVA") between two companies involved in the property development business. Waverly was a company which was set up by Mr Barnett and Mr Harney in order to carry on the joint venture. Harney was the sole Director but it was accepted Barnett acted at all material times as a shadow director. Both were named in the JVA. Mr York, who owned Ross River, was a property investor. The three men had met through previous business dealings and Barnett and Harney had previously owned other companies together. Ross River had land available for a multi-use development project which included a supermarket and a building with 8 shops and a number of flats. The JVA stated that the land would be sold to Waverly at an agreed price. Waverly would complete the development, sell on the property and then pay Ross River either £250,000 fixed profit or a 30% share in the net profits after legitimate project expenses, later increased to 40% by a side agreement. Ross River elected to be paid the profit share. The agreement also stated that the aim of the agreement was to "maximise the profits" of the scheme and for the parties to "share in the profits […] at the earliest possible time". The development did not go smoothly and Ross River became suspicious of the conduct of Barnett, after a delay in the payment of the profits. An investigation found that Barnett had sold or granted long leases on some of the property to himself and that both Barnett and Harney had used proceeds of the sale to give loans to other businesses they owned, as well as incurring large debts against the assets of Waverly. Ross River sued Barnett and alleged that not only Waverly but he personally owed fiduciary duties to Ross River, at minimum to act in good faith in the performance of the agreement, and also to pursue the development in a way such as to ensure maximum profit for all parties to the joint venture.

The case is a good illustration of the issues concerning fiduciary duties in this area. Barnett had essentially managed the company which had been set up to complete the joint venture in a manner which benefitted himself and Harney, at the expense of Ross River. On a strict common law analysis, this would not be unlawful, as he and Harney were the sole owners and Directors of Waverly. Ross River would have only a contractual claim under the

[9] *Supra* n7

terms of the JVA. Of course the men would owe fiduciary duties to Waverly as Directors, but they would be under no such obligations to Ross River merely by virtue of that position.

The question is why should Waverly and Barnett in particular owe Ross River fiduciary duties? In answering this question Lord Justice Lloyd made reference with approval to the work of Australian jurist Gerrard Bean and his work on Joint Operations Agreements ("JOA"), a kind of joint venture which is used in the petrochemicals industry.[10] Bean argues that since in such agreements there is generally one party, usually the one which holds the largest stake, taking the lead in the project and known as the Operations Manager, that party must owe the others fiduciary duties.[11] Bean advances 3 different arguments in support of this proposition. Firstly, he argues that the situation is closely analogous to that of a managing partner in a partnership. There are many partners who have a stake in the profitability of the undertaking, but only a smaller number actually manage the business of the partnership. Secondly, Bean argues that in situations of joint venture like that of the JOA the agreement between the parties is one in which, "the purpose of the relationship is maximising returns and one or more persons control the investment making decisions and profit-making apparatus from the others."[12] According to Bean this is the essence of all relationships which give rise to what he calls managerial duties, such as those of an agent, director or trustee. To complete this argument Bean relies on his third point which is one he credits to Finn. The rationale for the intervention of fiduciary duties is that where a situation arises in which a fiduciary office holder has the power to act for the benefit of another without supervision of his management, then it is the duty of the Court of Equity to supervise those actions.[13] Taking this together Bean advances a coherent argument that in situations where a contractual arrangement is made between parties to pursue a joint business enterprise, it is possible and even likely that fiduciary duties will be owed by any party with management or investment powers that are exercised independently of the other parties. The content of these duties will be an obligation to pursue the best interests of the venture in good faith and to avoid conflicts of interest and secret profits which preference the interests of one party over the others.

While this position is relatively complete on a theoretical level, it becomes more difficult when applied to real world situations. In particular the detail of the joint venture agreement becomes key. Some contractual arrangements may be more akin to relationships where one party is simply providing specific services such as construction or project management to the other for an agreed price. In another common type of business relationship one party simply

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[10] *Ibid.* para 51

[11] See Bean, G; *Fiduciary Obligations and Joint Ventures: The Collaborative Fiduciary Relationship* (OUP, Oxford 1995) Chapters 3 and 8 and Bean, G; "The Operator as Manager: A New Fiduciary Duty" (1993) JBL 24

[12] Bean, G; "The Operator as Manager: A New Fiduciary Duty" (1993) JBL 24, p27

[13] *Ibid.* p28 referencing Finn, P D; *Fiduciary Obligations*, (1977, Law Book Company), p9-14

offers investment to another in order that one party can pursue a profit making enterprise in exchange for an agreed return. In both such cases it would not be desireable to impose a fiduciary duty on the second party as to the manner in which they conduct themselves in fulfilling their contractual obligations. Rather, if they provide the result obliged of them under the contract they are entitled to do so in whatever manner is most beneficial to their own interests. In *Ross River* the defence sought to argue that the joint venture agreement created little more than an investment relationship. That Ross River could not restrain the behaviour of Waverly with money it received and of which it was absolute owner. This argument carries some force, it must be clearly understood that Ross River could not assert a claim to ownership of assets of money which were received by Waverly in payment for the sale of the completed properties. They were entitled only to a proportional share of the disbursement of the net profits of the completed enterprise. To attempt to alter this state of affairs would be an unjustified modification by the courts of the nature of the JVA. Rather the successful argument advanced by the Claimant was that in paying out money to connected companies and incurring large debts Waverly and Barnett had acted for improper purposes and/or had preferred their own interests to those of Ross River and the joint venture in breach of fiduciary duty.

To reach this positon the court recognised that it was necessary that the relationship must contain "special features" which uniquely identified the relationship as one which was a joint venture with a fiduciary character.[14] Some of these features were of a general character while others would turn on the individual facts of the case. The court cited[15] with approval the case of *Murad v Al-Saraj*[16] in identifying a number of features which could be of significance.

In *Murad* 2 sisters, ("M"), were enticed by an Iraqi national, Al-Saraj, who lived and had businesses in the UK, to enter into a joint venture to purchase a hotel in London. In order to persuade them to invest he offered to contribute £500,000 to the purchase price of £4.1 million. They would pay £800,000 and the rest would be financed by a bank loan he would arrange. He would run the hotel as a business, splitting the profit equally three-ways between them. If the hotel was sold he would receive 50% of the profits as would M. Al Saraj arranged the purchase through a complex legal vehicle and ran the hotel for some time. Eventually concerns about him were expressed to M and on investigation they discovered that the purchase price of the hotel was actually listed as £3.6 million and not the £4.1 million they had been told. Al-Saraj claimed to have made his contribution to the purchase by off-setting part of the cost with various debts he was owed by the vendor, which he contended but could not prove exceeded £500,000. The court held that as the hotel had been purchased for £3.6

[14] *Crossco No. 4 Unlimited v Jolan Ltd* [2011] EWCA Civ 1619
[15] *Supra* n7, p35
[16] [2004] EWHC 1235 (Ch)

million and not £4.1 Mr Al-Saraj was in breach of fiduciary duty. He had not obtained informed consent and had acted deliberately and deceitfully in order to make a profit. Thus he was liable to account to M for the full value of the profit he had made from the agreement. The hotel had by this time been sold for a profit of over £2 million and as a result Al-Saraj saw none of that profit. This result was obviously a drastic one, and potentially even arguably generated that risk of altering the terms of a contractual arrangement, in that it stripped on party to the joint venture entirely of its benefit.

In establishing the fiduciary duty which prevented Al Saraj from behaving in the manner that he did, Mr Justice Etherton states that the situation was, "a classic one in which the Claimants reposed trust and confidence in Al-Saraj by virtue of their relative and respective positions."[17] This highlights the trust and confidence vested in the relationship as the central distinguishing feature necessary for a joint venture to give rise to fiduciary duties. The judge also appears to be saying that identifying such a relationship flows from an examination of the positions of the two parties under the agreement and the manner in which they relate to one another. Specific features of the relationship in this case that gave rise to the finding were, among others: the fact that M lived abroad and expected Mr Al-Saraj to make recommendations for investments in England;[18] the joint venture itself and its over-riding importance over the corporate vehicle used to implement it;[19] the distribution of profits was determined by an agreement independent of that corporate vehicle;[20] the relative experience of Mr Al-Saraj in the London property market and in running the specific hotel as compared to M;[21] the fact Mr Al-Saraj was responsible for appointing agents and had at times himself acted as an agent for M;[22] and finally in the words of Mr Justice Etherton, the fact that the sum total of these factors was that, "the Claimants were wholly dependent on Mr Al-Saraj" in relation to most if not all of the significant decisions of the joint venture and its implementation.

Similarly in *Ross River*, having approved the dicta in *Al-Saraj*, Lord Justice Lloyd quotes with approval a long section of the judgement of Morgan J at first instance in which he sets out the relevant features of the relationship which gave rise to the necessary trust and confidence for a finding of a fiduciary duty.[23] These include: the JVA itself; the fact that the operation of the JVA was completely in the hands of Waverly and Mr Barnett; that profit was allocated in a specific way by the JVA and subsequent agreements going beyond simple

[17] *Ibid.* p332
[18] *Ibid.*
[19] *Ibid.* p328
[20] *Ibid.* p333
[21] *Ibid.* p328
[22] *Ibid.*
[23] *Supra* n7, p39

distribution of investment profits; that the JVA specified Waverly should provide Ross River with invoices and receipts for expenses and that the disbursement of profit should occur to Ross River before Waverly paid itself or treated the profit as its own; the fact that Waverly had all effective control over these payments; the fact that Ross River had no nominee Directors on the board of Waverly or even a shareholding in that company to protect their position, and; the fact that taken together these things constituted a high degree of trust in Mr Barnett, something which he freely admitted in evidence.[24]

While these factors are clearly highly sensitive to the specific facts of each case, there are some striking similarities. Important in both cases were factual control of the day to day operations by one party, with little or no means of effective supervision by the other. Similarly in both cases importance was placed on the centrality of the joint venture itself, rather than the vehicle or agreement used to pursue the opportunity itself. That is to say the courts in both case appear to treat the fact the opportunity was pursued together by the two parties of greater importance than the technical detail of how it was pursued, and found evidence to that effect in the actions and agreements of the parties themselves. In addition, in both cases there was emphasis placed on the agreements regarding the disbursement of the profits of the venture, which went behind a simple share distribution. Having said that one feature which is lacking in *Ross River* which is more apparent in *Murad v Al-Saraj* are features of the relationship which are closely related or analogous to a classic, status-based, fiduciary relationship. Al-Saraj was close to being an agent of the Murads, albeit one who shared in the profits of his labour, whereas while Mr Barnett was a Director of Waverly, he had no such relationship to Ross River itself. The case essentially ignored any issue of the corporate identity of Waverly and the fiduciary duties Mr Barnett owed to it, allowing a claim against him by Ross River for duties found to be owed to it directly.

At this point it is helpful to consider the practical reasons why the imposition of a fiduciary duty is desirable in the context of a joint venture, and how these factors relate to the factual indicators identified in the case law. A primary reason why the law should impose fiduciary duties in certain joint venture scenarios, which is also a factor in their identification, is that such cases involve control of the interests of one party by another. This power over the actions of the joint venture and thereby the financial interests of the other parties by one or more of the participants potentially requires the intervention of the law to police behaviour and enforce basic standards. Michael Lower argues that the imposition of fiduciary duties should extend as far as shareholders and parent companies in a group. He states that key reasons for such an imposition are the danger of a controlling party setting up in competition with the

[24] *Ross River v Waverly* [2012] EWHC 81 (Ch), p257

interests of the joint venture, diverting profits or opportunities from it to a new venture, and the risk of self-dealing.[25] While disagreeing with his ultimate conclusion for reasons which will be discussed below, it is undoubtedly the case that these concerns are reflected in the factual circumstances key in the finding of fiduciary duties in both *Ross River* and *Murad*. In addition to these key practical reasons there are important analogies that can be made with defined categories of status based fiduciaries. Some joint ventures are of a nature resembling quasi-partnership and fiduciary duties are important in controlling the excesses which result from the ability of one party to a joint venture to bind another or cause detriment to their interests.[26] Other joint ventures can be more akin to types of agency, as in *Murad*, or even Directorship in cases of managerial duties as identified by Bean.[27] Finally, analogy can be made in some cases of joint venture to the position of minority shareholders in a company. An action lies against a company where the decisions of the Directors unfairly prejudice the interests of some of the members over those of the others.[28] This action is notoriously difficult to utilise effectively both because it is difficult to prove and because it is generally very expensive to pursue. In a smaller or medium sized venture the imposition of fiduciary duties between the joint venture parties can potentially provide a more effective and more easily accessible remedy. A party who has a smaller stake, with limited control, or who has no managerial function can use the fiduciary duty as a means of protecting their interests. He is guaranteed a more attractive remedy in the event of a successful claim by virtue of the fact that the claim will be directly against the managing parties in the venture rather than against the corporate vehicle. This avoids the party cutting off his own nose to spite his face, being forced to pursue an action against a business in which he himself has an interest. As such the fiduciary duty in this context provides a valuable protection for investors in what otherwise could be highly risky ventures. Investing in a small or medium sized project will often require vesting a great deal of faith and trust in another individual or small group of business partners, in a context in which any real oversight or control will be impractical. The fiduciary duty can therefore be rightly imposed to correct the imbalance and reduce agency costs.

However, this imposition cannot be unrestrained. Altering the fundamental nature of a contract between parties is an unacceptable interference in the legal and business autonomy of the parties. It has the potential to undermine the rule of law, incentivise frivolous claims and discourage efficient and innovative business models. Similarly, too widespread a use of the

[25] Lower, M; "Good Faith and the Partly Owned Subsidiary" (2000) JBL 232
[26] See for example the case of *Elliott v Wheeldon* [1992] B.C.C. 489 which involved guarantees and as a result the court accepted there was an arguable case that one party had a duty not to act so as to cause the other to become liable for unnecessary debts.
[27] *Supra* n12
[28] Companies Act 2006, s994

fiduciary duty could easily interfere with the effectiveness of a large number of investment vehicles. The independent legal personality of the Company has proved a highly successful institution for the advancement of investment and commerce. The detached investor, who funds a project without wishing to be concerned with the management or subject to the risks of the venture beyond the scope of his initial investment is an important figure in modern commerce. Important too is the arms-length and straightforward character of the simple contract of sale. These simple common law vehicles should not be undermined by the imposition of onerous fiduciary duties except in extraordinary and well defined circumstances. For this reason they will not normally be found where the institutional vehicle for the conduct of the business is the clear object of the legal arrangements between the parties rather than the relationship itself. Birchall notes that for this reason much of the intense discussion which was developing in the 1990s around fiduciary duty in the context of joint ventures was "set back"[29] by the decision in *Re Goldcorp Exchange Ltd*.[30]

Goldcorp promised purchasers it would hold gold purchases for them until they ordered delivery but in fact it simply maintained a rolling investment stock and satisfied requests for delivery as and when they arose. In finding the purchasers could assert no proprietary claim when the company went bankrupt Lord Mustill delivering the judgment of the Privy Council stated:

> "Many commercial relationships involve just such a reliance by one party on the other, and to introduce the whole new dimension into such relationships which would flow from giving them a fiduciary character would (as it seems to their Lordships) have adverse consequences far exceeding those foreseen by Atkin L.J. in *In re Wait* [1927] 1 Ch. 606."

The nature of the contract was simply one of sale with no exceptional aspects which could be said to give rise to a relationship of trust and confidence based on loyalty. As such it would not have been appropriate to impose fiduciary obligations on Goldcorp Ltd. They were just in breach have contract. To retrospectively alter the position in this case, as unfortunate as it was, would have had far reaching and devastating impacts on commerce. Similarly in *Shalson v Russo*[31] the court declined to find a fiduciary duty in a case of a joint venture. One party had used a bank under his control to falsify accounts which made it appear to his partner he had made investments into the venture which he had in fact not made. In reliance on this his partner also put large sums of money in the joint venture company, which the dishonest

[29] Birchall, J; "Duties of Good Faith in Commercial Joint Ventures? Contractual Duties, Fiduciary Duties and Shareholder Remedies." (2005) JBL 269, p276
[30] [1995] 1 AC 74
[31] [2005] Ch 281

partner largely embezzled. While a case of shocking fraud it was found not to give rise to fiduciary duties between the joint venture parties in addition to the duties owed by the directors to the company. The innocent investor had not intended a relationship of trust and confidence. He was investing absolutely in a company of which he believed had equal control via a nominee director, and was deceived by a falsification of documents. The fiduciary duty is not a blanket remedy for all cases of fraud.

In two further joint venture cases since *Ross River* the courts have found no fiduciary duties arose. In *Pennyfeathers Ltd v Pennyfeathers Property Co*[32] 2 directors of a company set up with other parties to pursue the joint development of farmland on the Isle of Wight were found to have breached their fiduciary duties to the company but not to have owed duties to the other parties directly. The court made it clear a joint venture did not automatically give rise to fiduciary duties. In this case there could be no such duties as all parties to the venture were intended to have equal rights to participate in the management of the venture and all were made directors of the joint venture company. As such the court felt there had been no intention to create a relationship of trust and confidence.[33] Likewise in the case of *Miller v Stonier*[34] the court held that an engineer who designed gas fires owed no fiduciary duties to the individual with whom he had had bought out a previous business of his which had run into difficulties. He owed duties to the company they had set up together of which he was director. However, once that company had ceased to manufacture gas or electric fires, he was free to operate a company which competed with another business wholly owned by his former partner that still manufactured the patents belonging to their joint venture. The reasoning for this decision was more complex and involved some issues of restraint of trade, emphasising the practical importance of not imposing the fiduciary obligation too widely on commercial actors, but the primary reason for the decision was that the court found there was no reliance by one party to the venture on the other. The joint venture was pursued on an equal and arms-length basis.[35]

Concluding on this issue then, it is clear that a fiduciary duties can exist alongside of a joint venture contractual arrangement and persist independently of the legal or corporate vehicles used to pursue the joint venture. Michael Lower argued convincingly for this position in 1994[36] on the basis of the decision in *Ebrahimi v Westboune Galleries*[37] which sought to pursue outcomes in joint ventures which were 'just and equitable'. Fiduciary duties are relevant where two or more parties pursue a joint venture based on mutual trust and confidence and

[32] [2013] EWHC 3530 (Ch)
[33] *Ibid.* p101
[34] [2015] EWHC 2796 (Ch)
[35] *Ibid.* p75
[36] Lower, ; "Towards an Emerging Law of Joint Ventures: *Elliot v Wheeldon*" [1994] JBL 507
[37] [1973] AC 360

where one party or more has management responsibilities and power over the conduct of the venture because of the legal or factual vulnerability of the others. However, it is clear that if poorly understood or expanded in an excessive manner by the courts this principle has the potential to severely disrupt and interfere with the proper workings of commerce, investment and business. In order to avoid such confusion it is suggested that the courts must have clearly in mind the question which they must answer and the factual circumstances which are relevant to determine the matter. From the case law, it appears that there are three main principles required to establish that the parties to a joint venture are subject to fiduciary obligations:

Firstly, the court is seeking to identify a relationship which has the special character of a fiduciary relationship, namely that it is one of mutual trust and confidence which gives rise to an obligation of loyalty.

Secondly, for such a relationship to be present there must be the ability on the part of one or more parties to exercise power and control over the business and conduct the venture on behalf of the other parties to the venture. Though this in and of itself is not conclusive evidence of a relationship of trust and confidence.

Thirdly, the final determination of whether such a relationship is present and whether fiduciary duties should be imposed will turn on the specific factual circumstances of the case at hand. These may include but are not limited to: an independent joint venture agreement and its terms; specific or detailed arrangements as to the division of profits which go beyond standard company dividends or investment returns; factors relating to control over day to day finances such as time and distance; the presence or not of nominee representatives for all parties; the relative expertise of the parties; the relative importance in defining the relationship of the venture itself, the personal relationship between the parties and the institutional vehicle used to pursue the venture; any factual circumstances analogous with status based fiduciary relationships such as agency or partnership; along with any other specific features of the relationship at hand, and; any relevant policy considerations, especially the need to avoid any far reaching effects on a class or classes of common law contractual relationship.

By pursuing an analytical and definite inquiry such as the one above the courts can ensure that there is relative consistency in the imposition of fiduciary duties in joint venture relationships.[38] It should also be clear that what is being pursued is a defined legal status, the relationship of trust and confidence defined by a duty of loyalty, rather than any value judgement about the relationship and duties to which the court believes the parties 'should' be subject. In doing so the courts can pursue the benefits of the protection provided by the

[38] Recent judicial support for a very similar approach can be found in *Farrar v Miller* [2018] EWCA Civ 172 and *Instant Access Properties Ltd v Rosser* [2018] EWHC 756 (Ch)

fiduciary obligation in this context without risking far reaching and damaging unintended consequences.

4.3 The Equity in Pallant v Morgan

The case of *Pallant v Morgan*[39] concerned two rural landowners who for amenity reasons wished to acquire woodland being sold by a neighbouring estate. As each was aware of the interest of the other, they entered into negotiations to see if they could agree on a joint bid, to avoid pushing up the price either would have to pay at auction. Discussions were long and protracted and the day of the auction arrived without final agreement. Each sent an agent to the sale to bid for them, and on the day the two agents reached an agreement that only one of them would bid for the land. They agreed to work out an acceptable division later. After one had successfully made the purchase, his master refused to honour the bargain and sought to keep all the woodland for himself, having obtained it for a price well below his maximum. Harman J held that when he was bidding on the land, the agent of one was in fact bidding on behalf of both parties and that therefore the land was held on trust equally for the both.

This case was not apparently decided on the basis of fiduciary duty, nor indeed was the factual situation described as a joint venture. In fact the only justification offered for the decision in the case itself is an oblique reference to the principles of agency. The reason why it finds a place in this chapter is because in the modern case law, beginning with *Banner Homes Holdings Ltd v Luff Developments Ltd*,[40] the law behind the decision has become the subject of much controversy, with fiduciary duties being considered as a possible explanation.[41] Thus many of the questions which arise in respect of the proper limits of the fiduciary duty also arise in this context. When and how should the *Pallant v Morgan* equity arise? How should its proper limits be defined? How can the potential interference with the autonomy of commercial parties be justified and how can the courts avoid substituting the agreements of the parties for those of their own making? The status of this doctrine raises many of the analytical disputes about the nature and use of equitable principles in a commercial context which underlie this thesis.

The constituent factual elements of the *Pallant v Morgan* equity seem to be reasonably certain and uncontentious. *Banner Homes* was a case in which two parties agreed to purchase a development site with a view to a joint venture to sell on part of the site and to construct residential dwellings for sale on the rest. The negotiations reached an advanced stage and an

[39] [1953] Ch 43
[40] [2000] Ch 372
[41] See for example Grower, JAW; "Explaining the Pallant v Morgan equity" (2016) 6 Conv. 434

outline agreement was reached in principle, though not completed such that there was a binding contract. The plan was to formalise the contract in a shareholders' agreement of the joint venture company. Prior to this occurring, it became necessary to complete the sale and one party, Luff Developments bought the site outright. At this point they sought to exclude Banner Homes and develop the site exclusively themselves.

Chadwick LJ identified five constituent elements of a *Pallant v Morgan* equity which gave rise to a constructive trust and held that such a trust had arisen in the case before him.[42] Firstly, normally there must be an agreement or arrangement made prior to the acquisition of property, or where one party is already owner of the property an arrangement or agreement which is sufficiently certain that it could be specifically enforced. Secondly, the agreement need not be one which is contractually enforceable, and indeed it usually will not be, otherwise the equity will be unnecessary. Thirdly, the agreement will specify that when one party acquires an interest in certain property the other party will also have an interest in it. Fourthly, in reliance on the agreement the non-acquiring party must either have conferred some advantage to the acquiring party in its ability to acquire the property or incurred some disadvantage to its own relative ability to acquire the property. It is this fourth element, according to Chadwick LJ, which gives rise to the inequity at which the *Pallant v Morgan* Equity is addressed.[43] Fifthly and finally, while there will commonly be an advantage to the first party and disadvantage to the second in keeping the second out of the market, this is not itself necessary or the only possible form of advantage/detriment which will satisfy the fourth requirement. Similarly, while the advantage to one will normally correspond with the detriment to the other, this also is not a necessary or determinative element. The equity will probably not apply if the first party has warned the second they intend to withdraw from the agreement in time to reverse the benefit or detriment conferred by the second party.

Four or five, possible legal justifications for the existence of this equity have been advanced in the case law and by academic commentators. The rationale which currently carries legal authority is that the *Pallant v Morgan* equity is an example of a common intention constructive trust ("CICT"). A CICT arises when two parties, usually in the context of a family home, have an understanding that both parties should have a beneficial interest in the property in question which is not reflected in the legal ownership. The court can infer their intention as to the existence and proper proportions of this beneficial ownership from the statements and actions of the parties across the whole course of their relationship.[44] This is the authoritative interpretation of the *Pallant v Morgan* equity due to the reasoning in *Banner Homes*. Chadwick

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[42] *Ibid.* p397 et seq.

[43] *Ibid.*

[44] *Lloyds Bank plc v Rosset* [1990] UKHL 14, *Stack v Dowden* [2007] UKHL 17, *Jones v Kernott* [2011] UKSC 53

LJ bases his finding in that case on the findings in *Lloyds Bank plc v Rosset*[45] and *Gissing v Gissing*[46] that a trust could arise in the case of family homes in the sole name of the husband which modified the legal ownership of land in a situation where the proper formalities were not present.[47] This reasoning was recently confirmed in the case of *Crossco No. 4 v Jolan Ltd*,[48] in which a *Pallant v Morgan* equity was rejected in a case which arose out of complex demerger of businesses in the estate of a deceased. A group of beneficiaries who had become landlords of a property exercised a break clause in the lease agreement of other beneficiaries who owned a business operating out of the property. The judges ruled that until a decision of the Supreme Court found to the contrary, the Court of Appeal was not able to reassess the reasoning in *Banner Homes*. In the same case Etherton LJ forcefully argued that the CICT was no longer a reasonable basis for the *Pallant v Morgan* equity as its application was now either expressly or impliedly limited to the domestic context and was inappropriate in the commercial setting.[49]

Generally academic commentators have also endorsed Etherton's criticism, though not necessarily his solution, which is discussed below. Hudson has described the suggestion that the basis of the *Pallant v Morgan* was CICT as "simply wrong".[50] Some commentators such as Yip[51] and Nield[52] have advanced arguments that the CICT can operate in a different manner in the commercial context than in the domestic sphere. However, Yip argues that the presumption of resulting trust will cover most cases more effectively and ultimately concluded the CICT was an inappropriate basis for the *Pallant v Morgan* equity. Nield was writing before the developments in *Stack* and *Jones*. Lower has argued with some force that the common intention constructive trust should be viewed more as a continuum rather than a dichotomy between the domestic and the commercial,[53] especially in light of the case of *Yaxley v Gotts*.[54]

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[45] *Supra* n41

[46] *Gissing v Gissing* [1970] UKHL 3

[47] Normally any transfer of the beneficial ownership of land must be done in writing. Law of Property Act 1925, s53

[48] [2011] EWCA Civ 1619

[49] *Ibid.* p85-87. Essentially his reasoning is that the use of the CICT in the domestic context has now reached an advanced level of specialism which allows the courts to create an "ambulatory trust" the terms of which are flexible and inferred on an ongoing basis with reference to the conduct of 2 parties in an intimate relationship due to the lack of expertise and lack of forethought of domestic parties in such cases. This is clearly inappropriate in the context of arms' length commercial transactions between professional parties as it involves the courts investigating the facts and conduct of an informal relationship and creating a legal relationship accordingly and as such would be an unjustifiable interference in the process of commercial relations if applied in the same way in a business setting. Comments in *Stack v Dowden* [2007] UKHL 17 and *Jones v Kernott* [2011] UKSC 53 support this dichotomy.

[50] Hudson, A; *Equity and Trusts* (7th Ed. 2013, Abingdon: Routledge) p564

[51] Yip, M; "The Pallant v Morgan Equity Reconsidered" (2013) 33 Legal Studies 549

[52] Nield,S; "Constructive trusts and estoppel"(2003) 23 Legal Studies 311

[53] Lower, M; "The Pallant v Morgan equity" [2012] Conv 379

[54] [2000] Ch 162

However, he does not address the fact that in the domestic context the court has moved away from requiring direct financial contribution to purchase price as justification for a finding of a CICT, a point emphasised by Yip,[55] nor the fact that the court can impute rather than infer the common intention. Both of these aspects of the domestic CICT are inappropriate for transfer to its application in a commercial context for obvious reasons. No boundary line as to when and how they should be limited on the continuum analysis has been suggested, and in any case neither is of determinative importance to the *Pallant v Morgan* equity. This means that two of the defining features of the modern law on the domestic CICT are absent from the *Pallant v Morgan* equity. It is at least strongly arguable that to continue to cling to the more limited developments that took place in *Lloyds Bank plc v Rosset* and *Gissing v Gissing* as justification for the jurisdiction are flawed and no longer of relevance. The factors which now drive the development of the CICT, and drove it at the time of those earlier decisions, are now clearly understood to relate exclusively to domestic relationships, even if it is theoretically possible for the pre-existing principles of the CICT to continue to exist in the commercial context. Ultimately therefore the position is that the understanding of the *Pallant v Morgan* equity as based on a CICT, although it has legal authority, is now widely regarded as unsustainable. This has in turn led to considerable uncertainty about the proper limits of the *Pallant v Morgan* equity.

The second possible justification for the equity, and that espoused by Etherton LJ in *Crossco* is that it arises, at least in most cases, through a simple operation of fiduciary duty. Relying on *Murad v Al-Saraj*[56] Etherton LJ states that in the special circumstances of a joint venture it is possible for the parties to be in a position where they owe one another fiduciary duties and that this is the best and most practical explanation for the decision in *Banner Homes*.[57] While this is a rather limited theoretical analysis, Etherton LJ goes on to say that he regards the fiduciary duty analysis as the most practical solution in that it provides certainty to the *Pallant v Morgan* jurisdiction through its simplicity. Given the complexity of fiduciary duties, this may seem a little optimistic, however there are many ways in which merging the *Pallant v Morgan* jurisdiction with that of fiduciary duties in joint ventures appears attractive. For one thing, as discussed above, joint venture relationships giving rise to fiduciary duties can now be regarded as having a relatively firm limit in that they require a relationship of trust and confidence in which one party has the power to act on behalf and with authority over the interests of the others in the venture. The paradigm facts of *Pallant v Morgan*, especially in a commercial context, also appear to fall relatively well into the envisaged category of a joint

[55] *Supra* n52
[56] *Supra* n16
[57] *Supra* n49 p88

venture. Two parties pursuing a commercial acquisition in which one will become legal owner and the other will have an interest creates the power imbalance, the separation of control and the vulnerability necessary to impose fiduciary duties.

However, the analysis is by no means perfect. Uguccioni objected to an understanding of *Pallant v Morgan* equities based on fiduciary duties on the grounds that the appropriateness of a proprietary remedy, which is the normal result of a *Pallant v Morgan* equity, was in dispute in the context of fiduciary duties.[58] Much of this criticism was based on the decision in *Sinclair v Versailles*[59] which now must be read in the light of *FHR European Ventures*[60] which adopts a wider approach to the imposition of constructive trust in cases of breach of fiduciary duty. However, differences between the imposition of constructive trusts in breach of fiduciary duty in joint venture situations and in the *Pallant v Morgan* equity do still remain. The *Pallant v Morgan* equity appears to cover situations in which the relationship in question will not yet have given rise to fiduciary duties in respect of the acquisition as it precedes the beginning of the venture. To apply fiduciary duties to some *Pallant v Morgan* situations might expand their remit to an unacceptable degree. If two parties are considering an acquisition of land for development, where one party is essentially an investor who will profit from the eventual sale and the other is a construction company whose main interest is to profit from contracts related to the development, then what we have is arguably less a joint venture than a proposed contractual relationship for the development of a site. A number of cases where *Pallant v Morgan* equities have been asserted but not found have been such facts. If this kind of pre-contractual negotiation can become subject to fiduciary duties that could have unfortunate effects in limiting negotiation and entrepreneurial co-operation. As the distinguishing feature of the fiduciary obligation is loyalty[61] the imposition in such a context could potentially introduce highly limiting duties of disclosure and good faith, as well as non-conflict and non-profit obligations. It would be extremely difficult to begin such discussions without it being impossible to withdraw later.

At the same time there could be fiduciary relationships into which we do not wish to see *Pallant v Morgan* principles extended. Where a fiduciary joint venture contains an ongoing business element which requires negotiations between parties to continue beyond the initial agreement some business freedoms are still necessary. Equity should not conclude that fiduciary joint venturers are bound to hold every piece of property they discuss on trust.

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[58] Uguccioni, J; "Buyer beware: failed joint venture negotiations and involuntary business partnerships" [2011] JBL 160

[59] [2011] EWCA Civ 347

[60] [2014] UKSC 45

[61] *Bristol & West Building Society v Mothew* [1996] EWCA Civ 533

Nield has argued,[62] with later support from Lower,[63] that the features of the *Pallant v Morgan* equity do give rise to a fiduciary relationship. She contends that the need for a sufficiently certain pre-acquisition arrangement demonstrates a relationship of trust and confidence and that the conferment of a benefit or detriment in the acquisition demonstrates the vulnerability of the non-acquiring party. This analysis is compelling. It substantially simplifies the doctrine, uniting it with a larger category of equitable principles, but the analogies by which the conclusion is reached bear some further consideration. It is questionable whether it is desirable to conclude that a relationship is one of trust and confidence merely because the parties reach a definite but informal agreement to co-operate on some future purchase or venture. Such a position seems at once both too narrow and yet also too vague. Fiduciary relationships can arise where one party has become the legal owner or custodian of the beneficial interests of another without any agreement,[64] and equally they should clearly not arise as a matter of course in the type of pre-contractual negotiations envisaged above, as between prospective entrepreneurs and their investors. An agreement to agree, which is unenforceable at common law, need not necessarily give rise to any trust and confidence. Obviously Nield's argument has more subtlety than this as the finding of a fiduciary relationship on her account is also tied to the second issue of a change of position in relation to acquisition, which creates a vulnerability. However, this second limb is again limiting to the concept of a fiduciary relationship but in not directly relevant in establishing one. Where it is the actions or omissions of the non-acquiring party that confer the benefit on the acquiring party or the detriment on themselves, in what sense is there a vulnerability of the non-acquiring party to the acquiring one, or a power which the former holds over the later? The actions may even be unsolicited by the acquiring party. It is ordinary commercial behaviour to attempt to induce another to do business by making the deal more attractive.

It may be that the fiduciary relationship could be said to be a consequence of the intersection of the two elements, the agreement and the benefit or detriment, however in this case the fiduciary relationship does not arise at any defined point in the conduct of the parties, rather emerges in a rather unclear fashion out of the course of their dealing, neither created by the agreement itself, which must wait for the benefit or detriment to be incurred, nor by the changes of position, which are dependent on being prompted by a definite agreement. This is not an acceptable approach to the imposition of the fiduciary duty in that, much like the domestic CICT, it is rather too 'ambulatory'. The nature of the legal relationship of the parties is not sufficiently clear to justify the level of intervention which comes with the imposition of

[62] *Supra* n53
[63] *Supra* n54
[64] *Foskett v McKeown* [2000] UKHL 29

the fiduciary obligation. Rather, as has been seen above, such a finding must necessarily be based on the nuances of the factual relationship as clearly established and understood by the parties. The parties may not be aware they owe fiduciary duties per se, but they should be aware the relationship is one of mutual trust and confidence. The conscience of the fiduciary party should properly be affected by breach of the duties of their trust, regardless of their awareness of the legalities. This is not necessarily satisfied by the paradigm of the *Pallant v Morgan* equity. Rather in such a situation it appears to be sufficient that the acquiring party has an advantage in acquisition relative to the non-acquiring based on an informal agreement to share the target property.

The fundamental issue is that the fiduciary duty approach and the core approach of the *Pallant v Morgan* equity address similar, but ultimately distinct possible sources of unconscionability. The *Pallant v Morgan* equity serves to address the inequity created when negotiations and associated actions by the parties reach a stage which confers a benefit on the acquiring party such that their relative ability to freely bid to acquire the property is altered. The conscience of the acquiring party is affected directly by the advantage he receives from the informal agreement that the other party should share in the property. On the other hand the joint venture fiduciary duty addresses an ongoing imbalance in the power and control of a joint venture which might allow one venturer to exploit his vulnerable partner. It protects the trust and confidence of their relationship. These equities can obviously overlap, and the fiduciary joint venture covers a far larger range of possible factual scenarios, but there is still the narrow possibility of a distinct *Pallant v Morgan* situation in which fiduciary duties are not owed. In such a situation we might find that no formal agreements have been reached, no continuing relationship is contemplated and each party is pursuing independent financial goals through the acquisition. In short the parties are not in a relationship of trust and confidence. Yet the conscience of one party could become affected such that they cannot freely acquire the property without sharing it with the other or first giving them enough warning to rectify the relative imbalance in their ability to acquire. The fiduciary joint venture envisages an ongoing arrangement and relationship whereas the *Pallant v Morgan* equity intervenes in a specific moment in the dealings of some parties, the moment of acquisition by one, ostensibly on behalf of himself and others.

Two other possible justifications for the *Pallant v Morgan* equity are raised in the literature which are of significant interest but are of less relevance to the focus of this paper which is on the limits of fiduciary duties.

Firstly there is the obvious similarities of the jurisdiction with proprietary estoppel. Rather than commonly being suggested as the foundation of the equity itself proprietary estoppel is often pleaded as an alternative cause of action in *Pallant v Morgan* cases.[65] In both cases there is usually an action for a right to property based on a representation, unenforceable at common law, that a party will acquire an interest in the property owned by another. However, there are also clear differences. Nield conducted a thorough review of the similarities and differences between the *Pallant v Morgan* equity and the doctrine of proprietary estoppel and concluded that while there was much in common the two have a clearly different basis, with the former being based on some form of 'express' constructive trust and the latter being 'remedial'.[66] There are also differences between the doctrines in the nature of both the representation required and the form of the detrimental reliance.[67]

Secondly it is sometimes observed that in the case of *Pallant v Morgan*[68] itself, Hudson J does not overtly adopt any of the above rationales and that instead he makes an oblique reference to agency as a possible basis for his decision. He states that when bidding on the property in question that the defendant's agent was "bidding for both parties".[69] This raises some suggestion that the judge may have believed he was deciding the case on the grounds of agency. In some way the agreement to split the land had rendered the purchaser at auction an agent for them both. However, this would clearly not be in line with the accepted rules on the formation of an agency relationship, and for such a relationship to be established without the proper intention to do so would be obviously undesirable. Sir Roy Goode has developed a theory in relation to the finding of a constructive trust in the case of fiduciaries who make what he terms "deemed agency gains".[70] He believes that the constructive trust found in the case of a director who makes a profit pursuing opportunities he should have pursued for his company is justified as the director should have been an agent of the company when making those gains. However, Yip points out this theory has little application in the context of the *Pallant v Morgan* equity as it still requires the defendant party to be in an established agency relationship with the claimant prior to the acquisition, which he is not.[71] Thus it seems likely

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[65] See for example in *Banner Homes*, *Supra* n33, *Crossco*, *Supra* n40 and *Cobbe v Yeoman's Row* [2008] 1 WLR 1752 for a *Pallant v Morgan* pleading in what is normal read as a 'proprietary estoppel case'.
[66] Nield; S, *Supra* n53, p326
[67] In the *Pallant v Morgan* equity there needs to be an express agreement to share the property and merely some alteration in one direction or the other in the relative ability to acquire it, while in a case of proprietary estoppel there need only be an understanding on the part of the claimant that they will acquire an interest which the defendant permits to exist, but there must be clear and direct detrimental reliance on the part of the claimant on that understanding. See in general, Hudson; *Supra* n41, chapters 12 and 13.
[68] *Supra* n40
[69] *Ibid.* p50
[70] Goode, R; "Property and unjust enrichment" in A Burrows (ed); *Essays on the Law of Restitution* (Oxford: Oxford University Press, 1991) ch 9
[71] Yip; *Supra* n52, p568

that the reference to agency by Hudson J was either merely an offhand reference to the facts or his decision or was in error.

Ultimately the best approach may be to regard *Pallant v Morgan* as a distinct equity of its own, separate from other jurisdictions but with some related principles. The difficulty with the current state of affairs is the uncertainty it creates, especially for decision makers. The lack of a clear jurisprudential basis makes it difficult to properly confine the jurisdiction in borderline cases. A recent example of a case in which a *Pallant v Morgan* equity was argued demonstrates the problem. In *Generator Developments LLP v Lidl (UK) GMBH*[72] the claimant ("Generator"), a construction company, and the defendant ("Lidl"), a supermarket chain, both identified the same development site for purchase. At the suggestion of the vendor, representatives of the two companies met to discuss a possible joint venture. They agreed in principle to a joint bid. A store and car park would be built and leased to Lidl, and a number of flats which Generator would market and sell. Generator submitted three offers for the property in letters seen and approved by representatives of Lidl, strongly implying Lidl were refraining from bidding and allowing Generator to do so. However, at a late stage in the negotiations the decision was taken to substitute Lidl as the purchaser of the site. A number of drafts of a joint venture agreement which granted Generator an interest were produced and marked, 'subject to contract' but none was agreed by the time Lidl completed the purchase of the site. After the purchase Lidl informed Generator that they would not be proceeding with the venture and chose to proceed with an open market tender for a partner in the development. The facts are markedly similar to those in *Banner Homes*, but in this case no *Pallant v Morgan* equity was found. The judgement is a detailed and well-reasoned one, particularly in how it addresses the important question of whether negotiations which were said to be 'subject to contract' could ever give rise to a *Pallant v Morgan* equity. At the same time the difficulties the judge faced and the different conclusion reached on similar facts to *Banner Homes* demonstrate how the confusion over the proper analytical basis of the equity has the potential to lead to uncertainty.

The judge rightly rejected the contention that the mere use of the words 'subject to contract' exclude the possibility of an equitable pre-acquisition agreement. There may be an agreement which affects the conscience of the acquiring party prior to all the specific details of the formal legal arrangement being completed. The 'subject to contract' label on legal documents merely demonstrates those documents are not in force, not that no agreement at all exists on an informal level. Indeed were those contracts in place there would be no need for the equity but in exceptional cases. He also correctly distinguished earlier cases on the

[72] [2016] EWHC 814 (Ch)

same subject, *London & Regional Investments*[73] and *Crossco*[74], both cases in which no *Pallant v Morgan* equity was found in negotiations which were 'subject to contract'. These were properly identified as using that as a factual reason for finding there was insufficient agreement for the equity to arise, rather than a determinative legal bar to such a finding. *Kilcarne Holdings*[75] was also distinguished as it did not contain a pre-acquisition agreement.

However, difficulties arose in the reasoning of the judge due to the legal precedent which established the *Pallant v Morgan* equity as a form of CICT. He concluded that there must be a clear agreement demonstrating common intention at the particular moment that Lidl became sole purchaser of the development site. This then coloured much of his analysis as to whether the facts demonstrates the *Pallant v Morgan* equity arose in the case. From the facts as he analysed them it may have been perfectly reasonable to conclude that there had never been sufficient agreement between the parties that they would both have an interest in the property. However, to find that there needed to be direct evidence of a common intention at the moment of purchase seems to make it very difficult for the equity to prevent the unconscionability at which it is directed. The appropriate question should have been whether at any time there had been a clear agreement that both the acquiring and the non-acquiring party would have an interest in the property. Then secondly, whether that agreement conferred a benefit on the acquiring party or a detriment on the non-acquiring party in respect of the acquisition. Then finally, whether the fact Lidl became the acquiring party extinguished either the agreement or the benefit, and if it did not do so, whether there was sufficient time for Generator to be returned to parity with respect to the acquisition prior to the sale being completed. On the facts of the case and the findings of the judge, the result in *Generator* may well have been the same, however in order to confine the doctrine and to avoid uncertainty, it is important to define the terms of the equity which is being addressed, and the inequity which is being regulated.

The competing theories of the jurisprudential basis of the *Pallant v Morgan* equity are in danger of obscuring the factual and legal elements of the doctrine. This danger is one which is common to many equitable doctrines, and indeed it is one which also affects the fiduciary duty, both at the imposition stage and at the remedies stage. Attempts to unify Equity in terms of overlapping jurisdictions and shared values, such as the attempts made to bring *Pallant v Morgan* into the sphere of the fiduciary duty or CICT, may assist in our wider understanding of equitable principles, but arguably can make the doctrines more difficult to apply. Factual scenarios which are outside the paradigm are shoehorned into more widely recognised

[73] *London & Regional Investments Ltd* [2002] EWCA Civ 355

[74] *Supra* n49

[75] *Kilcarne Holdings Ltd v Targetfollow Ltd* [2004] EWHC 2547 (Ch)

equitable forms in search of an illusory coherence. To do so undermines the consistency and clarity of both the smaller and the larger jurisdiction. The starting point for a consistent analysis of an equitable jurisdiction must be the equity itself and potential inequity to which the line of judicial reasoning is addressed. While important in assessing the value of a jurisdiction as a whole, improving the analytical coherence of equitable doctrines may not ensure their clarity and certainty in practice. The purpose of equitable jurisdictions is, or certainly once was, to mitigate inequity in the application of the common law. That historical fact forms the foundation of its many principles.

4.4 Modification of Fiduciary Duty by Contract

One of the most significant areas of debate on fiduciary duties over the last 20 years has been the question of the extent to which it is possible to contract out of fiduciary duties and to modify them by contract.[76] This is a question which goes to the heart of the nature of fiduciary duties and their relevance in a commercial context. The extent to which fiduciary obligations are subject to contractual negotiation has a profound effect on the scope for a commercial fiduciary to pursue their own personal interests, even where those interests may apparently conflict with those of his principal.

It is of great importance that the commercial autonomy is respected. Business people must be allowed to conduct their affairs in the manner that they perceive as most efficient in creating wealth and advancing their commercial interests. It is clearly inappropriate and would give rise to serious uncertainty if the courts are seen to be disapplying the agreements made by commercial men and instead substituting legal relationships of their own design. On the most basic level business law should be seeking to advance the profit making capacity of actors, not inhibiting the conduct of commerce except where absolutely necessary.

On the other hand the ability to contract out of fiduciary duties has the potential to neuter their function to the point of rendering them useless as a regulatory mechanism. The fiduciary obligation is designed to address the power imbalance in a relationship of mutual trust and confidence where the fiduciary party has power and control over the interests of his principal. We have already seen how it achieves this by creating prophylactic protection which prevents even the potential for disloyal behaviour. This also overcomes practical difficulties such as the fact fiduciaries have control over evidence of their own wrongdoing and incentivises enforcement by the offer of forceful equitable remedies. Where parties can freely

[76] The Law Commission has taken the view in two reports in that time that it is possible to do so in limited circumstances: Law Commission Report No. 236; *Fiduciary Duties and Regulatory Rules* 1995 HMSO Cm 3049 and Law Commission Report No. 350; *Fiduciary Duties of Investment Intermediaries* (2014) HMSO Cm 350

and easily contract out of any or all of the behavioural requirements, disbarments and legal remedies of the fiduciary obligation, most of these benefits are rendered far less effective. If a party would be a fiduciary were it not for technical exclusions in a contract then exactly the risks the fiduciary duties are designed to mitigate will be manifested without restraint. In fact, the presence of the exclusion itself suggests that the fiduciary is likely to seek to pursue their own interests above those of the beneficiary in so far as they are able to under the contract.

However, a danger of the analysis in this area, and the competing tensions of the policy considerations mentioned above, is that the debate can be seen as strictly divided between two opposing perspectives. A middle ground may be possible and may be a truer reflection of the actual nature of the fiduciary obligation. While the imposition of the obligation is a matter of strict law, the content of the fiduciary obligation is flexible in how it regulates behaviour in the context of ad hoc fiduciary relationships. This thesis advances the position that it is the nature of the relationship between parties which governs the imposition and content of the fiduciary obligation. A relation with a higher level of trust and confidence will carry with it a stricter interpretation and application of the duties. There is support for this position in the case law on contracting out of the fiduciary obligation.[77] In a commercial context the nature of the relationship between the parties is governed by the legal agreements between them as well as the factual circumstances. Where a legal agreement is freely negotiated at arm's length and with informed consent that can modify the level of trust and confidence placed in the relationship by the parties. The trust they place in one another and what constitutes loyal and disloyal behaviour is governed by their mutual expectations of the relationship based on their agreement.[78] Therefore not all self-interested behaviour need necessarily be disloyalty in the context of commercial relationships. Obviously such an approach limits the ability to clearly and precisely define the exact nature and function of the fiduciary obligation at the abstract level as it is inherently specific rather than general, but it is none the less capable of sound legal analysis and can create predictable outcomes for parties.

One commentator who has written extensively on this subject in recent years is James Edelman, a Justice of the Federal Court of Australia.[79] He is a strong proponent of the view that the fiduciary obligation and fiduciary duties are best understood as voluntary undertakings akin to contractual obligations. On this basis he argues that their imposition is essentially consensual and that parties can freely contract out of any provisions of the duties. However,

[77] See *Kelly v Cooper* [1993] AC 205 and *Harlequin Property Ltd v Wilkins Kennedy* [2016] EWHC 3188 (TCC) for discussion of the effect of the different types of legal relationship on fiduciary obligations.

[78] *Kelly v Cooper* [1993] AC 205

[79] See Edelman, J; "When do fiduciary duties arise? (2010) 126 LQR 302, Edelman, J; "Four Fiduciary Puzzles" in Bant, E and Harding, M (eds); *Exploring Private Law* (2010 Cambridge, CUP) pg 298 and, Edelman, J; "The importance of the fiduciary undertaking" (2013) 7 J Eq 128

unlike the economic commentators of American jurisprudence such as Easterbrook and Fischel[80] and Langbein[81] he bases his argument not on efficiency but on case law and legal doctrine. He therefore makes the unorthodox argument that the inherent nature of fiduciary duties is contractarian or at least analogous to that approach. In order to support this conclusion he advances a range of propositions. In general he suggests that all developed human society and law is founded upon voluntary relations and on a specific level he explains the fiduciary duties as a voluntary undertaking by the fiduciary to promote the interests of their beneficiary at the expense of their own. Broadly speaking his supporting arguments settle around two main themes. Firstly he holds that fiduciary duties always arise out of some more established form of voluntary relationship, and secondly that case law suggests that fiduciary obligations have been developed by the courts as consensual undertakings. For the latter argument he places significant emphasis on the dicta of Lord Millett in *Bristol and West Building Society v Mothew*[82] in which his Lordship describes the obligation as an undertaking. On the specific issue of contracting out of fiduciary duties, Edelman relies not only on the fact that the propensity to do so flows naturally from the position that they are voluntary undertakings, but also cites *Kelly v Cooper*[83] as Privy Council authority.

There is some academic and judicial support for Edelman's approach. In a recent report on fiduciary duties the Law Commission took it as established that it was possible to modify and even exclude the fiduciary obligation by contractual provisions.[84] The Commission stated that "the contract is the starting point."[85] In *Kelly v Cooper* the fiduciary defendant was a firm of estate agents who had acted for the sellers of two houses next to one another and had secured a sale of both to the same person. The sellers has sued for breach of fiduciary duty for a conflict of interest and a failure to inform each of them that a higher price could potentially have been obtained as the buyer wanted to buy both properties. Lord Browne-Wilkinson in delivering the judgment of the court cited with approval the Australian case of *Hospital Products Ltd v United States Surgical Corporation*[86] in which Mason J famously said that "the fiduciary relationship, if it is to exist at all must accommodate itself to the terms of the contract".[87] The decision in *Kelly* states that where a client takes on a professional adviser or agent whom he is well aware will act for other clients, this state of affairs and its consequences

[80] Easterbrook, F and Fischel, D; "Contract and fiduciary duty" (1993) 36 *Journal of Law and Economics* 425
[81] Langbein, J; "Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?" (2005) 114 *Yale LJ* 929
[82] [1998] Ch 1
[83] [1993] AC 205
[84] Law Commission Report No. 350; *Fiduciary Duties of Investment Intermediaries* (2014) HMSO Cm 350 para 3.37-3.39
[85] *Ibid.* 3.38
[86] (1984) 156 C.L.R. 41
[87] *Ibid.*

are necessarily part of the contract by implication. The client of an estate agent cannot then turn round and accuse his adviser of breach of fiduciary duty for failing or refusing to supply him with the confidential information of other clients. This is not part of their agreement, therefore nor is it a necessary element of the fiduciary obligations owed by the one to the other. The same has also been said of an accountant[88] and even solicitors in relation to certain types of transaction.[89] This is clearly a sensible approach. Fiduciary duties should not be used to impose obligations on contracting parties which are far outside their ability to perform.

However, it should be noted that both Lord Browne-Wilkinson and the Law Commission continued by emphasising the fact sensitive and flexible nature of the fiduciary obligation. Rather than advancing fixed rules of universal application both sources can be read as highlighting the unique manner in which the fiduciary obligation tailors itself to the circumstances of specific relationships. In applying the legal principles to the case in *Kelly* Lord Browne-Wilkinson did not place great importance on an implied contractual term excluding liability for breaches of fiduciary duty. Instead he focused on what should have been a natural understanding on the part of the claimants that the relationship they would have with an estate agent would not be an exclusive one but one in which the agent was acting to sell many properties at the same time. The Privy Council appears to find that there was no breach of duty in that case, rather than finding a breach which was excluded by terms of the contractual agreement. The Law Commission recognise a number of caveats to their position on the ability to exclude or modify the fiduciary duties by contract.[90] These include a clear statement that the court would look at the substance and not the form of the relationship where the contract was a sham.[91] As well as this they thought that no exclusion would be effective to exclude fraud or deliberate breach of duty.[92] Further they doubt on whether or not *Kelly* would apply to imply a contractual term modifying fiduciary duties where a firm was self-dealing or buying from the beneficiary.[93] The larger the number of such caveat, the less implication contracting out has for a wider understanding of the fiduciary obligation. Where there is an express contractual term *Kelly* is also authority for the principle that this would constitute consent to breach and there for it is simpler to simply rule that no duty is owed in relation to actions excluded by contract.[94]

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[88] *Harlequin Property Ltd v Wilkins Kennedy* [2016] EWHC 3188 (TCC)
[89] *AIB Group (UK) Plc v Mark Redler & Co Solicitors* [2014] UKSC 58
[90] Law Commission Report No. 236; *Fiduciary Duties and Regulatory Rules* 1995 HMSO Cm 3049 at para 3.29 – 3.32
[91] *Ibid.* para 3.29
[92] *Ibid.* para 2.11
[93] *Ibid.* para 3.31
[94] *Supra* n79

It could be argued, as Edelman suggests, that this case is evidence fiduciary duties are voluntary undertakings akin to implied contractual terms. However there is no particularly compelling reason why this should be the preferred analysis, and in fact in is somewhat ill-fitting. The key question is why is it possible to contract out of fiduciary duties or modify them by contract? There is a good argument that exclusion by contract is only applicable where the contract would effectively constitute consent to breach of duty were the duty applied.[95] An alternative is that the fiduciary duties should not impose obligations which are not present in the contract.[96] Modification of the fiduciary duties in *Kelly* appears to be justified on the basis of the obvious and necessary facts of the relationship between seller and estate agent. This is described as an implied term of the contract, but in reality the discussion is not really couched in contractual terms. The Privy Council does not apply any of the standard legal tests for implication of terms. Rather the focus of the reasoning is broader, and betters suits the understanding of fiduciary duties as a mandatory legal intervention alongside contractual obligations. All suggestions of possible implied terms in the contract are dismissed briefly and without the need for detailed inquiry, nor is the court willing to delve into the specifics of whether any alleged breach is of a contractual term or fiduciary duty. It is simply clear on the basis of the relationship entered into by the parties there is no breach of fiduciary duty, just as there was no breach of contract terms. These things need not always be aligned, but in this case it was simple enough for the court to find that they were. It is not apparent that this involved any direct assertion that the fiduciary element of the relationship had been voluntarily undertaken rather than imposed as a matter of law.

Out of this more nuanced approach arises a difficult question, which does not so significantly trouble Edelman's straightforward voluntary undertaking analysis. When will a contractual or voluntary exclusion of fiduciary duties be effective? Lim astutely criticises the simplicity of Edelman's approach by undertaking a thorough review of the extent to which it is possible to modify or exclude Directors' Duties in English law and effectively demonstrates that there is a core element of the obligations which can never be fully excluded.[97] He analyses the available legal approaches in the Companies Act 2006, discussing the distinction between ratifiable and non-ratifiable breaches and the limitiations on exclusions of Directors' Duties in company articles. He also reviews indirect attempts to exclude the duties and concludes they are largely ineffective at producing any general exclusions. Moreover he says this should be so where there is a potential threat to the security of the interests of minority shareholders, among other concerns. From this he concludes that there is at least one clear and identifiable

[95] *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 C.L.R. 41
[96] *Ibid.*
[97] Lim, E; "Contracting Out of Fiduciary Duties" (2015) 44 CLWR 276

policy concern at the heart of the use of the fiduciary obligation in this context, not dissimilar to the idea of an equity at which the Directors' duty is addressed. He further asserts that this lends support to the idea that there is a "vital moral dimension to fiduciary duties" which is "not necessarily captured" by the simple voluntary undertaking approach of Edelman.[98] Though it should be noted that even in his own analysis Edelman accounts for an "irreducible core" of the fiduciary obligation, however he defines it very narrowly as only encompassing a requirement to act honestly in the performance of duties, powers and obligations.[99] Edelman recognises this core element must arise by operation of law and therefore cannot be excluded by voluntary undertaking.[100]

An element of Edelman's approach which seems particularly helpful is that he distinguishes situations in which a fiduciary relationship predates an attempt to exclude or modify the obligation from one where the exclusion or modification forms part of a contractual document which creates the relationship.[101] The Australian case of *ASIC v Citigroup Global Markets Ltd*[102] highlights the potential significance of this distinction. In that case Citigroup were acting for a corporate client in a large takeover; giving advice, administering the takeover process and even contributing to the financing of the transaction. This relationship would clearly have placed Citigroup in a fiduciary position with respect to that client and especially that transaction. However the letter of instruction from the client to Citigroup expressly excluded any fiduciary relationship and described Citigroup as an independent contractor. As part of its compliance with ASIC regulations and Australian law Citigroup had to maintain 'Chinese Walls' between its private side and its public side operations. This resulted in the investment arm of Citigroup being unaware of the relationship with the client and they invested in stock of the target company of the client when rumours of the takeover began to circulate and they made a significant profit. In finding no fiduciary duties had arisen and so could not have been breached the Federal Court of Australia discussed the pre-contractual relationship and activity at length. They determined that at the point these two commercial parties chose to define the nature of their relationship they expressly decided it was not fiduciary in character. Interestingly the court decided no informed consent was required for this exclusion as this would only be the case where the fiduciary obligations arise from the status of the fiduciary or arise prior to the existence of the contract. In the case it was not contended the fiduciary duties predated the letter of mandate as legally prior to that point Citigroup did not act for, advise or represent the client. According to the court then, the exclusion of the fiduciary

[98] *Ibid.* p278
[99] *Supra* n80 (2010) p303-305
[100] *Ibid.* p305
[101] *Ibid.*
[102] [2007] FCA 963

duty in part relies on the parties not already being tied together by the obligation of loyalty which is capable of predating the voluntary obligation and so it must arise by operation of law. However where not already bound by the obligation, parties, especially commercial parties are freely able to avoid entering into such a relationship in a contractual context. This also suggests that contrary to Edelman's contention, the mandatory core of the fiduciary obligation is more than just honesty in performance of duties. The character of the relationship of the parties determines the extent to which they are capable of excluding the obligation from that relationship. Therefore the mandatory core includes the obligations of trust, confidence and loyalty.

In light of this it is likely that the best approach to contractual exclusion of fiduciary duties is that it is fact and context specific, possible in some relationships to a complete degree but only to a more limited extent in others. It is almost certainly the case that the context in which exclusions are most effective is where the potential fiduciary obligation arises from a contractual relationship and so is already to some extent defined by the nature of the contract. However this will not necessarily hold true in all situations of contractual fiduciary relations nor will the same principles translate to all situations of status based fiduciary obligation. Where the core policies of the use of the fiduciary duty, the 'equity they address', is undermined by allowing exclusion, for example when it affects the protection of minority shareholders in the context of Directors' Duties, the exclusions will and should be given less effect by the courts.

Other such variations in the effectiveness of exclusions can be observed in the context of other types of fiduciary relationship. In the case of *Hayim v Citibank NA*[103] the Privy Council gave effect to a complex will arrangement where a testator had made a will in both America and Hong Kong. The true beneficiaries of the estate were the beneficiaries of the American will. The Hong Kong will concerned one property in that jurisdiction in which the testator had lived with his brother and sister. The beneficiary of the Hong Kong estate was the American estate, and essentially the will contained only a power of sale in accordance with the instructions of the American executor. The American executor was given an exclusion of liability in respect of the Hong Kong estate, effectively excluding his fiduciary obligations to his beneficiaries in respect of that property. The court held this was effective when the executor of the American estate refused to instruct the Hong Kong executor to evict the elderly brother and sister and sell the property. His actions were held properly to represent the stated intention of the testator that his siblings should not be forced to leave their home. His actions were loyal to the specific nature of his trust.

[103] [1987] AC 730

Similarly the nature and intention of the relationship was key in *Hilton v Barker Booth & Eastwood*.[104] The House of Lords refused to find an implied exclusion of liability for a solicitor's firm that had taken on two clients where their duty to each came into conflict. The firm had acted for a client in a fraud trial and bankruptcy proceeding before later acting both for him and a new venture partner who he ultimately also defrauded. In not making the new partner aware of the first client's past they had breached their duty. To have told the second client would have breached their duties of confidentiality to the first. The court unanimously and straightforwardly held that, while the implication of such a term was not impossible in principle, no term could be implied into the contract limiting the fiduciary obligations of the solicitor as no client would have naturally accepted their solicitor withholding the details of the fraudster's past. The solicitor had simply placed themselves into a position of conflict for which they were responsible. They were forced as a matter of principle to fulfil their obligations under their fiduciary duties to both clients as far as possible, even if that meant meeting the requirements perfectly and paying damages to the other.

This is a particularly interesting and important decision. The key point is that the House of Lords ruled that the solicitor in question had to do "as best he could" to fully meet the fiduciary obligations of both relationships, even though they were contradictory.[105] In a relationship which contained the highest level of trust and confidence, and with no express contractual provision excluding the fiduciary duties, the courts were not prepared to imply one as they had in *Kelly*. While clients will know that both estate agents and solicitors represent many clients at once, the court held that a solicitor has no right to do so where there is a clear conflict between the interests of the parties. In fact a solicitor has professional rules prohibiting them from doing so.[106] In the case of *Harlequin Property Ltd v Wilkins Kennedy*[107] Coulson J elaborated on this principle, explaining the different standards expected of the two different types of fiduciary based on the differences between the contractual relationships they had with clients. This demonstrates that different relationships impose fiduciary duties in slightly different ways, and that in contractual relationships the contractual terms are key. However, it is still good law that an agent who seeks to act for both sides in the same transaction must seek express consent to do so.[108] This supports the idea of an irreducible core of the fiduciary obligation. A clear violation of loyalty in a fiduciary relationship, for example by self-dealing, or

104 [2005] UKHL 8
105 Ibid. at para 44
106 Solicitors Regulation Authority Code of Conduct 2011, Version 19 October 2017 available at http://www.sra.org.uk/solicitors/handbook/code/content.page last accessed July 2018
107 [2016] EWHC 3188 (TCC)
108 *North and South Trust Co v Berkeley* [1993] AC 205

by failing to disclose the fraud of a client to his business partner who was also a client, must be expressly authorised.[109]

From these two examples we see that the courts incorporate a range of factors into their assessment of whether the fiduciary obligation can be excluded, many of which are dependent on the fact specific context of the case at hand and the relationship of the specific parties. In each case though we can clearly see the core issue of legal morality which governs the decision. In *Hayim* it was the need to give effect to the settlor's intentions and ensure his property was distributed in the manner and with the restrictions he intended. In *Hilton* it was the concern that clients of solicitors should have certainty that their representative is acting absolutely in their interests, rather than their own or the interests of another. Lim concludes his discussion of the issue by perhaps wisely suggesting that attempts at far-reaching and over-arching generalisations and definitions of the nature of the fiduciary duty may always fail to fully capture and explain all the detail and nuances of what he calls a "complex and multifaceted" area of law.[110] In short different applications of the fiduciary obligation will likely require different approaches to exclusion.

4.5 Conflicts of Interest: Acting for both parties and Chinese Walls

An issue which arose in the *Citigroup* case above,[111] as well as in *Kelly v Cooper*[112] are the conflicts of interest which can arise when a fiduciary company is a large financial or legal institution which has a variety of different business functions or acts for multiple clients. In many such companies the ability to act across different fields of commerce and finance and to represent many clients who may interact with one another is essential to staying in business. Examples include estate agents like Cooper and financial conglomerates like Citigroup, but the problem also extends to large firms of solicitors who act for big commercial clients, including banks, who have dealings with smaller companies the firm represents. The conflicts which can arise take a number of forms. A common example is where the fiduciary firm or company has financially sensitive information on one client which is relevant to the investment decisions of another, or to the investment arm of the fiduciary financial institution itself. The firm will owe duties of confidentiality to the one client, and may be under regulatory obligations not to divulge confidential information under insider trading legislation or professional rules of conduct, but will also owe a duty to other clients to serve their best interests which would

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[109] See also *HIH Casualty & General Insurance Ltd v JLT Risk Solutions Ltd* [2007] EWCA Civ 710
[110] *Supra* n98, p297
[111] *Supra* n103
[112] *Supra* n79

include acting on the financial information the firm may have to protect them from loses or to improve their profit making potential.

In this context there is great importance in the flexibility of the fiduciary obligation and its ability to adapt to different commercial situations, without compromising on its regulatory function, its strict application and the protections it provides to the principal. One of the common means used by large firms to manage conflicts is to create so-called 'Chinese walls' between different parts of their business in order to prevent confidential information being passed between parts of the company. A Chinese wall involves entirely separating the employees and departments which deal with one side of the business or one customer, from those who deal with the other. It also requires oversight and coordination to ensure its integrity, usually done by a senior manager or by a compliance department. To ensure it functions effectively a 'stop list' of banned clients or trading stock may be maintained. There will be times when the only way to maintain integrity is to refuse to represent a potential client. The Chinese wall is not primarily used as a means of attempting to avoid fiduciary obligations, its purpose is to avoid the regulatory consequences of insider trading legislation and the rules imposed by the Solicitors Regulation Authority. However, whether or not the approach is sufficient to prevent large firms being in breach of fiduciary duty has proved controversial.

The Law Commission in their 1995 report: "Fiduciary Duties and Regulatory Rules" conducted an extensive review of the issue of conflicting fiduciary duties and the use of Chinese Walls as a means of managing such conflicts of interests.[113] They concluded that the ability to operate Chinese Walls and to exclude conflicts of interest in some contexts was an essential part of doing business, especially in large commercial law firms and financial advice and consultancy businesses. However they doubted the full effectiveness of such provisions, emphasizing that their success would depend significantly on the context of their use.

Conaglen examined the issue of conflicting duties directly and concluded that an independent duty to avoid a conflict between duties exists alongside the duty to avoid conflicts between the interests of the principal and the interests of the fiduciary.[114] He identifies this as a key distinction as there is no need to consider conflicts where the fiduciary is interested in the transaction of his beneficiary or where they self-deal. These situations are covered by the ordinary rules of the fiduciary duty to avoid conflicts of interest. Only informed consent would be sufficient to authorise such transactions. In transactions in which Conaglen describes the fiduciary as acting in a "purely ministerial capacity,"[115] when they are an intermediary between

[113] Law Commission Report No. 236; *Fiduciary Duties and Regulatory Rules* 1995 HMSO Cm 3049
[114] Conaglen, M; "Fiduciary Regulation of Conflicts Between Duties" (2009) 125 LQR 111
[115] *Ibid.* p115. The Law Commission also recognised that the self-dealing situation had a different level of seriousness to the conflict between interests. *Supra* n88, p3.31.

two clients, acting for both sides in a transaction or even for two parties with conflicting interests in separate transactions, a separate form of analysis is necessary as in this case the fiduciary is drawing no personal benefit. This is of particular relevance to Conaglen's thesis of fiduciary duties as a means of protecting the performance of non-fiduciary duties, criticised in Chapter 1, but the distinction is still of relevance here. The issue is not that the fiduciary is in danger of behaving or appearing to behave in a self-interested manner, rather it is that they are incapable, as a result of their competing duties, of fully performing their obligations to both of their principals. There is a risk that confidential information in the hands of the fiduciary about one of their clients either will or will not be used to benefit the other. In either case there is a breach of duty to one of the clients. Chinese Walls become relevant then as a potential means of mitigating or preventing this conflict and addressing the equitable issue created by a fiduciary who has conflicting duties to two clients. The fiduciary is seeking to be deemed not to have confidential information on one of its clients when dealing with another who may have an interest in that information.

The case law on the use of Chinese Walls since the Law Commission report has established strict rules governing their use but has confirmed that such measures can be effective in managing conflicts of interests in some circumstances. In *Bolkiah v KPMG*[116] the House of Lords upheld an injunction preventing KPMG from acting for the sovereign wealth fund of Brunei in investigating payments made by a former Director. He had previously engaged KPMG in a variety of roles and the company had substantial knowledge of his financial affairs. The court recognised Chinese walls as a legitimate method of avoiding conflicts of interest on duties owed to a former client but only where there was no risk that the sensitive information of that client could be released to other parts of the business.[117] Lord Millett stated that there could be no justification for a fiduciary exposing his client to any risk that confidential information might be released without the consent of the client or the courts.[118] On the facts, the judge at first instance had ruled that KPMG's wall was effective in preventing deliberate disclosure but was not certain to stop accidental disclosure. As a result the injunction was granted. The House of Lords described the necessary standard of proof imposed on proving a Chinese wall as a "heavy burden".

Only a few years later the Court of Appeal was asked to consider Chinese walls further in *Marks and Spencer plc v Freshfields Bruckhaus Deringer*.[119] A large city law firm who had acted for many years for Marks and Spencer in a variety of legal matters agreed to represent

[116] [1999] 2 WLR 215
[117] *Ibid.* p236
[118] *Ibid.*
[119] [2004] EWCA Civ 741

the retail magnate Sir Philip Green in an attempted takeover of the chain. The Court of Appeal granted an injunction against Freshfields preventing them from acting for Green, citing in the process a number of passages from *Bolkiah*. Freshfields argued that the principle in *Bolkiah* was limited to situations where a fiduciary advice firm acted for both sides in the same or same type or transaction and that therefore the situation of acting for another party in a take-over did not represent a conflict of interest. They also sought to argue that the fact they had immediately implemented Chinese wall procedures meant they had effectively managed and prevented any conflict. Pill LJ flatly rejected both submissions, stating that it was clear that Millett LJ in *Bolkiah* was intending to articulate general principles of fiduciary law. He also found that the argument in favour of the Chinese wall could be made in both directions.[120] Since Chinese wall procedures were only implemented once Freshfields was considering accepting Green as a client there likely was a conflict of interest and the firm was not prepared in advance to correctly ensure the interests of their earlier client were protected. These findings significantly broaden the effect of *Bolkiah*. Firstly because the principle that a Chinese Wall must eliminate all risk of release of confidential information was found to be of general application in all circumstances where an advisory fiduciary has clients who may have competing interests. Secondly, because Pill appears to support the proposition that an ad hoc arrangement will never sufficiently eliminate such a risk. Writing for practitioners, Adam Carvalho of Farrer & Co. advises that as a result of *Bolkiah* and *Freshfields* firms seeking to establish effective Chinese walls must now do so as long standing institutional arrangements.[121]

However it is clear that *Bolkiah* is not authority for a universal principle preventing former fiduciaries from having any involvement in the same sphere of business as their former client. Nor that all fiduciary advisors have an unlimited duty to protect confidential information. Examples of situations in which the courts have declined to apply or distinguished *Bolkiah* include an employee who went to work for a competitor and was not injuncted against doing so as a result of confidential information they possessed.[122] Similarly an individual senior solicitor who switched firms during an arbitration but took no further part in proceedings did not taint the whole firm,[123] an expert witness called by a party to an arbitration later called to give evidence on the same subject against that party in a separate arbitration was not prevented from doing so,[124] and a group of firms of solicitors were entitled to view disclosed

[120] *Ibid.* p10 and p25
[121] Carvalho, A; "Contracting out of fiduciary relationships in engagement letters: The Citigroup case" (2008) 14(6) Trusts & Trustees 406
[122] *Caterpillar Logistics Services (UK) Ltd v Huesca de Crean* [2011] EWHC 3154 (QB)
[123] *Koch Shipping Inc v Richards Butler* [2002] EWCA Civ 1280
[124] *Lloyd's Syndicate v X* [2011] EWHC 2487 (Comm)

documents in one set of proceedings even though they may provide them with confidential information relevant to other proceedings.[125]

The ultimate position in the English law relating to fiduciary duties, conflicts of interest and Chinese walls is one of strictness mixed with context specific flexibility. The courts are willing to countenance the use of Chinese walls to preventing the occurrence of a conflict of interest in circumstances where a fiduciary owes potentially conflicting duties to two clients, but the standards are very high. For a Chinese wall to be effective it needs to be institutional in the fiduciaries' business and it needs to ensure there is no risk at all of the information of one client being released to another. Even then there is dicta in *Bolkiah* and *Freshfields* to the effect that there may be times when the conflict appears so unjustifiable that a Chinese wall will not be effective in preventing an injunction except where a client has given informed consent to the arrangement. Carvalho advises at the end of his piece that the best course of action for any firm is to obtain express informed consent in contractual provisions to the use of Chinese walls from the client.[126] The *Citigroup* case, while it is Australian is a useful guide on the effectiveness of such consent. The more sophisticated the client and the more routine the Chinese wall arrangements, the more effective express provisions limiting liability and excluding or modifying the fiduciary duty to avoid conflicts of interest will be.[127]

Once again the relationship between the parties and the precise context of their arrangements is key in determining whether there is a breach of duty by a fiduciary or not. Central to this determination is the wrong which is being address by the fiduciary restriction in that context. In the case of conflict between duties it is the entitlement of the client no to be exposed to any risk the fiduciary will disclose their confidential information to another. Where a Chinese wall can maintain the necessary appearance and substance of fiduciary loyalty in a relationship it is of great value to the business community. Similarly where there is an objectionable conflict it is in the interest of all parties that a firm does not tarnish its reputation by acting. In a fascinating insight into the world of professional legal and financial advice in the City, Alex Newman describes how taking on a client whose interests conflict with those of a major corporate client can have a significantly damaging effect on the business relationships of an advice firm and ultimately cost them important business.[128] He also highlights how internal competition between departments in large firms can lead to pressure to take on clients despite conflicts, underscoring the need for strong procedures to deal with such situations and a coherent legal framework to address concerns. The fiduciary framework has both strengths

[125] *BskyB Plc v Virgin Media Communications Ltd* [2008] EWHC 1283 (Ch)
[126] *Supra* n122
[127] *Supra* n103
[128] Newman, A; "Drawing the Battle Lines" (2014) 16(1) Legal Week 12

and weaknesses in this context. It is a valuable means of encouraging uniform standards which can give clients the confidence to engage with large advice firms. It also has the necessary flexibility to adapt to specific and complex business relationships. However, this uncertainty may also give rise to dissatisfaction among professionals over what sometimes may appear arbitrary rules. Another concern is that the standards are not uniform with those of professional conduct rules and insider trading legislation. Carvalho suggested that there may be some value in attempting to harmonise the two frameworks.[129] This is a question which the Law Commission did not consider in its 1995 report and it may be a valuable line of enquiry, however time and space prevent such an examination here. Thus while it is clear that in this context the rules governing the operation of the fiduciary duty in the context of Chinese walls and conflict of interests are understandable and explicable in the wider framework of fiduciary law, this field also highlights the tension which can exist between that law and real world business concerns.

4.6 Limits of fiduciary duty of directors

One final area of the law that merits further consideration are the limits of the fiduciary duties of office holders, with particular reference to directors. This is an extensive field of study and time and space prevents a complete analysis, but it is still of value to consider some key points on the specific issue of whether a director is bound by fiduciary duties when presented with a new business opportunity. This is important because many directors are entrepreneurs in their own right, with valuable and exploitable skills, and because it once again focuses on the tension at the limits of the fiduciary obligation.

A detailed review of the law in this area has been undertaken by Ernest Lim,[130] who as we have already seen has conducted considerable research in the area of the liability of directors. He identifies Section 175 of the Companies Act 2006 as the starting point for any examination of the fiduciary duties of directors.[131] Lim points out that it is significant that in Section 175 there is no separate duty to avoid the making of unauthorised profits, rather it is subsumed into the duty to avoid conflicts of interest in Section 175(1). The focus of the burden on a director is therefore the avoidance of conflict, whether they benefit personally or not. He also observes that for a director of a company under Section 175(4)(a) his duty is not infringed if the situation in question cannot be reasonably regarded as likely to give rise to a conflict of interest. By virtue of Section 175(4)(b) the duty is not infringed if the actions of the director are

[129] *Supra* n122
[130] Lim, E; "Directors' fiduciary duties: a new analytical framework." (2013) 129 LQR 242
[131] Companies Act 2006, s175

authorised by the board. The key point Lim seeks to establish is that he believes a middle way can and should be found in English law between the classical strict approach to fiduciary duty and the American style flexible approach which empowers the courts to take into account many factors including good faith by the director, the source of the opportunity exploited, and whether his company is actively pursuing the opportunity as a maturing business opportunity.

The intention behind this analysis is identified by Lim as the gains to be made for society and the economy in creating space for directors to use their entrepreneurial drive and expertise. To this end Lim proposes a threefold "framework" to examine whether a director has breached this unique duty under Section 175, which unlike the equitable duty, can only occur where the situation can be reasonably regarded as likely to give rise to a conflict of interest. Turning on this idea of "reasonably regarded as likely", Lim suggests that first the question the court should ask is whether the company has "explicitly considered and rejected the opportunity in question on a bona fides, fully informed and unbiased basis".[132] This does not mean that the director has fully disclosed their interest and intention to pursue the opportunity, as this would be covered by Section 175(4)(b), but simply that the director in no way influenced the decision of the company not to pursue the opportunity and that such a decision was genuinely taken in the interests of the company. Where this has occurred, according to Lim, there should be considered to be no reasonable prospect of a conflict arising if a director pursues the opportunity for himself. If no such consideration has occurred then the court should ask whether the exploitation of the opportunity by the director was pre-resignation or post resignation. If the former then the second stage of the framework is to determine whether the opportunity was within the scope of the business of the company. If it falls within the scope of the business of the company there is a conflict, if it falls outside then there is not. If the exploitation of the opportunity is post resignation then Lim states the court should proceed to the third stage of the framework. This third stage is to determine whether the opportunity was a 'maturing business opportunity'. If it was then there is a conflict, if it is not then there is no reasonable prospect of one.

This framework is undoubtedly elegant, though it has been criticised for being excessively focused on the principal and not enough on the motivation of the director.[133] In particular, it identifies and demarcates the key factors as to whether or not a conflict has arisen when a director, or any fiduciary office holder for that matter, exploits an opportunity for himself rather than his principal. The order of consideration is perhaps open to question, but the issues are undoubtedly as identified by Lim. Namely, whether such opportunity falls within the scope

[132] *Supra* n131, p244
[133] Gibbs, D; "The absolute limit of directors' fiduciary liability for conflicts of interest: the director's perspective" (2015) 36 Comp. Law. 231

of the duty, which in case law appears an uneasy combination of issues including whether the opportunity comes to the fiduciary in the course of his office. Whether the principal could, should or would have pursued such opportunity for itself and whether it falls within the scope of the fiduciary relationship in the first place. Whether any conflict has been properly authorised.Finally, the extent to which the fiduciary duty to avoid conflicts and unauthorised profits by exploiting opportunities continues after the resignation of an office holder. The framework proposed by Lim orders and addresses each of these concerns in a far more concise and straightforward fashion than has previously been set out. However the element of Lim's approach which is novel and perhaps to some extent rather radical, is the certainty with which the response to each question will determine whether a conflict of interest has occurred, not to mention the fact that, as recognised by the author himself, some of the answers are at odds with current authority.

In the first stage of his analysis Lim seeks to demonstrate that for a director there is no reasonable possibility of a conflict in a situation where he exploits an opportunity which has been considered in an unbiased, fully informed and bona fides manner.[134] The type of consideration by the board envisioned here must be less than the informed consent and authorisation required in the case of a breach under Section 176, otherwise Lim's analysis would be unnecessary. Rather Lim suggests that where the decision is taken first not to exploit an opportunity by the board, then a director has no conflict of interest if he exploits for himself.

To make an argument for this proposition Lim relies heavily on the Canadian Supreme Court judgment in *Peso Silver Mines v Cropper*.[135] In that case Cropper, the managing director of the mining company Peso was offered the right to exploit claims neighbouring the property of the company. He correctly took this offer to Peso, not at this stage having any inclination to exploit the claims for himself, and participated in a bona fides manner in the discussions of the board. The board concluded the company was already over extended and declined to exploit the claims. Sometime later the owner of the claims approached Cropper and asked him to participate in the exploitation of the claims in a personal capacity, which he did. Peso was later bought out and the new owners dismissed Cropper and claimed his interests in the claims belonged to Peso, as his behaviour amounted to conflict of interest and breach of duty. The court held that this scenario could not constitute a conflict of interest apparently because there were two separate moments of possible transaction rather than one. When the opportunity had first been brought to Cropper he was acting as a director of Peso and rightly took the possibility to the board. The court found that once the board had rejected the

[134] *Supra* n131, p246
[135] [1966] SCR 63

opportunity, when Cropper was approached a second time he acted in a purely personal capacity.[136] Cartwright J delivering the judgment of the court that there was no conflict of interest states that, “on the facts of the case [he finds] it impossible to say that the respondent obtained the interests he holds […] by reason of the fact that he was a director of the appellant.” Lim argues that so long as there was no change of circumstances between the initial rejection of the opportunity by the board and the exploitation by the Director this approach strikes a better balance between the strict and inflexible principles of equity and the need to respect the entrepreneurial expertise and inclinations of directors. He argues that such a situation contains neither the prophylactic policy concerns which underpin fiduciary duty, as the director has alleviated the risk of self-interested action by taking the opportunity first to the board of his company prior to considering it himself, and that there are no policy issues of informational asymmetry between the director and the company as the board is given full, unbiased information.

There are a few difficulties with this analysis. Firstly, Lim notes himself that the Canadian case of *Peso* is not in line with other English law authority, especially *Phipps v Boardman*[137] and to some extent *Regal (Hastings) v Gulliver*[138], as well as the Privy Council decision in the Australian case of *Queensland Mines v Hudson*[139] and the more recent English Court of Appeal decisions in *Bhullar v Bhullar*[140] and *O’Donnell v Shanahan*.[141] To that already long list of contrary or inconsistent authority examined in detail by Lim I would also now add the recent Supreme Court decision in *FHR European Ventures v Cedar Capital Partners (Mankarious).*[142]

The *Queensland Mines* case concerned a factual scenario similar to that in *Peso* in Australia rather than Canada. Two directors of a uranium mining company decided to make a bid for licences to explore for iron in South Queensland. While this bid was under consideration one of the directors, who was providing most of the proposed finance, began to experience

136 *Ibid.* per Cartwright J, p24

137 [1967] 2 AC 46 This case demonstrates that even a sound rejection coupled with the need for court authorisation is not sufficient to free a fiduciary to pursue an opportunity which can be regarded as a conflict of interest. Lim points out that there was arguably a taint of bias in the actions of Boardman as he was a solicitor to the trust so his advice could have been influenced. However the House of Lords itself was careful not to impugn his motives and reached it decision purely on equitable principle.

138 [1967] 2 AC 134 Lim points out that *Rega*l was considered in *Peso* and accepted but found to cover different facts. Lord Russell in *Regal* stated he did not regard the scenario as being one which was as straightforward and unimpeachable as where a board had rejected an opportunity that a director later decided to exploit. The situation was instead that an entire board reached a decision which they then exploited immediately. However, once again the court did not find wrongdoing in *Regal* beyond breach of duty.

139 (1978) 18 ALR 1

140 [2003] EWCA Civ 424

141 [2009] EWCA Civ 751

142 [2014] UKSC 45

financial difficulties. After this the bid was successful he informed the other that he would have to pull out of the operation. The remaining director was subject to considerable personal financial liability as a result of the successful bid and the company faced substantial reputational damage if the terms of the licence were not honoured. The remaining director involved in the bid, after consulting with the other directors of the company, chose to find alternative financing and exploited the licence for himself. When it proved to be profitable the company sued. Lord Scarman delivering the judgement of the Privy Council stated that only the fully informed assent of the board was sufficient to absolve the director of liability for a conflict of interest that arose due to his position and as a result of his work for the mining company. In this case the court, overruling the original trial judge, found that such assent had been obtained. This ruling contradicts that in *Peso*, and rejects the analysis proposed by Lim, despite reaching a similar factual conclusion. The Privy Council in *Queensland* state very clearly that a conflict cannot be justified even if the board takes a definite decision not to exploit an opportunity. Only direct, fully informed authorisation will allow the director to pursue it.

However, some aspects of this decision are open to question. There did not appear to be any formal process of authorisation by the board which occurred to ratify the director's actions. The court inferred it from the fact the board was kept fully informed of the director's intentions and individually all of the members agreed to them as the best course of action. This appears to move the analysis slightly closer to that suggested by Lim than the basic statement of law in the case. There are also factors which make the *Queensland* case unique and arguably could have affected the equitable balance. The peculiar situation of the desirability and necessity to both the individual director and the company that the licence be exploited strongly indicate that not only would the board have assented to the actions formally if invited to do so but also that to some extent the director was acting on the instructions of the board in exploiting the opportunity for himself. The individual had also exposed himself to particular financial risk, the positive potential of which he realised through considerable effort and expenditure of expertise. Finally during all of the relevant period, including when the application was made, the company of which the defendant was a director was actually mothballed. It was never intended by any party that it would be used to exploit the opportunity, though its name was used to secure the licence. The case therefore demonstrates many of the complex and competing factors which inform Lim's analysis, even though it still adopts a legal rationale which is contrary to the one he proposes. It demonstrates the value and possibilities of allowing directors the opportunity to pursue ventures which their company is not able to pursue itself. In this case the effect was positive for all involved, and the company was claiming a pure windfall if its claim had succeeded. Ultimately it feels like the result in the

Queensland case is undoubtedly correct, but whether or not the interpretation of the law entirely fits with the outcome is rather open to question.

More modern cases like *Bhullar* and *O'Donnell* have straightforwardly adopted the position in *Phipps v Boardman*. The exploitation of an opportunity that came to a director by virtue of his office is a conflict of interest and breach of fiduciary duty, even if the company itself has freely decided not to pursue it. In *Bhullar* the company was a family one which invested in property. It had taken a decision not to buy or lease any new sites while it was being unwound due to disputes. The directors who belonged to one faction were still found to have breached their fiduciary duties when they bought a property which neighboured one of the company for themselves. In *O'Donnell* two directors of a company which brokered property investment agreed to take a share in a property on the insistence of a customer. In doing so they cost the company £30,000 in commission. A conflict was found even though the deal would have fallen through if they had not taken a personal share in the venture. Finally the recent Supreme Court judgement in *FHR European Ventures* has quashed any idea that the strictness of fiduciary liability for conflicts and secret profits can be made more flexible. The court gave a very straightforward statement of the existing law, affirming the rules in *Regal* and *Phipps* in their strictest form and even emphasising that liability for a conflict arose even from the possibility of a conflict, not even requiring evidence the conflict had actually occurred.[143]

There are a number of reasons to adopt this strict approach rather than the more flexible one proposed by Lim, despites its possible advantages for directorial entrepreneurism. Firstly there is the simplicity and unity of analysis which is a major part of the reasoning behind the decision in *FHR European Ventures*. However it is certainly debateable whether this simplicity would justify the loss of the economic and business advantages that Lim's framework purports to offer. Another notable reason to reject the framework though is that Lim perhaps underestimates the difficulties created by informational asymmetry. He notes that his framework provides for the court to investigate whether the director has misled or affected the decision of the board in rejecting an opportunity, however he does not account for the problem that the control of information by the director may allow them to mislead the court. Assessing whether or not a board has reached a decision which was uninfluenced by the actions and information control of an interested director has the potential to be extremely difficult. Finally, Lim also takes a narrow view of the prophylactic concerns of the fiduciary duty. He views the core equity of the strict requirements of the fiduciary duty on directors regarding as being about preventing dishonesty and ensuring bona fides performance of the role. However, if the equity

[143] *Ibid.* p5

addressed is also considered to include protecting the integrity of the fiduciary relationship by ensuring trust and confidence remain, then the mere appearance or possibility of conflict is damaging and should be prevented by the rule. This explains and justifies a strict approach to the exploitation of opportunities. The danger of managers diverting business and undermining the value of the company is a serious economic threat to the interests of investors and shareholders. Maintaining trust and confidence requires avoiding even the appearance of such a possibility.

It should also be remembered that a proper procedure for allowing the entrepreneurial activity by the director is placed within the law. Authorisation or ratification of the breach of duty will allow the director to pursue the opportunity provided he has satisfied the requirements placed on him by the relationship of trust and confidence in which he is engaged. Viewed in this light the strict approach is actually quite well balanced as it sets out a clear process which can be followed which ensures a director can pursue a valuable conflict as long as he has first satisfied the obligations of his position by being completely open and honest with his company.

The second stage of Lim's framework is also, by his own admission, imperfect. The use of a scope of business test also appears to be contrary to English law authority. Lim states that such a test appears to be rejected by the Court of Appeal in *O'Donnell*.[144] Lim identifies two lines of reasoning for this rejection. Firstly that the test in English law came from a partnership case which the judge said was a circumstance more clearly defined and limited by the partnership agreement. Secondly because the judge ruled that the reasoning in *Keech* and *Regal* precluded further inquiry once it was established that the opportunity arose by reason of a director's position. Lim makes compelling arguments that both of these lines of reasoning are flawed. He gives a variety of reasons, including a more nuanced understanding of the test in earlier English authority, similarities between partnership and other types of fiduciary relationship, and arguing that the scope of business test underpins much of the reasoning in the cases cited and so is there in all but name. The last point in particular does have considerable force. There is no doubt that the courts have recognised that there must be a limit to the activities which will constitute a conflict for a director. In *Regal* it was suggested a stock market share purchase should not usually be seen as a conflict.

However, this also points towards another flaw in Lim's framework, the problem of attempting to define the scope of the fiduciary obligation to avoid conflicts of interests by reference to abstract principles rather than specific facts. The scope of business test undoubtedly has some usefulness in identifying the positive obligation. A personal business venture by a director will clearly be a conflict and so prohibited if it is within the same scope of

[144] *Supra* n141, p841

business as his company. Attempting to use it in the negative quickly runs into trouble. In *O'Donnell* the company gave financial advice and brokered property investment. Whether a property investment by a director constituted a conflict did not depend on the nature of the business conducted by that company. The company did not usually invest in property. Rather it turned on whether the investment was an unconscionable use of position by the director. Investing in a property deal being brokered by the company was a conflict for a director because it might cause him to seek to rebalance the deal in his own favour, or lose the company commission as seen in this case. Investing in property in general will not create any such problem. Worthington recognised this when creating her framework for determining the applicability of the proprietary remedy for breaches of fiduciary duty.[145] When the actions of the fiduciary constitute an unacceptable use of property, information or position is highly fact dependent. Therefore in her taxonomy all cases where the opportunity comes to the director as a result only of his position will attract the remedy. This is far broader than Lim's approach but equal in its attractive simplicity and analytical justification. Lim chooses to read ***O'Donnell*** as a direct rejection of the scope of business test, but equally it can be read as rejecting merely the claim that it can provide a definitive answer to the question of whether there has been a conflict of interest and a breach of duty. The principles that test lays down undoubtedly inform part of the analysis, but they are more helpful in some cases than others. At times such a rigid approach can be misleading, calling into question whether such a test can really be used as part of so formal a framework as that proposed by Lim.

The final stage of Lim's framework also identifies a valuable factor in identifying whether or not a conflict of interest has occurred. He conducts a thorough analysis of the law on whether resignation does or does not release a director from the obligation to avoid conflicts of interest. Lim states that a former director is only bound where he is seeking to exploit what is a maturing business opportunity of his company. Where the company had begun to exploit the opportunity or it had come to his attention while he was an officer of the company, he is duty bound to exploit it for the company. This part of Lim's analysis seems completely sound, and is a very straightforward statement of the relevant rules. It is however, a somewhat separate issue from the other parts of the framework. Only a small number of cases will involve resignation and diversion of opportunities by a former director and where they do that is plainly the central issue at stake in deciding whether or not a conflict has occurred. This part of the framework does not require the first two parts nor do those parts require it.

[145] Worthington, S; "Fiduciary Duties and Proprietary Remedies: Addressing the Failure of Equitable Formulae" [2013] 72 CLJ 720

Therefore the fiduciary duties of directors raise very similar issues to those in the other areas raised by this chapter. Once again we see the competing tensions of the demands of free enterprise balanced against the strict ethical and legal requirements of the fiduciary obligation. The inequity which must be address by the obligation in this context is the power and incentive directors have to pursue their own goals, and the damaging distrust that has the potential to create in commercial relationships. The current law is explicable only in terms of standards governed by the specific factual situations directors encounter and the exact scope of their office and the relationship they have to the company, the other directors and the shareholders. This is justifiable if the goal is to maintain a relationship between director and company that has the necessary trust and confidence for shareholders to invest. Clearly a choice could be made to reform either in the direct of greater flexibility or towards more stringent regulation, however the fiduciary duty when functioning correctly has the potential to provide a highly nuanced and effective balance.

4.7 Conclusion

Throughout this chapter it has been seen that similar issues and tensions arise in a variety of different circumstances where the fiduciary duty is found in English law. From these we can discern some potential answers to the questions posed at the start of this chapter. When it is legitimate for a commercial actor who is subject to the fiduciary obligation to pursue their own financial interests is necessarily dependent on the level of obligation and loyalty they owe. This obligation is dependent on the precise nature of the relationship they have to those they owe it. A joint venture requires pursuing common goals together, a director must pursue only the interests of his company, business associates and financial advisers must either clearly define their relationships or be open and honest about all their interested dealings. None of these situations is precisely the same, nor are they entirely different. In each case the limits of acceptable behaviour can be defined with relative clarity by that which would be disloyal and undermine the level of trust and confidence invested in the relationship by the respective parties. The greater the level of trust and confidence the stricter and less easily modified the fiduciary obligation which protects and enforces the loyalty of that obligation. The level of trust and confidence and the nature of disloyalty in each relationship will always be to some degree subjective and require investigation. Many factors and guiding principles exist which inform and govern this investigation. The starting point will often be to identify the potential inequity at which any given equitable jurisdiction is aimed.

To some such an analysis will always seem too vague and uncertain, or perhaps too obstructive and intrusive to business, or both. The alternative is either to tend towards the more certain and heavily regulated or the more laissez-faire and highly competitive. The fiduciary duty has the potential to offer an attractive middle ground, both flexible and strict, specifically tailored and of universal application. The real test is however, in the practicality of the fiduciary duty. Is the duty capable of functioning effectively in the modern business environment, especially given that at present it is relatively unknown to the actors it purports to regulate, as well as highly complex and poorly understood? This is the question to be address in the next chapter of this thesis.

Chapter 5

The Effectiveness of Fiduciary Regulation

5.1 Introduction

In the first four chapters of this thesis it has been posited that the fiduciary obligation is intended to protect the integrity of relationships of a fiduciary character. It does so by regulating the behaviour of the fiduciary to ensure that the beneficiary retains the necessary trust and confidence in the relationship and in the loyalty of the fiduciary. It has been suggested that this occurs not merely by instituting direct legal controls on fiduciary behaviour, or by simply providing remedies for breaches of such standards, but also by influencing the wider context in which such relationships occur. This promotes fiduciary standards and confidence in the whole system.

Accomplishing such a complex and ambitious task will clearly be difficult for any kind of legal intervention. In the previous chapter the manner in which equitable solutions operate in borderline cases involving commercial relationships was shown to include a great deal of flexibility, discretion and adjustment to specific factual circumstances. What the courts are required to do by the nature of such rules when applying them to factual situations is to maintain clarity as to the precise nature of the 'wrong' which required the intervention of equity in creating the rule. This informs both the analysis as to the application and as to the content of the obligation in any specific relationship. As stated previously, this type of approach inevitably involves a level of uncertainty for those who are regulated and creates difficulties for those seeking to construct a perfectly coherent analytic framework for the fiduciary duty. It may also be the case that there is an economic downside to this uncertainty, in that some actions which could be legitimately pursued by fiduciaries are not for fear of the duty. This is counterbalanced by a possible economic benefit in ensuring trust and confidence as well as loyalty in certain types of commercial relationship.

Ultimately the key question is one of the effectiveness of the fiduciary duty as a regulatory measure. If there are clear and valuable regulatory objectives which the duty achieves in an efficient or effective manner, or a more efficient or effective manner than alternatives, then there is clear justification for its use. The less evidence there is for a useful regulatory function, or for the function being better fulfilled by alternative measures, the less justification there is for its continued presence in the law.

There has been very little, if any, attempt to directly assess the effectiveness of the regulatory impact of the fiduciary duty in either an economic or empirical manner or even in theory. There are a number of obvious reasons why this is the case. The nature of the regulated activity means that public examples of breach of fiduciary duty usually only occur where a fiduciary relationship has broken down. In one sense the regulation may have already failed in that the breach occurred and was not prevented or discouraged. Secondly, quantification of the economic effect of breach of fiduciary duty difficult. It involves considering hypothetical scenarios which may have occurred had there been no breach. There is also the problem that the success of any such venture depends on a plethora of different factors, of which fiduciary behaviour is only one small element, hard to separate and quantify independently of the others. The same issue applies to the broader question of what value can be placed on having a relationship based on trust, confidence and loyalty in the first place, and what contribution it makes to wider investment confidence and decision making.

Therefore this is in some ways the most ambitious of the chapters in this thesis. The originality of the work, in attempting to assess the effectiveness of the fiduciary duties, is also the source of the most significant challenges. However, attempting such an assessment can make a significant contribution to scholarship. Both of the main parts of this Chapter attempt new things. In the first part there is an extensive assessment of the existing regulatory codes and legal provisions which govern the activities of commercial actors. In the later part there is a survey of over 1000 cases over a 12 year period, which is analysed to provide new and useful information on the operation of the fiduciary jurisdiction. This work is built on an existing theoretical understanding of corporate governance in the literature, and on the evidence and experience of previous attempts to assess regulatory effectiveness in that area of study. However, such an endeavour has not previously be attempted in relation to the fiduciary duties.

In attempting to tackle the question of the regulatory effectiveness of the fiduciary duty, this chapter can be no more than a ‘first pass’ at the problem. There is neither time nor space to consider the issue from all possible angles, nor to conduct carefully constructed empirical research in the confines of this project. What will be attempted here is to draw together some theoretical and empirical ways of thinking about the fiduciary duty, and to provide some comparisons with other legal interventions in this areas. In doing so this chapter will seek to reach some preliminary conclusions about the contribution made by the fiduciary duty to the regulatory landscape, as well as make some suggestions for continued research.

5.2 Regulatory Objectives

In order to assess the effectiveness of the fiduciary duty as regulation it is necessary to first define the regulatory objectives of the duty against which success can be measured. To some extent this has already been done in earlier sections of this thesis but it is useful to do so again here in a simplified fashion. The three objectives of the fiduciary duties which will be examined here are: firstly, to provide a legal remedy in cases where a fiduciary has failed to avoid conflicts of interest or has made secret profits; secondly, to discourage fiduciaries from putting themselves in a position of conflict of interest and from making secret profits; and finally, to introduce the principles of loyalty, trust and confidence into fiduciary relationships as organising concepts. This is not intended as an exhaustive list, but an attempt to define the core objectives at a high level of abstraction.

The first of these objectives is uncontroversial, breach of fiduciary duty is a cause of action with a range of remedies appropriate to the specific facts of the case. The second, too would rarely be disputed. The law is generally understood to be intended to induce compliance and have a deterrence effect against non-compliance. Fiduciary duties are particularly seen as been intended to have a kind of deterrence effect in that liability is strict and remedies are forceful.[1] Going beyond simple deterrence it is also commonly understood that fiduciary duties impose an obligation of loyalty.[2] Loyalty is a positive obligation to observe standards of behaviour considered loyal, as well as a negative one to avoid acts which could be considered disloyal. This leads into the third objective, which might be considered most controversial. Some commentators would deny that it is a regulatory objective of fiduciary duties at the most basic level.[3] They would hold that regardless of the fact the nature of the duty is expressed as an obligation of loyalty, it is in fact, or at least should be, simply a system of legal rules proscribing specifically conflicts of interest and secret profits. However, most would accept the proposition that loyalty is a central concept of the fiduciary duty,[4] and this position is supported

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[1] Consider for example the famous discussion on the strictness of the rule in the cases of *Regal (Hastings)* [1967] 2 AC 134 and *Phipps v Boardman* [1967] 2 AC 46. For further discussion of the value of this strict approach see Flannigan, R; "The Strict Character of Fiduciary Liability" [2006] *New Zealand Law Review* 209. For some commentary on deterrence as a rationale for fiduciary accountability directly see *Grimaldi v Chameleon Mining (No2)* [2012] FCAFC 6, para 576, and Goode, R; "Proprietary Liability for Secret Profits: a Reply" (2011) 127 LQR 493.

[2] It was described as the "distinguishing obligation" of the fiduciary in the leading case of *Bristol and West Building Society v Mothew* [1998] Ch 1 at pp 18.

[3] See for example, Goode, RM; "Proprietary Liability for Secret Profits - a Reply" [2011] 127 LQR 493 and "Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?" (2005) 114 Yale LJ 929 .

[4] Almost any of the other commentators referenced in the 1st Chapter or other Chapters of this these would subscribe to this view to some extent. See for example, Millett, P; "Bribes and Secret Commissions" [1993] R.L.R. 7, Millett, P; "Remedies: The Error in Lister v Stubbs" in Birks, P (ed.); *The Frontiers of liability: Vol I* (Oxford1994), p51 and most recently in Millett, P; "Bribes and Secret Commissions Again" [2012] 71(3) CLJ 583

by case law,[5] but might have disagreements about precisely what that means for the practical regulatory objectives of the fiduciary obligation.

Consider for example Worthington's explanation of fiduciary duties in her study of the whole field, *Equity*.[6] She begins Chapter 5 with a study of the measures taken by equity to restrict the personal autonomy of particular actors. This is an examination of the way in which different prescriptive and proscriptive strategies are pursued in different contexts in order to achieve outcomes which can be complex or difficult. Of fiduciary duties she makes the following claims: Firstly, that due to the "impossibility of defining an end position,"[7] equity, "identifies the type of conduct that is likely to put the claimant most at risk, and bans, or proscribes it."[8] A compelling position which she builds out of the necessity and difficulty of regulating the exercise of discretionary powers in complex factual scenarios. Secondly that equity, "imposed fiduciary duties of loyalty to ensure that trustees preferred their beneficiaries' interests to their own in managing the property."[9] This is offered as a straightforward description of how the fiduciary duties operate to address the problem identified above by banning the highest risk behaviour. And thirdly that, "the fiduciary duty of loyalty requires fiduciaries to put their principals' interests ahead of their own; it requires fiduciaries to act altruistically."[10]

As Worthington moves deeper into the analysis of the fiduciary duty she sets out an explanation of how the fiduciary duty restricts personal autonomy in order to proscribe behaviour. Taking those ideas together Worthing clearly recognises that the objectives of the fiduciary duty cannot merely be remedial and the deterrence of specific behaviour, but the wider objective of ensuring that no trustee behaviour is not tainted by self-interest and instead is conducted in an altruistic manner. She herself does not reach the conclusion that the fiduciary duty is intended to promote loyalty in the relationship in general, rather than simply in the moment of particular decisions of when and how to exercise powers and discretions. However it could be said this flows naturally from the logic of the position. Given that it is accepted that there are specific desirable and altruistic actions which constitute the "end position" sought by equity it seems unrealistic to suppose that the only means of achievement is by merely by prohibiting the greatest risks to their occurrence. Rather it is the contention of this thesis that in grounding the response to such risks in the concept of loyalty and altruism it is intended that the regulation increase the likelihood of loyalty and altruism in the actions of

[5] *Supra* n2.
[6] Worthington, S; *Equity* (2nd Ed 2006; Oxford: Oxford University Press)
[7] *Ibid.* p128
[8] *Ibid.*
[9] *Ibid.* p130
[10] *Ibid.* p131

trustees in general, by endowing the relationship with a particular 'fiduciary character', making desirable but unknowable fiduciary actions more likely to occur.

This contention is in part based in the fact that it is difficult to conceptualise any of the regulatory objectives being successful without the pursuit of the others given the context and manner in which fiduciary duties operate. Once the loyalty, trust and confidence is gone from a fiduciary relationship that is a state of affairs which requires a remedy in and of itself, as well as restitution of lost assets. A replacement fiduciary is needed to conduct and advance the affairs of the principal. Thus discouraging disloyalty in fiduciary relationships in general is the most desirable approach to the problem. Given the informational asymmetry in fiduciary relationships, and the power advantage which is by definition enjoyed by the fiduciary, adequately providing remedial responses will always be challenging.[11] The complexity of the factual scenarios and the flexibility in determining what constitutes desirable behaviour by fiduciaries in different circumstances mean that to some degree the law of fiduciary duties will not know clearly what it is trying to remedy or deter until it occurs. In that context it is highly desirable that the guiding principle of the regulation be to instil an ethic into such relationships which will allow them to 'self-govern' to some extent. Ideally it will be apparent to the participants in any given fiduciary relationship what the desirable actions of the fiduciary are given the level of loyalty which is present and necessary in their relationship to their principal.

5.3 The Place of Fiduciary Duties in the Wider Legal Context

Having established a basic framework for the regulatory objectives, it is also instructive to consider how the fiduciary duties operate alongside other legal regimes which attempt to address similar problems. Examination of these other areas of the law is by necessity very brief, and much more could be said about their relationship to fiduciary concepts, however what is attempted here is simply a summary to illuminate the way in which the fiduciary duty operates relative to other types of legal intervention.

5.3.1 Criminal Offences

The kind of legal intervention which is arguably likely to be most prominent in the minds of lay people is the criminal law rather than the civil. There are a number of relevant criminal offences which regulate activities which would also constitute breach of fiduciary duty. Of

[11] See below, 5.4

course there is the classic and long standing offence of theft,[12] which as any law undergraduate can tell you is defined as when a person, “dishonestly appropriates the property of another with the intention of permanently depriving the other of it”.[13] A fiduciary who appropriates trust property for himself could in the most egregious cases to be guilty of this offence. In more complex cases, two more recent statutory codifications of criminal offences could also be of relevance. Firstly, the Fraud Act 2006 establishes that an offence of fraud is committed by abuse of position when an individual in a position which requires him to safeguard the financial interests of another dishonestly abuses that position for his own personal gain or with the intention of causing loss to another.[14] Obviously most of those in a position requiring of them to safeguard the financial interests of another will be fiduciaries and so this provision has the potential to have an impact on those who make dishonest use of the funds or property within their care. Secondly, the recent Bribery Act 2016 establishes an offense of being bribed where one of four different cases is satisfied.[15] The differences between the cases relate to minor technical differences in whether the bribe is already received or expected and whether the act being purchased has occurred or will occur. However, common to all are the key concepts of, “financial or other advantage”[16] in exchange for the, “improper performance of a relevant function”.[17] As a “relevant function” is defined as any function in which there is an expectation of impartial performance in good faith then this will clearly cover many of the powers exercised and activities undertaken by fiduciaries.[18] Again exceptionally egregious cases of what would be called secret commissions in fiduciary parlance may fall within the remit of this Act.

To many the key difference between these offences and breach of fiduciary duty would be the fact these attract criminal penalties rather than civil. Imprisonment, fines and a criminal record can result from conviction on any of these offences. This is in large part because of one of the key differences in regulatory approach, which is that these crimes have a significant *mens rea* element, with dishonesty being required in the first two cases of theft and fraud and the intention to improperly perform a function in exchange for advantage in the case of bribery. On the other hand it is well established that a breach of fiduciary duty can be committed even where intentions and motivations were innocent and even positive, as the fiduciary obligation

[12] Theft Act 1968, c 60, s1
[13] *Ibid.*
[14] Fraud Act 2006 s4
[15] *Ibid.* Bribery Act 2010 s2
[16] *Ibid.*
[17] *Ibid.*
[18] *Ibid.* s3

is subject to the provisions of strict liability.[19] From the penalties imposed it is also clear that while the criminal offences focus on punishment of offenders, fiduciary liability serves the twin purposes of disgorgement and restitution of losses or missed profits.[20] The criminal provisions are therefore intended to address specific cases of behaviour considered to be harmful to society as well as punish unacceptable dishonest violations of personal property rights, providing both punishment and deterrence. On the other hand the fiduciary obligation must be primarily seen as governing interpersonal relationships between individuals, rather than the relationship between individuals and the state. As such they are also of a much more general character and govern activity which covers a much wider range of morally unacceptable behaviour, perhaps even stretching into morally neutral but proscribed behaviour. This suggests a regulatory objective which is not simply concerned with vindication of rights but also with economic efficiency and the principles of good governance of financial affairs.

5.3.2 Regulatory Codes

Another type of regulation which sits alongside the fiduciary obligation are the codes or rules of conduct issued by various professional bodies and organisations whose members are generally fiduciary office holders. The codes in this section are differentiated from those in the subsequent section as they are enforced by means of significant penalties such as professional disciplinary action, fines, suspensions and even exclusion or disbarment from further involvement in the profession. Generally the power to publish and enforce such codes is also derived from statutory authority or chartered status. What is chosen here is a limited, representative selection of such codes. While each specific example has minor quirks and differences, the general thrust of such provisions is largely the same across different fiduciary professions.

One of the primary examples of a regulatory code is the Solicitors Regulation Authority Code of Conduct 2011.[21] This code governs every solicitor in England and Wales and carries a range of enforcement measures, including disciplinary action, fines, closure of firms and suspension or being struck off from practice by referral to the Solicitors Disciplinary Tribunal. The Code is divided into two main types of rule, Outcomes, which are mandatory, and Indicative Behaviours, which are non-mandatory. Indicative Behaviours are indicators and examples which will inform any decision as to whether the mandatory provisions have been

[19] For example the intentions of the solicitor and beneficiary who acted together to turn around a company to benefit both themselves and the trust in *Boardman v Phipps* [1967] 2 AC 46.
[20] See below, 5.4
[21] Solicitors Regulation Authority Code of Conduct 2011, Version 19 October 2017 available at http://www.sra.org.uk/solicitors/handbook/code/content.page last accessed July 2018

complied with. A number of the provisions of the Code cover areas of activity which are also regulated by the fiduciary duty, though the Code only refers to the duties directly in the introduction[22] and in the rules related to confidentiality and disclosure.[23] Chapter 3 of the Code is entirely dedicated to conflicts of interest,[24] while fees and ancillary financial benefits are dealt with in Chapter 1.[25] Some provisions which closely mirror the fiduciary duties are O1.15 which states that solicitors must "account to clients for any financial benefit you receive as a result of your instruction,"[26] and O3.4 which mandates that solicitors "do not act if there is an own interest conflict or a significant risk of an own interest conflict."[27]

Some interesting inferences can be drawn from the fact that the SRA have chosen to codify many of the obligations imposed by fiduciary duties in this way. It is obviously noteworthy that the SRA considers the content, aims and objectives of those obligations valuable enough that they bear repeating and enforcing. Due to the nature of this Code, which regulates professional conduct, the obligations are also seen as part of kind of professional morality. The client is considered to be owed full and complete information about fee structures and incidental financial benefits, as well as protection from potential conflicts, by virtue of the solicitor client relationship. The provisions of the Code suggest that the SRA see such obligations as arising as a matter of right and professional ethics and also as having value in promoting the reputation and reliability of their profession.

However it also must be recognised that in creating such a Code the SRA are attempting to supplement the fiduciary obligation itself in a number of ways. This may indicate some deficiency in its regulatory effectiveness, or may simply may a mark of differing and complimentary roles for the Code and the fiduciary duties. Firstly, the Code is more specific in its provisions, laying out more clearly defined behaviour which is acceptable and

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[22] *Ibid.* Overview

[23] *Ibid.* IB 4.2 This is a rule requiring the solicitor to comply with their fiduciary duties relating to confidentiality and disclosure, which indicates that in this area the fiduciary obligations are broader and more flexible than the specific requirements of the code.

[24] *Ibid.* Chapter 3, O3.1 to IB 3.14

[25] *Ibid.* Chapter 1, O1.1 to IB 1.28

[26] *Ibid.* O1.15, a mandatory provision which is supplemented by IB1.20 which sets out three possible courses of action in the case of receipt of such a benefit: give it to the client, offset the value in fee arrangements, or keep it where appropriate and where the client has been informed and agreed to the solicitor retaining the benefit. These Indicative Behaviours closely follow the outcomes which would be expected by equity in the case of a fiduciary who has the prospect of making an ancillary profit. Such a profit must be authorised by the beneficiary after full disclosure of all relevant facts for the fiduciary to retain the benefit, otherwise the profit will be considered as being held on trust for the beneficiary.

[27] *Ibid.* O3.4 This provision is supplemented by a number of other mandatory rules specifying that a solicitor or firm of solicitors must have systems in place to identify and manage conflicts (O3.1-O3.3) and that a solicitor should not act where there is a risk of client conflict unless certain exceptions are met (O3.5-O3.7). Alongside that there are a number of both positive and negative Indicative Behaviours (IB3.1-3.7 and IB3.8-3.14). Many of these behaviours relate to activities which are either known to be or are likely to be breaches of the fiduciary duty of conflicts of interest. Some mirror examples in the case law.

unacceptable, both in a mandatory sense in the Outcomes which must be achieved and in the specific instructions contained in the Indicative Behaviours. This approach still retains much of the flexibility of the duties themselves, not least in adopting mandatory provisions alongside more flexible indicative behavioural guidance, but it must be said there is likely also a desire to clarify in more detail the type of acceptable behaviour. This is something which the Code can do more effectively given that it regulates one specific type of fiduciary office holder, rather than regulating the behaviour of all fiduciaries. The Code also is enforced by means of serious and punitive censure against the solicitors who breach its provisions. This again points to the perceived ethical significance placed on the behaviours regulated but also perhaps suggests that deterrence and ethics require responses beyond those which can be imposed by equity for breach of fiduciary duty. This could be seen as lending support to the idea that fiduciary duties are fundamentally only a remedial response to the legal issues created by dishonest fiduciaries. Certainly fiduciary duties can be viewed as primarily having that role, but this Code clearly draws heavily on the regulatory and ethical framework created by the fiduciary obligation. This points towards the broad and significant legal and psychological effect that the jurisdiction of the fiduciary obligation has on commercial fiduciaries, suggesting that the duties have accomplished a considerable amount in regulating behaviour in this area.

The SRA Code of Conduct is by no means unique. A number of different professional bodies enforce such codes or standards of behaviour with respect to their members, with the power to enforce their codes with disciplinary action. Fiduciary standards, particularly in how they restrict conflicts of interest, play a significant role in many of these codes. Another notable example are the codes and guidance issued by the Pensions Regulator. This is the governing organisation for occupational and public service pension schemes and maintains a register of pension trustees. One of the means at its disposal to enforce its standards of conduct is removal from the register and prohibiting individuals from acting as pension trustees in the future.[28] The Statement on Prohibition Orders 2016 states that the main criteria by which individuals are judged is whether or not they are a “fit and proper person”.[29] The statement emphasises that such a determination will be based on evidence as to the honesty and integrity of the trustee as well as their competence and financial soundness.[30] Any breaches of trust, such as breaches of fiduciary duty will clearly count against a potential trustee.[31] The Regulator also publishes two codes of conduct for the trustees of occupational pension

[28] Pensions Regulator Statement on Prohibition Orders 2016 available at http://www.thepensionsregulator.gov.uk/doc-library/statements.aspx#s21966 last accessed July 2018
[29] *Ibid.* pg 2
[30] *Ibid.* pg 4
[31] *Ibid.* p5

schemes and public service pension schemes respectively.[32] Each of these codes has a section which deals with conflicts of interest, and in both cases emphasis is placed on having systems in place to monitor and prevent conflicts of interest.[33] This issue is of particular importance in the Code of Practice relating to public service pension schemes as the prohibition on conflicts of interest is statutory[34] and therefore the Code is aimed at managing even the potential for conflicts to occur.[35] These Codes take the form of guidance rather than legal documents but given that the regulator has the significant power of prohibition and the manner in which it will enforce it, these Codes have significant regulatory force.

One final relevant document the regulator issues is detailed guidance on conflicts of interest for the employers and trustees of smaller pension schemes.[36] Unlike the other documents issued by the regulator this guidance makes specific reference to the fiduciary obligations of the pensions trustee from the beginning and throughout the document. It emphasises not only the importance of complying with the legal obligations but also the complexity of this area of law, recommending legal advice is taken where such issues are raised. It also gives significant practical guidance about how to go about ensuring there is integrity and the avoidance of conflicts in the behaviour of pensions trustees.

The focus of these regulatory documents is once again not only compliance with the legal requirements of the fiduciary obligation but also ensuring the integrity of the professionals participating in this field of fiduciary activity. They contain uniform practical guidance about how trustees can fulfil such requirements and create systems within their organisations to manage risks correctly. This once again highlights the successes and failures of the fiduciary obligation. The values and obligations it creates are shown to be of value to the commercial actors involved in the business of pensions, but equally create significant complexity, requiring compliance systems to ensure the necessary standards are met.

There are many more of these codes of practice and conduct across a range of different fields of fiduciary activity, too many to address all in detail here, but one final example of particular relevance is the Handbook of the Financial Conduct Authority.[37] According to its

[32] Pensions Regulator Code of Practice no. 13, 2016 and Pensions Regulator Code of Practice no. 14, 2015. Both are available at http://www.thepensionsregulator.gov.uk/doc-library/codes.aspx last accessed July 2018

[33] In Codes of Practice no.13 the relevant sections are paragraph 61 and 62 and in Code of Practice no. 14 they are 61-89

[34] Pensions Act 2013

[35] Pensions Regulator Code of Practice no. 14, 2015 pp 61-89. These sections go into significant detail not only about the regulatory requirements for managing potential conflicts of interests but also suggesting a range of practical measures and examples of how such conflicts can be avoided or managed.

[36] Conflicts of Interest, Pensions Regulator 2008, available at http://www.thepensionsregulator.gov.uk/guidance/guidance-conflicts-of-interest.aspx last accessed July 2018

[37] Financial Conduct Authority Handbook available at https://www.handbook.fca.org.uk/ last accessed July 2018

website the FCA are the conduct regulator for 56,000 UK financial services firms.[38] These range from banks, to credit firms, to financial advisers, to investment managers, to insurance providers. Its stated aim is ensuring the financial services market is "honest, fair and effective" for consumers.[39] This is an organisation significant role in regulating the financial sector of the UK economy. To operate in many of the main financial services industries in the UK a business must seek the authorisation of the FCA and will continue to be monitored and supervised by this organisation. It has the power to remove or refuse authorisation and issue a range of lesser sanctions for misbehaviour, including suspension and fines directed at individuals or businesses. It can issue warnings or directions against businesses operating in a risky or prohibited manner, harming their reputation.

The FCA Handbook itself is too extensive a document to examine in detail here, as it contains a large number of different codes and provisions relating to different industries and business types. However it begins with a statement of overarching business principles which must be complied with by all firms authorised and regulated by the FCA.[40] Amongst these is a general principle on the avoidance of conflicts of interest as follows:

> "A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client."[41]

In this principle statement we see a recognition of the importance of this fiduciary principle to the effective operation of financial services across the entire sector. It is essential for the standard to be met for there to be faith in the financial industry. At the same time we see the inherent flexibility in such an idea. It cannot be too precisely defined or set out in a manner which is too restrictive. In some parts of the financial services sector conflicts are necessary or unavoidable and instead must be correctly managed rather than completely prohibited. The broad principles set out in this Handbook are incapable of imposing a precise or strict legal rule or standard, and instead an ethical standard of "fairness" is used to create discretionary professional regulation The fiduciary duty works to retain the same level of flexibility while at the same time offering a strictly applicable legal rule which can provide a means of enforcement and remedy for aggrieved beneficiaries.

5.3.3 Voluntary Codes of Conduct and 'Soft Law' Regulation

[38] "About the FCA" 2016 available at https://www.fca.org.uk/about/the-fca last accessed July 2018
[39] *Ibid.*
[40] *Supra* n39, Prin 2.1: The Principles
[41] *Ibid.* Prin 2.1.1, Principle 8

Another comparison that can be made in order to assess the regulatory role and effectiveness of the fiduciary duty is to voluntary codes in the commercial world, and especially to the concept of stewardship. The reason this is of particular relevance is due to the fact that one of the claims of this thesis is that fiduciary duties exert a kind of soft law pressure across the whole of the commercial environment, or at least have that capability as part of their design. To some extent we have already seen this in the sections above. Fiduciary rules have found their way into a wide number of professional codes of conduct, and the avoidance of conflicts of interest in particular. While sensitive to the needs of each specific profession there appears to be a fiduciary standard of behaviour which is readily accepted as an essential part of good management. Professor Kay in the Kay Review discussed in Chapter 1, spoke of the value of spreading "fiduciary standards" throughout the chains of investment intermediaries which exist in the financial world.[42]

Stewardship is a concept which has already been discussed in some detail in Chapter 1. A reasonable definition of stewardship is that it is the responsibility which governs the conduct of the steward in any situation where he is responsible for the financial interests of another, particularly with regard to protecting and promoting those interests in the future.[43] In this way it is similar to the fiduciary obligation. It arises out of a relationship by virtue of the steward holding a management position of trust, and serves to impose standards of conduct. The regulatory objective of stewardship, and the means by which it seeks to achieve this goal bears further examination.

The most significant piece of regulation to utilise the principle of stewardship is the FRC UK Stewardship Code.[44] This is a voluntary code to which investment fund managers sign up. It is designed to encourage standards of good practice for those that manage resources and invest them in companies and other assets designed to generate returns for clients. Part of what the Code intends is that investment managers should take a more active role in ensuring that directors of companies with whom they invest the money of the investment fund live up to high standards of behaviour. It also seeks to ensure that beneficial and long term business strategies are pursued, rather than quick profits or short term returns. As noted in Chapter 1, the principles of the Code in a number of places mirror fiduciary standards, particularly Principle 2 which concerns conflicts of interest. What is perhaps of greater relevance is the manner in which the Code is designed to achieve its lofty objectives. It has

[42] *Final Report of the Kay Review of UK Equity Markets and Long-Term Decision Making* 2012 http://webarchive.nationalarchives.gov.uk/20121204121011/http://www.bis.gov.uk/assets/biscore/business-law/docs/k/12-917-kay-review-of-equity-markets-final-report.pdf, July 2018.
[43] See Milman, D; *Governance of Distressed Firms* (2013, Cheltenham: Edward Elgar) and Reisberg, A; "The Notion of Stewardship from a Company Law Perspective" (2011) 18.2 Journal of Financial Crime 126
[44] http://www.frc.org.uk/FRC-Documents/FRC/The-UK-Stewardship-Code.aspx, last accessed July 2018

no enforcement mechanism, it is a voluntary scheme. Signatories are required to comply with the provisions of the Code or explain their non-compliance in submissions to the FRC. This is what is known as a "comply or explain" approach. The FRC will then publish assessments of the quality of the compliance of the signatories with the obligations of the Code. The idea is that where compliance is not occurring, there will be either a requirement to justify such behaviour, or there will be some level of reputational damage. In fact the focus of the Code is very much concerned with increasing the information available to individual investors about the behaviour of both their fund managers, and the managers of the firms with which their money is ultimately invested. In doing so it is hoped that the need to preserve an exemplary reputation, as well as the ability of the investment market to reward good management and punish poor decision making will ensure the standards of the Stewardship Code are promoted throughout the industry.

This is an approach with both some similarities and some striking differences with that of fiduciary duties, and one which is not without criticism.[45] Clearly one difference is that the fiduciary obligation is designed to create legally binding duties on the fiduciary, on which the beneficiary or principal can rely, and enforce through the courts. However, it also appears, as discussed at length in the preceding chapters of this thesis, to attempt to impose a quasi-moral obligation on the fiduciary, one which can be subject to social and reputational pressures, as well as the deterrence created by legal liability. One of the defining characteristics of the fiduciary obligation is also the obligation of "loyalty."[46] Which manifests itself in an obligation to ensure that if a conflict of interest does occur, the fiduciary has obtained fully informed consent to that conflict before he continues to act. If he makes a profit outside of any agreed fee, then he must either account for it to his principal or seek the formal and fully informed authorisation to retain it himself. In fact at any time a trustees can be called to give account of his trust to his beneficiary. A fiduciary is under an obligation to at any time it is required of him, fully detail and explain his actions undertaken on behalf of the trust. So in a way somewhat similar to the Stewardship Code, part of the intention of the fiduciary obligation was to ensure access to information and transparency in the fiduciary relationship. Ethical, social and reputational pressures would thereby act as a means of enforcement.

[45] See Chapter 1 references in n21. The basic concept of comply or explain regulation was also criticised by the Norton Rose Group (2003).*The Higgs Reports: views of the role and effectiveness of non-executive Directors*, January, p31, and by a Green Paper issued by the European Commission; (2011). *Green Paper-the EU corporate governance framework* (COM: 2011) 164 final, p24, which found that in 60% of cases explanations given for non-compliance were unsatisfactory.
[46] *Supra* n2

5.3.4 Corporate Governance Theory and Fiduciary Regulation

In the sections above we have seen how fiduciary standards and values have been co-opted in different forms of regulatory instrument throughout the commercial sector. We have also seen that there are similarities and differences in the approaches taken by these forms of regulation and the fiduciary duty. One of the advantages of making such a comparison, alongside placing the fiduciary obligation in context as a regulatory measure, is that some of the theory behind the non-fiduciary regulatory approaches becomes relevant to considering the effectiveness of the fiduciary duties themselves.

In a 2008 article Alnoor Bhimani reviewed the theoretical principles which underlie regulation in the field of corporate governance.[47] In particular he focused on the role played by both neoclassical economics and Western business ethics in the formulation of corporate governance codes. By neoclassical economics he means the way in which the market can be used to regulate the behaviour of corporations and commercial actors through, “agency theory, transaction cost economics, stakeholder theory and stewardship theory”.[48] He states that the “owner-manager disassociation dilemma”,[49] is present in virtually all market based systems of corporate governance regulation and that therefore regulators have tended to believe that what is required is a standard response. This response has created corporate governance ‘principles’ which are in turn based on what are essentially ethical standards.[50] The duty to avoid conflicts of interest is one such examples, as is the duty to maximise investor returns, or corporate value. This is a methodology which explains how fiduciary standards have fed into so much commercial regulation, in large part due to the perceived link to economic rationality and agency cost. However Bhimani then identifies an issue with this kind of regulation in that there has been an assumption of universality in both the economic underpinnings and the ethical, without proper consideration of the extent to which the two are actually related. In essence ethics have been deployed as a solution to an economic problem, when it is not at all clear that this is exactly their function. It is certainly not the core reason for deploying an ethical standards, which would generally be the prevention of unethical behaviour for ethics sake. Bhimani cites some references from the field of evolutionary theory, who would assert ethics are little more than a tool used to pursue successful behaviour,[51] but

[47] Bhimani, A; “Making Corporate Governance Count: The fusion of ethics and economic rationality” (2008) 12 Journal of Management Governance 135

[48] *Ibid.* p138

[49] *Ibid.* p140

[50] *Ibid.*

[51] *Ibid.* p141

as he notes, this is far from a definitive justification for the use of ethical standards in pursuit of economic ends.

As an example of the somewhat confused regulatory process which can occur as a result, Bhimani describes the process which led to the publication of the Combined Code on Corporate Governance by the FRC.[52] The Cadbury Report,[53] followed by the Greenbury Report[54] expressed economic and ethical concerns about the practices of large commercial organisations with respect to financial reporting and accountability and Directors' remuneration respectively. Prior to their enactment into a regulatory measure, there first was produced the Hampel Report[55] which as Bhimani puts it was designed to, "balance business prosperity and calls for accountability."[56] While this is not identified as an incorrect decision per se, as both considerations are important, it does serve to highlight the manner in which the ethical and economic are intermingled. At times considered to be in tension and at other times seen as working in tandem or even as one and the same issue.

One of the implications this may have for the fiduciary obligation is to highlight the issue of the extent to which the fiduciary duty can be seen as serving an economic purpose in its protection of beneficiaries either alongside or as opposed to a purely ethical one. To put it another way: Is the protection of the interests of the beneficiary from even the appearance of disloyalty of ethical value, independently of whether it is also of economic value? It is important to at least consider the question and answer it in either the affirmative or negative when presented with difficult cases or considering reform of the jurisdiction. It should be considered specifically, and not merely as a subsidiary issue to the economic value of the fiduciary duties and fiduciary standards. A confused approach to this issue is likely to result in confused legal rules, and less effective regulatory standards.

This question has been brought into sharp focus by the 2008 financial crisis, which has been widely seen as a regulatory failure on many fronts.[57] Given that many of the regulatory measures listed above were already in place in some form at the time of the crisis it is right that there should be a re-examination of whether such measures are really effective. Soltani and Maupetit undertook a wide ranging review of review of corporate governance codes

[52] *Ibid.* p142, referencing: The Combined Code on Corporate Governance. (2006) London: Financial Reporting Council.
[53] Cadbury, A; Report of the committee on the financial aspects of corporate governance. (1992) London: Gee & Co. Ltd.
[54] Greenbury, R; Directors' remuneration, report of a study group chaired by Sir Richard Greenbury, confederation of British industry. (1995) London: Gee & Co. Ltd.
[55] Hampel, R; Committee on corporate governance: Final report. (1998) London: Gee & Co. Ltd.
[56] *Supra* n49 p142
[57] There have continued to be scandals in the regulation of banking risk, executive pay, short-term strategic thinking, the Libor scandal, and the Madoff Ponzi Scheme, among other examples.

passed in different EU states and by the EU itself in the period leading up to 2008.[58] They found that regulatory failures in 2008 were not the failure of specific provisions relating to financial accounting and reporting, which had been widely implemented, but rather were systematic failures resulting from a lack of guidance on business ethics in corporate governance. There had been no adoption of ethical standards which discouraged or prevented risky behaviour, or promoted integrity and honesty.[59]

Ahrens commenting on Bhimani's article, identified the problem of the mismatch between the ethical aspirations of corporate governance and the practical and financial results of the codes.[60] This is what is called a "box-ticking" approach. He states that regulation beginning from what he calls a "presumption of mistrust"[61] loses the respect of managers as a true source of ethical guidance. In practice he says that managers primarily see their role as one of advancing the interests of a business. Trust can be more or less important in an owner-managerial relationship. Generally where a business is succeeding financially, trust is seen as of less concern by both parties. The fiduciary obligation adopts a better approach by encouraging managers to see themselves as men and women of high integrity, altruistic and even noble, responsible for the interests of others. Ethics which are of importance whether the business is profitable or not.

Formalistic corporate governance requirements can come to be seen as merely a bureaucratic exercise by a manager. Ahrens states that this will cause him to be only concerned with profit and economic performance, regarding these as the true standard by which his work will be judged.[62] The remedy according to Ahrens is to create regulation which is of greater use in the internal processes of management itself, which allows members of an organisation to better understand their role in relation to other members and more successfully complete their function.[63] Essentially he is arguing that ethics requirements need to yield tangible results in order for managers to be persuaded to give them regard.

Demonstrating the value of regulation in empirical or financial terms is notoriously difficult. Hamilton concludes that the benefit is at best "uncertain" when it comes any or all of

[58] Soltani, B and Maupetit, C; "Importance of core values of ethics, integrity and accountability in the European corporate governance codes" (2015) 19 *J Manage Gov* 259
[59] *Ibid.* p282
[60] Ahrens, T; "The hidden ethics of corporate governance and the practical uses of corporate governance codes: a commentary on Bhimani" (2008) 12 *J Manage Gov* 149, p151, also citing the use of the phrase in the Hampel Report, *Supra* n57.
[61] *Ibid.* p150. This "presumption of mistrust" means regulation in which managers are assumed to be in a position of power over the assets of investors and that this power must be curtailed as far as possible. Essentially this is the classic agency cost problem.
[62] *Ibid.* p151
[63] *Ibid.* p152.

the different measure adopted in the last 50 years to govern managerial behaviour, be it accounting or reporting requirements, non-executive directors, board composition or any other such measure.[64] The performance of any business depends on a wide range of factors, mostly to do with the economic environment and fundamental profitability of the enterprise. Governance is only likely to yield a very small statistical contribution.[65] Studies that have been attempted to measure it have reached mixed conclusion.[66] This really leaves only the possibility of changing the mind-set of managers to see the values of ethics for their own sake. Future development of the fiduciary obligation should aspire to help managers properly define their role and the expectations their beneficiaries have of them. Ethics must be seen as a way to help their business function within society.

Like Ahrens, David Campbell voices the opinion that using agency theory as the foundational principle of corporate governance regulation is misguided, but for different reasons.[67] Campbell states that the pressure created by the success or failure of a company on a manger will significantly affect the manager's assessment of his interests, and his morals.[68] Therefore imposing informational requirements on a manager will do little to influence his ultimate behaviour. The problem is with the belief that the market will regulate the behaviour as long as it is given perfect information. It will not be given perfect information. Thus a manager is unlikely to feel any coercive effect from the market.[69] What is really desired is that a manager should behave in a responsible and ethical manner, and Campbell contends that therefore assuming him to be a legitimately selfish actor is counter-productive, rather what is required is a regulatory regime which fosters and promotes ethical management.[70]

Clearly achieving this is easier said than done. Some scholars, such as Ferran[71] consider the use of mandatory regulation enforced by sanction, rather than voluntary codes more effective. However, others argue that the flexibility afforded by voluntary and industry code is economically beneficial and will achieve a better regulatory balance.[72] Morck argues

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[64] Hamilton, R; "Corporate Governance in America 1950 – 2000: Major Changes but Uncertain benefits" (2000) 25 JCL 349, especially at p364 et seq.
[65] *Ibid.* p366
[66] *Ibid.* p367 et seq. References to important studies in this area include Bhagat, S and Black, B; "The Uncertain Relationship Between Board Composition and Firm Performance" (1999) 54 Bus. Law 921 and Lin, L; "The Effectiveness of Outside Directors as a Corporate Governance Mechanism: Theories and Evidence" (1996) 90 Nw.U.L.Rev 898
[67] Campbell, D; "The Role of Monitoring and Morality in Company Law: A Criticism of the Direction of Present Regulation" (1997) 7 Austl.J.Corp.L. 343
[68] *Ibid.* p357 et seq.
[69] *Ibid.* p359 et seq.
[70] *Ibid.* p364.
[71] Ferran, E; "Corporate Law, Codes and Social Norms – Finding the Right Regulatory Combination and Institutional Structure" (2001) 1 JCLS 381
[72] See Soltani, *Supra* n60

that the key object of corporate governance regulation should be to encourage a boardroom environment in which management actions are questioned and examined with great care and scrutiny.[73] He applies the famous Milgram experiments which demonstrate how humans can be influenced to unthinkingly co-operate in immoral or unwise activity where they are following the lead or instruction of charismatic or authority figures. He demonstrates that it only takes one or two members of a board to begin to properly question decisions before the quality of oversight and governance improves dramatically for all members. Here again fiduciary regulation has a role to play. What is desirable is that ethics should be regularly and freely discussed by managers and active steps taken to avoid unethical behaviour. This likely cannot be achieved simply by imposing specific rules of compliance requirements. These are only capable of creating the approximation of ethical behaviour among managers. To create an ethical environment regulation must encourage managers to actually have personal standards of business ethics. This in turn will lead to environmental and social pressure among managers to live up to the high standards of behaviour of their profession. Greater awareness of fiduciary obligations can help to foster these ethics. The strong remedial responses of equity will help ensure that managers cannot afford to ignore the jurisdiction, even when under economic pressures.

It has been the contention of this thesis that the fiduciary duties are properly understood as reflecting the ethical value of a relationship between parties. Loyalty is the defining characteristic of the obligation and the content of the duties is determined by reference to the ethical requirements that the relationship imposes on parties' behaviour. It is a jurisdiction which is designed to address the subtle problem that it is real ethics which will result in ethical behaviour, not the mere imposition of rules of behaviour which approximate such values. Clearly a number of different criticisms can still be levelled at the jurisdiction. It may still be understood primarily in terms of the strict rules it imposes and not its underlying values. It may be too complex to create the desired awareness of ethics. It may be too confused and unwieldy a legal instrument, encompassing as it does elements of basic property rights, contractual obligations as well as standards of selflessness, honesty and accountability. However, it does appear from studying recent approaches to corporate governance that the fiduciary obligation is at least the right kind of regulatory intervention. It has had a profound impact on the values of Anglo-American business law. In attempting to introduce ethical principles to the regulation of property relationships it aims to address the difficult problem of

[73] Morck, R; "Behavioural Finance in Corporate Governance: Economics and Ethics of the Devil's Advocate" (2008) 12 *Journal of Management and Governance* 179

limiting self-interest. If what is desired is that business fiduciaries behave in an ethical manner, then they must be held to ethical standards.

5.4 Remedies for Breach of Fiduciary Duty

Another important factor when considering the effectiveness of the fiduciary duty in achieving its regulatory objectives are the remedies available when the duties are breached. It is the remedies which actually correct the consequences of the censured behaviour for the aggrieved beneficiary. While this thesis cannot undertake a detailed review of the remedies for breach of fiduciary duty and related issues, a brief discussion of this subject will be valuable in demonstrating that the unique role that the duties fulfil in the law.

5.4.1 Basic Remedies

A beneficiary who makes a successful claim against a fiduciary for breach of fiduciary duty is "entitled to the full range of equitable remedies".[74] To summarise these remedies briefly, a fiduciary may be able to: obtain a range of injunctions to restrain continuing or future behaviour that breaches fiduciary duty, prevent the transfer of assets, or obtain evidence of the details of the breach; avoid contractual terms agreed in breach of duty;[75] receive equitable compensation to restore the trust and compensate for losses;[76] require the fiduciary to personally account for profits made; or obtain a proprietary remedy to recover misapplied trust property or profits made by the fiduciary in breach of duty.[77]

Equitable remedies are discretionary but in deciding whether a remedy claimed is appropriate "there are no binding rules" but there are "settled principles".[78] Therefore there is relative certainty to a beneficiary making a claim for breach of duty which remedies are likely available to him on the basis of the nature of the alleged breach and it financial consequences.

There is some debate about the limitation period for claims for breach of fiduciary duty.[79] However it is clear that in certain cases there will be no time bar on a claim for fiduciary duty, thereby providing an advantage over common law claims.[80]

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[74] Moffat, G; *Trusts Law* (2009 5th Ed, Cambridge; Cambridge University Press) p881
[75] *Aberdeen Railway Company v Blaikie Brothers* (1854) 1 Macq 461
[76] *Nocton v Lord Ashburton* [1914] AC 932
[77] *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45
[78] *Cooperative Insurance Society Ltd v Argyll Stores Ltd* [1998] AC 1, p16
[79] See Mather, J; "Fiduciaries and the Law of Limitation" [2008] JBL 344
[80] *Paragon Finance v Thakerar* [1999] 1 All ER 400

The remedies available for breach of fiduciary duty are therefore comprehensive, with an ability to adapt to provide the best remedial response to the given facts of a case at the discretion of the court. This ensures that a beneficiary in a claim can be sure that if they are successful they are more likely to get valuable and nuanced redress than they would be with a simple common law claim resulting in compensatory money damages. This again highlights the flexible and justice led approach of Equity. It also is consistent with the high standards of behaviour that equitable rules demand that the remedies are more potent than those available at Common Law.

5.4.2 Equitable Accessory Liability

In addition to the forceful remedies available against a defaulting fiduciary, a claim for breach of fiduciary duty also opens the door to a beneficiary to pursue claims against 3rd parties under the equitable principles of 'dishonest assistance' and 'knowing' or 'unconscionable receipt'. This is of enormous value to a beneficiary in a business context as the nature of modern commerce means that moving money and property will often require 3rd party involvement in professional services and brokering, and in laundering the money. Accessory liability expands the number of potentially solvent claimants from whom the beneficiary can recover, increasing their chances of recovery, as well as ensuring that all those involved in unconscionable activity are made liable for their actions.

In a well-considered review of the these equitable principles David Salmons explains that equitable accessory liability is more easily available than similar claims at common law for a number of reasons.[81] At common law accessory liability can be explained essentially as 'knowingly causing a primary legal wrong by another legal actor'. This has a conduct element which is positive action which is a substantial cause of the primary wrong, and a mental element which is that the defendant knows that their actions will cause this wrong.[82] In contrast Salmons states that accessory liability at equity operates in a different manner with a lower threshold on actions, reflecting the vulnerability of the beneficiary to actions affecting his property, but higher mental culpability requirements, as Equity is a conscience based jurisdiction.[83]

[81] Salmons, D; "Dishonest Assistance and Accessory Liability" (2017) 80(1) MLR 133
[82] See Davis, PS; *Accessory Liability* (2015, Oxford; Hart Publishing)
[83] *Supra* n83, p140 et seq.

To make a claim in dishonest assistance for breach of fiduciary duty the third party must have acted in any way which dishonestly assisted the breach of duty.[84] This can be through acts or omissions, as much as being a co-conspirator, or as little as providing the bank account through which a transaction was conducted.[85] The actions in question can even occur after the breach of duty, if they assist with the consequential action of the fiduciary in relation to that breach.[86] The key question is whether or not such actions or omissions can be said to be dishonest, in that they fall short of the actions that would have been taken by an honest person in those circumstances.[87] This is generally considered an objective test. This was thrown into some confusion in the case of *Twinsectra v Yardley*[88] in which a majority of the House of Lords held that there was additionally a requirement that the defendant subjectively appreciated that ordinary people would regard what he had done as dishonest. This is technically the leading case on this subject however the problems it created were made plain in the later Privy Council case of *Barlow Clowes v Eurotrust*. The defendant attempted to argue that his personal morality was such that he simply always followed the instructions he was given by his clients.[89] For this reason the judges declined to follow *Twinsectra* and used the objective test for dishonesty laid down in *Royal Brunei*. Most commentators now believe the objective test is good law and the *Twinsectra* requirement is not.[90]

'Knowing' or 'unconscionable' receipt[91] will impose liability on a third party in a case where that person receives property with the knowledge that the transaction is in breach of fiduciary duty.[92] This entire jurisdiction essentially depends on a knowledge requirement, the mere possession of the property is sufficient to satisfy the active element. The knowledge requirement is not simply actual knowledge however. It includes wilfully closing one's eyes to the breach of fiduciary duty and being reckless to that fact.[93] Case law has gone on to expand this idea further to the point that any receipt of the property in a manner made unconscionable by the breach of trust of another will be sufficient for the court to impose liability.[94] There must

[84] *Royal Brunei Airlines v Tan* [1995] 2 AC 378
[85] *Customs & Excise v Barclays Bank* [2007] 1 AC 181, at para 75 a bank was said to be capable of being made liable if they 'deliberately shut their eyes to dishonest dealings by their customers'.
[86] *Twinsectra v Yardley* [2002] 2 AC 164
[87] *Royal Brunei Airlines v Tan*, *Supra* n86
[88] *Twinsectra v Yardley, Supra* n88
[89] *Barlow Clowes v Eurotrust* [2005] UKPC 37
[90] See for example excellent discussion of this subject in Hudson, A; *Equity and Trusts* 9th Edition (Routledge: London, 2017) Ch 19, and Salmons, D; "Dishonest Assistance and Accessory Liability" (2017) 80(1) MLR 133
[91] Commentators are using different names. The classic formulation was 'knowing receipt' but as explained below the knowledge requirement has been broadened into essentially an 'unconscionability' requirement, hence the dual terminology.
[92] *Re Montagu's Settlements* [1987] Ch 264
[93] *Ibid.*
[94] *BCCI v Akindele* [2001] Ch 437

be some level of unconscionability in the knowledge or actions of the third party in receiving the property however. If the third party is entirely innocent when in receipt then the mere fact that a breach of duty has occurred in relation to the property will not make them liable in 'knowing' or 'unconscionable' receipt.[95]

In both of these forms of equitable liability the question of conduct which the court considers unconscionable in all the circumstances is central to the imposition of liability under this principle. This provides a means to ensure that beneficiaries can properly recover from any party who participates in their misfortune at the hands of their fiduciary. The remedy available from such a claim is to subject the third party to *in personam* liability to account as if they were a constructive trustee.[96] A confusing formulation that simply reflects the fact that the beneficiary can recover from the third party all that they could have recovered from the fiduciary directly.

5.4.3 Equitable Tracing and Breach of Fiduciary Duty

In addition to opening up potential claims against third parties in accessory liability, the equitable remedies available in cases of breach of fiduciary duty also potentially give rise to claims in equitable tracing. Tracing claims allow a claimant to 'follow' specific property which belongs to him into the hands a defendant and demand its return. If the property is substituted, he can then 'trace' his beneficial ownership into that new property. As with a number of issues in this chapter, a detailed examination of the nuances of tracing claims will not be undertaken in this thesis, however there are important differences between equitable and common law tracing rules. Thus the potential for breach of fiduciary duty to give rise to proprietary remedy greatly increases the chance a claimant beneficiary will recover some or all of their property.

Common law tracing rules are relatively basic. Where someone has taken specific and identifiable property of the claimant and put it in the hands of the defendant then the claimant can assert his continued ownership of that property and any proceeds from its use.[97] This continues to be the case if that property is substituted for other specific and identifiable property, the claimant can assert ownership in this new property.[98] The great limitation of common law tracing is that if the original property or substitute property is mixed with other property belong to the defendant or others then the tracing claim fails immediately on

[95] *Westdeutsche Landesbank Girozentrale v Council of the London Borough of Islington* [1996] AC 669
[96] *Ibid.*
[97] *Lipkin Gorman v Karpnale* [1997] 2 AC 548
[98] *Jones, FC (A Firm) v Jones* [1996] 3 WLR 703, and where completely unmixed perhaps proceeds as well as the value of the property itself.

mixture.[99] Since in many cases a claim will concern money, or assets which are rapidly liquidated, the chances of the property being placed into a mixed fund early on in the process are quite high.

Equitable tracing claims can follow ownership into mixed property.[100] However an equitable tracing claim requires that the claimant must have had a pre-existing equitable interest in the property.[101] Where the property in question is subject to a pre-existing equitable interest then in all cases other than mixed funds in bank accounts the claimant will be entitled to a proportional interest in the mixed property with the other contributors. Mixed funds in bank accounts are subject rules that will not be set out here, but essentially where the mixed fund is with exclusively the property of the fiduciary themselves then the claimant will likely be entitled to the best possible outcome depending on how the fiduciary has invested the fund.[102] Where the fund is mixed with those of innocent third parties then the rules are significantly more complicated. The most likely outcome will be a proportional approach where by the participants in the fund all bear gains and losses in proportion to their shares in the fund.[103]

The advantages of the equitable tracing rules are therefore plain to see. Not only do they increase the simple likelihood of recovery of the value of the original property and its profits, as conversion to money in a mixed fund is likely before profitable investment occurs, they increase the likely number of hands through which the property can be traced. In the case of a modern fraud,[104] the chances are that property will be liquidated, mixed with funds of other victims, and moved through bank accounts and shell companies. Really only equitable tracing has a chance of reaching these funds for the wronged beneficiary. The fact that breach of fiduciary duty is an equitable claim, capable of giving rise to remedies which create an equitable interest in property taken or acquired in breach of those duties means that this jurisdiction is a key source of the property rights necessary to make use of equitable tracing claims. This in itself is a hugely important and useful function this jurisdiction performs. In general, making legal claims is difficult and expensive. Recovery is uncertain, especially where the defendant has power over the evidence of his actions as is the case with most

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[99] *Westdeutsche Landesbank Girozentrale v Council of the London Borough of Islington Supra* n96
[100] *Ibid.*
[101] *Re Diplock's Estate* [1948] Ch 465
[102] This will either be accomplished by treating the trustee as if he was honest, bearing the losses of bad investments himself and attributing gains from good investments to the trust, *Re Hallett's Estate* (1880) 13 Ch D 696, or by allowing the beneficiary to elect which transactions he wishes to adopt and which he wishes to attribute to the fiduciary's own funds, *Re Oatway* [1903] 2 Ch 356.
[103] *Barlow Clowes International Ltd v Vaughan & Ors* [1992] 4 All ER 22, though there is the possibility of a traditional approach being applied based on a 'first in, first out' approach to the fund in which the court commissions a chronological accounting of the fund to establish the respective remaining funds of each participant in the mixture, *Clayton's Case* (1816) 1 Mer 572
[104] Such as that in *Sinclair v Versailles* [2012] Ch 453

fiduciaries.[105] The force and proprietary nature of the remedies offered by the fiduciary duty, in combination with associated claims based on accessory liability and tracing greatly improve the odds of a satisfactory resolution for the beneficiary. This in turn will encourage claims to be made where problems of trust have occurred in fiduciary relationships. The increased likelihood both of a claim being made, and of it resulting in recovery reduces the chance it will prove profitable for a fiduciary to breach his duties in the first place. This improves not only compliance with fiduciary principles but confidence in their general function.

5.5 Substantive Assessment of the Impact of Fiduciary Duty in Business Law

5.5.1 Introduction to the Review

As already discussed, while a theoretical assessment of the effect and effectiveness of the fiduciary obligation as a regulatory tool in the commercial environment is possible, assessing the impact that the duties have in practice is far more difficult. In preparing this thesis I have not found any direct econometric analysis of the fiduciary duty, or even anything that comes close. This is not surprising as the fiduciary duty is not something that can be easily measured. Any preventative impact it has on fiduciary behaviour is dependent on the conscience and the fear of deterrence of the individuals who are regulated by it. The noticeable practical impact of the fiduciary duty is not in cases where it prevents wrongdoing, rather it is in those cases where the duty is breached and is used as the basis of a claim for a legal remedy.

Even in this sphere there is surprisingly little research that has been conducted. As with econometric studies, I have not encountered any empirical or statistical studies measuring the impact of claims for breach of fiduciary in the English court system. Such a study could have potential to deliver useful insight into the level of usage of the fiduciary duty as a foundation for legal claim as well as the outcomes it tends to generate. This may add at least a little to an assessment of the usefulness and importance of the fiduciary obligation as a regulatory tool. To investigate this possibility further I have conducted a brief review of cases in which fiduciary duty was pleaded as a cause of action in the High Court and Courts of Appeal over a 12 year period, and recorded the rate of success.[106]

This review cannot claim to reach the level of a reliable empirical study for a number of reasons which will be explained however it has yielded some useful insights. A brief table of conclusions is included below at *fig 1*. To summarise, over the 12 year period 1st January

[105] Flannigan, R; "The Strict Character of Fiduciary Liability" [2006] *New Zealand Law Review* 209.
[106] A complete list of the cases reviewed is available on request to the author.

2005 to 31st December 2016 breach of fiduciary duty was pleaded as a cause of action in at least 39 cases every year and the cause was successful in more than 50% of the court hearings recorded in all but one of the 12 years (2008). This in itself has some significance as it demonstrates that the usage of the fiduciary duty as a means to achieving legal redress is in fact reasonably common. It is certainly not at the level of say the Tort of Negligence[107] but it is not an unheard of event. On average, breach of fiduciary duty is being pleaded somewhere in a court in England and Wales most weeks. It is also not being used merely as a "Hail Mary" plea, a poorly understood catch all claim when all else fails, though that undoubtedly does occur,[108] but it is more likely than not to be successfully deployed by Claimants and their legal advisers. Equally of course this demonstrates that breaches of fiduciary duty themselves are not infrequent either.

5.5.2 Methodological Comments

A brief word about methodology is necessary to clarify why the review cannot be described as an empirical study. The review was conducted using the BAILII database[109] of case reports, using a "keyword search" for "fiduciary duty".[110] This in itself is enough to render the review imprecise as BAILLI cannot be claimed to be a complete record of all reported and unreported cases which occur within the jurisdiction. It non-profit enterprise for the benefit of legal scholarship and as such is reliant on HMCS to provide it with reports to catalogue and upload to the database.[111] Some cases undoubtedly will fall the cracks or go completely unreported. However, BAILLI was chosen as the most appropriate platform on which to conduct the review as it is a database which is far more reaching and comprehensive than any published case reports series or professional database such as LexisNexis or Westlaw. The results were then limited to only those cases from England and Wales, excluding results from Scotland and Ireland, as well as claims which were heard before various tribunals rather than the High court, such as employment or tax tribunals. This was both for simplicity and because were such claims do mention fiduciary duties it is almost always in passing rather than as a cause of action.

The greatest difficulty however occurs in deciding which of the court reports are appropriate to include and which are not. This is to a significant extent a judgement call by the

[107] A keyword search for "negligence" yields over 20,000 results on Bailii in the same 10 year period.
[108] Especially when the Claimant is a litigant in person, for example in *Mensah v Darroch & Ors* [2014] EWHC 692 (QB) and *Bezant v Cork* [2006] EWHC 2134 (Ch). Such claims are also often poorly formulated.
[109] Available at http://www.bailii.org
[110] The "exact phrase" search function was used.
[111] See http://www.bailii.org/bailii/ for more information.

author and not something which can really ever be subject to completely objective criteria. In this review for example I have largely tried to include court reports relating to procedural applications, applications for interim or injunctive relief and applications for summary judgement or striking out of a claim. In *fig 1* and below I refer to all of these court reports as "procedural applications" or "procedural hearings" as catch all terms, though I am aware neither is strictly accurate as the different applications are drawn from substantially different parts of the Civil Procedure Rules and are not considered to be of the same type in legal practice.[112] However here I am referring to any matter which comes before the court prior to trial of the claim. The reason for the inclusion of the results of such hearings is readily understood when one considers what is also perhaps a significant limitation of the review as a whole, that is that many claims of this type are either resolved by settlement[113] between the parties early in proceedings or in fact are decided behind closed doors in arbitration[114] and the only appearance they make in the courts system is in procedural applications or appeals of issues related to that process. This fact is worthy of some analysis in and of itself, discussed below, but it also means that this review only represents part of a larger body of proceedings on the basis of breach of fiduciary, the extent of which cannot be fully known. I have however been anecdotally informed by more than one friend or acquaintance in a relevant field of legal practice that those claims which make it to open court, and especially all the way to trial are very much in the minority. With this in mind it is important to include reports of early procedural hearings as they may in fact represent the final resolution of the case, and in many cases there is no subsequent hearing of the same claim. A successful or unsuccessful application, such as for a freezing injunction, disclosure, or especially for security for costs, may render it impossible or at least very unwise for one party to continue with the proceedings.[115] Therefore such applications can be used tactically by legal advisers to push with more favourable settlement, with no intention of ever taking a claim to trial. If the fiduciary duty is an effective means of finding success in pre-trial proceedings, and the results of the review suggest that it

[112] For example an application to strike out is made under CPR 3.4, while applications for injunctive relief are made under CPR 25.1.

[113] See for example *Charter Plc & Anor v City Index Ltd & Ors* [2006] EWHC 2508 (Ch) which concerned a counterclaim for contribution after the successful settlement of a claim for breach of fiduciary duty.

[114] There are many examples that could be cited in support of this. In *ET Plus SA & Ors v FIS Ltd (Jamaica)* [2005] UKPC 40 a claim was allowed to continue in the courts alongside arbitration proceedings. *Patley Wood Farm LLP v Brake & Anor* [2014] EWHC 4499 (Ch) is a recent example of an appeal that resulted from an arbitration award, which upheld the arbitration finding of breach of fiduciary duty. *Weissfisch v Julius* [2006] EWCA Civ 218 is an example of a claim being deciding in arbitration whose only interaction with High Court proceedings was a small set of applications relation to proper venue for the claims.

[115] The only hearing reported in the claim *Regalway Care Ltd v Shillingford & Ors* [2005] EWHC 261 (Ch) is a set of applications to vary a freezing order. The only report of *Dass v Beggs & Anor* [2014] EWHC 164 (Ch) is an unsuccessful application for security for costs.

is often a useful tool in such hearings, then it is likely fulfilling its remedial function at the pre-trail stage in many cases.

In some cases however, there is a very substantial number of hearings related to such applications, sometimes across the course of several years.[116] In these situations I have tried to reduce the inclusion of the court reports down to one or two in total, but this is to some degree an arbitrary distinction, and one which may have resulted in some errors of repetition in the results as it is not always easy to keep track of some claims when both lead Claimants and Defendants can be subject to change as the litigation proceeds. Some procedural hearings and applications were also so unrelated to the substance of the claim that it did not seem appropriate to include them, for example an application to amend a claim to include a matter unrelated to fiduciary duty, or where breach of duty was pleaded in the main claim and mentioned in passing in the hearing at issue. The cumulative effect on the results as a whole is not likely to be particularly substantial, as instances of such complex litigation are relatively rare, but the key point is that a different reviewer may make some decisions as to which precise reports to include in the results in a slightly different way.

This complexity and the subjectivity of which reports to include is compounded further when it comes to the question of what constitutes a successful claim. While this may sound straightforward, breach of fiduciary duty is rarely pleaded as the sole cause of action in a claim.[117] A Defence may contest not only to whether the duty existed and was breached but may also argue the claim should fail for an unrelated reason, such as limitation or abuse of process.[118] This review has taken the view that where the claim fails, whether due to the failure of the claim for breach of fiduciary duty or for another reason, then it is counted as a failure.[119] When the intention is to assess the regulatory impact and practical usefulness of the jurisdiction in providing a remedy, the failure of the claim as a whole seems logically to indicate that the claim for breach of duty was not of use. If the claim succeed in part, then whether or not the specific pleading of breach of fiduciary duty was successful determines whether the report is recorded as a success or a failure. In terms of procedural application, a similar approach was adopted. Where the application succeeded, this was usually counted as a

[116] See for example the numerous proceedings in the litigation of *Datel Europe Ltd & Ors v Makki & Ors* [2005] EWHC 2258 (Ch)

[117] For example the single judgement in *Ultraframe (UK) Ltd v Fielding, Northstar & Ors* [2005] EWHC 1638 (Ch) is so long and complex it requires 3 separate entries in the Baili database.

[118] One striking example is *Clark & Anor v In Focus Asset Management & Tax Solutions Ltd & Anor* [2014] EWCA Civ 118 in which a couple who had accepted the maximum compensation award possible against a fiduciary adviser under the Financial Ombudsman were refused permission to claim the rest of their losses in the High Court due to the *res judicata* principle.

[119] The example in the note above, *Supra* n120, has been counted as an unsuccessful claim in the year 2014 as while there was a successful claim to the Ombudsman, the legal cause of action failed as a result in the High Court.

successful use of a pleading of breach of fiduciary duty, and a failure counted as a failure. Again where a number of applications were dealt with in one hearing, success of any single application related to a claim for breach of fiduciary duty was recorded as a success in the results. As above, this decision making is subjective, and another reviewer may make some of the specific decisions differently, however it is suggested that the totality of the results, and the conclusions that can be drawn from such, would not be drastically affected.

5.5.3 – Results of the Review

The results of the review are summarised below.

Year	**Success-ful**	**Unsucce-ssful**	**Total**	**Procedural Application**	**Power of Attorney**	**Other**
2005	20	19	39	13	N/A	Diversion of business opportunities to competing business by fiduciary: 3 successful, 3 unsuccessful Fraud or dishonesty: 9 successful, 6 unsuccessful
2006	26	19	45	19	N/A	Diversion of business opportunities to competing business by fiduciary: 7 successful, 3 unsuccessful Fraud or dishonesty: 15 successful, 7 unsuccessful
2007	31	24	55	24	N/A	Diversion of business opportunities to competing business by fiduciary: 4 successful, 1 unsuccessful Fraud or dishonesty: 17 successful, 11 unsuccessful
2008	22	29	51	25	N/A	Diversion of business opportunities to competing business by fiduciary: 4 successful, 3 unsuccessful Fraud or dishonesty: 11 successful, 8 unsuccessful

2009	37	26	63	20	0	Diversion of business opportunities to competing business by fiduciary: 5 successful, 2 unsuccessful Fraud or dishonesty: 21 successful, 15 unsuccessful
2010	44	24	68	19	0	Diversion of business opportunities to competing business by fiduciary: 7 successful, 2 unsuccessful Fraud or dishonesty: 18 successful, 10 unsuccessful
2011	29	25	54	30	0	Diversion of business opportunities to competing business by fiduciary: 3 successful, 3 unsuccessful Fraud or dishonesty: 21 successful, 12 unsuccessful
2012	48	31	71	42	0	Diversion of business opportunities to competing business by fiduciary: 10 successful, 5 unsuccessful Fraud or dishonesty: 34 successful, 18 unsuccessful
2013	36	28	64	23	2	Diversion of business opportunities to competing business by fiduciary: 6 successful, 2 unsuccessful Fraud or dishonesty: 13 successful, 5 unsuccessful
2014	33	21	54	14	5	Diversion of business opportunities to new competing business by fiduciary:

						6 successful, 4 unsuccessful Fraud or dishonesty: 19 successful, 7 unsuccessful
2015	56	24	80	46	10	Diversion of business opportunities to competing business by fiduciary: 5 successful, 1 unsuccessful Fraud or dishonesty: 39 successful, 16 unsuccessful
2016	42	30	72	33	2	Diversion of business opportunities to competing business by fiduciary: 7 successful, 1 unsuccessful Fraud or dishonesty: 26 successful, 15 unsuccessful

Fig 1

5.5.4 Conclusions

From these results a number of general conclusions can be drawn. Firstly, it is clear that the fiduciary duty does frequently provide Claimants with a remedy in cases where there has been breach of the duty. This in itself demonstrates that the duties do serve a useful purpose. Though not recorded in *fig 1*, it was also observed that the number of cases arising out of commercial, company or commercial trust relationships far outweighed those arising out of the classic paradigm of private and familial trusts. The fiduciary duty is a significant source of regulation in certain commercial relationships therefore, especially when one considers the true number of claims is probably significant higher when those that are settled prior to reaching court or are concluding in arbitration are included. Whether or not this useful remedial function is sufficient to justify the complexity of the fiduciary obligation and the severity of the remedies is obviously still a matter of contention and is discussed in many ways throughout this thesis. However, the significant usage of the jurisdiction as a basis of claim, and its frequent success in those claims demonstrates that the duties are not so poorly understood that actors are unaware when they are being breached or unable to use them to vindicate their rights.

The obligation of loyalty as described by Lord Millett as the distinguishing feature of the fiduciary relationship[120] can also be observed to be a common thread through many of the cases. As demonstrated in *fig 1*, in the years in which further investigation was conducted, cases involving the commission of direct dishonesty by a fiduciary were the single most frequent type of claim, especially in successful claims. Many of the claims also joined secondary Defendants in order to pursue tracing claims for dishonest assistance and knowing receipt.[121] This demonstrates the manner in which the ability to pursue strong remedies, and to enforce proprietary claims, is of enormous value to commercial claimants in particular. In any kind of complex business fraud it is very likely that the proceeds of the fraud will have passed into the hands of a connected person or company and will no longer be in the hands of the original fraudster. The proprietary remedy is vital in such circumstances, not only in ensuring a remedy for claimants, but also in fully unravelling the fraud and providing a deterrent by ensuring that fraudsters are deprived of dishonest profits.[122]

Another form of disloyal behaviour which consistently appears in the decided cases is the issue of diversion of business opportunities by former directors and senior employees to new companies under their control, at the expense of the original company to which they may continue to owe fiduciary duties.[123] In such cases the fiduciary obligation provides a useful standard of behaviour which can, in certain circumstance, continue beyond the end of a common law relationship. This use of the jurisdiction can also provide creditors with important protection against asset stripping in a case of a failing business, and more remote shareholders against other managers and shareholders who might use their influence to devalue or extinguish the interest of the others.[124] This protection of creditors found in the regulatory role of the fiduciary duty stands as a counter-balance to the arguments often

[120] *Supra* n2

[121] For example in *Barlow Clowes International Ltd & Anor v Eurotrust International Ltd & Ors* [2005] UKPC 37, *Novoship (UK Ltd & Ors v Nikitin & Ors* [2014] EWCA Civ 908, and *Goldtrail Travel Ltd v Aydin & Ors* [2014] EWHC 1587 (Ch) among many others. All of these were disputes between large corporate entities, demonstrating the value and importance of such claims against 3rd parties as a means of retrieving assets diverted in breach of fiduciary duty. It is rare the fiduciary will still personally hold legal title to these assets in such cases.

[122] *Ibid.*, see n94.

[123] For example *Wexham Drinks Ltd v Corkery* [2005] EWHC 1731 (Ch) and *Sukhoruchkin & Ors v Van Bekestein & Ors* [2014] EWCA Civ 399.

[124] Some stark examples include *Relfo Ltd v Varsani* [2014] EWCA Civ 360 in which an entrepreneur sought to return money from a failing business to a wealthy investor with who he had a close personal relationship in preference to other creditors and *Oxford Fleet Management Ltd v Brown & Anor* [2014] EWHC B19 (Ch) in which a husband resigned his *de jure* Directorship in order for the other Director, his wife, to be able to make supposed re-payments to him of loans they had invested in the company before the business went into administration.

advanced against certain proprietary equitable remedies and remedies of rescission and voiding agreements that they unfairly adversely affect creditors of a bankrupt company.

The effect that the fiduciary obligation has on the mind-set of Directors is also observable in both these kinds of case. In cases of dishonesty it is often clear that nothing could have prevented the fraudster from committing their fraud,[125] and the issues in the case often relate to the extent to which those around the dishonest individuals should have or did know of or participate in their immoral actions.[126] In the diversion of opportunity cases we find many of Directors surreptitiously removing or copying client lists or databases or other material from company offices,[127] and the fiduciary duty in successful claims serves to highlight their knowledge that the behaviour in which they were engaging fell short of the standards required of business people of integrity. In cases in which the director is exonerated factual circumstances are usually highlighted which demonstrate that the fiduciary had made a proper and clean break from their former beneficiary and had legitimately used their skill and expertise to start a new enterprise.[128] In such cases the factual differences can be slight, but the moral substance of the affair distinguishable.

A final type of case worth mentioning is the gradual appearance in the court reports of claims by the Public Guardian to revoke lasting power of attorney granted over the interests of a vulnerable person.[129] In a number of such cases breach of fiduciary and dishonest or honest but excessive use of the assets is a principle reason for the revocation of the power of attorney. Such cases have a distinctly moral flavour, in the manner of classic trust cases, in that there is an imposition of high legal standards of avoidance of self-interest when one takes on the responsibility of caring for the interests of another individual, especially one who is vulnerable.[130]

To summarise then in general the pleaded cases in the relevant 12 year period demonstrate significant use of the fiduciary duty as a source of legal claims. It frequently

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[125] For example *Alpha S Communications Ltd v Caz Distribution Services Ltd & Ors* [2014] EWHC 207 (Ch) concerned the administration of companies used by organised crime to launder money and commit massive VAT fraud.
[126] *Supra* n96
[127] These are essentially the facts of *Harbro Supplies Ltd v Hampton & Ors* [2014] EWHC 1781 (Ch).
[128] In *Halcyon House Ltd v Baines & Ors* [2014] EWHC 2216 (QB) a family dispute caused the managing director who was the daughter and sister of other Directors to leave the family property management firm. In this case she had not used any opportunity or information of the company when she began her own firm but a number of clients had chosen to follow her to the new enterprise. It is submitted that where commercial clients chose to follow an agent to a new business of their own free will this is both common and to be expected in the business world and should be no cause for legal intervention, otherwise there is a significant interference with an individual's ability to exploit their skills and expertise as a professional agent.
[129] A cause of action introduced under the auspices of the Mental Capacity Act 2005, s22.
[130] Some examples include *The Public Guardian v AC & Anor* [2014] EWCOP 41 and *Re DP* [2014] EWCOP B4.

provides a legal remedy, and forms the foundation of important claims against third parties to dishonest behaviour. While it at times pleaded simply as a catch all or “Hail Mary” claim, this is relatively rare. The level of sophistication of claimants in fiduciary duty cases, and the commercial actors involved in the proceedings, is relatively high.

5.6 The Kay Review

5.6.1 Introduction

An interesting way to tie together all these different forms of assessments of the use, function and effectiveness of the use of the fiduciary duty as a means of regulating the behaviour actors is found in examining the process of The Kay Review[131] and the implementation of its recommendations. This example is particularly relevant as it represents the regulatory process in action and a government sponsored study of appropriate measures. The final report devoted an entire chapter to fiduciary duties[132] which contained two significant recommendations. Firstly Recommendation 7[133] suggested that fiduciary standards and obligations should be applied to all parties in the investment chain and Recommendation 9[134] suggested a Law Commission review into the uncertainties and misunderstandings of trustees and fiduciaries in relation to their duties. This review was completed in 2014,[135] and sought to clarify a number of issues related to the fiduciary obligation, as discussed in Chapter 1, but ultimately did not recommend any changes in the law. Taken together these two substantial reports, and in particular the many submissions by commercial and non-governmental organisations to the consultations they both conducted, provide an interesting picture of how the fiduciary obligation is seen in wider society.

5.6.2 The Kay Review itself and Responses

In summarising how the submissions to the Kay Review influenced its conclusions it is worth noting that in the initial call for evidence a number of submissions came in from organisations concerned primarily with corporate social responsibility issues such as climate change, higher wages and ethical investment. A number of these submissions,[136] from Carbon

[131] *Supra* n44
[132] *Ibid.* Chapter 9.
[133] *Ibid.* para 9.15.
[134] *Ibid.* para 9.23-9.25.
[135] Law Commission Report No. 350; *Fiduciary Duties of Investment Intermediaries* (2014) HMSO Cm 350
[136] All submissions are contained in a single document compiled and released by the Kay review under the title *Responses to the Review’s Initial Call for Evidence* available at

Tracker, Aviva, Network for Sustainable Financial Markets, and the TUC, referenced the work of the organisation Fair Pensions, which also contributed in its own right, and a particular report it had published in 2013[137] which identified fiduciary duties and a narrow interpretation thereof as either the main or a significant cause of short term, profit-focused thinking by Trustees. Others may have independently arrived at that conclusion as it was reflected as a concern in some other submissions. This was coupled with another issue identified in submissions by investment professionals such as Hermes, a major institutional fund manager which manages the BT pension scheme, and the Church of England Ethical Investment Advisory Group. They emphasised the need for clarity on fiduciary duties which they felt were poorly understood. These submission framed their arguments against a backdrop of the decision in the case of *Cowan v Scargill*,[138] a famous case which appeared to many scholars to make it legally questionable for a fund manager to pursue ethical investments, requiring them instead to focus only on the maximisation of value.

Professor Kay seems to have accepted these analyses to be an accurate statement of one of the problems of the equity management chain. In his Interim Report[139] he devotes several paragraphs to the fiduciary duty[140] and as mentioned above ultimately recommends measures are taken to increase the use of fiduciary standards throughout the investment and that the law commission investigate whether legal changes should be made to clarify and strengthen fiduciary duties to achieve this end. Arguably Kay too readily accepted an analysis of fiduciary duties which is not entirely accurate. These submissions and the Reports appear to conflate the non-fiduciary, statutory and equitable duties of Directors and Trustees, with the fiduciary obligation. An important difference between the two is the fact that the fiduciary obligation is imposed on any relationship with the necessary characteristics of loyalty and vulnerability, while the other duties are only applied to the specific class of fiduciaries which they purport to regulate. Thus while the fiduciary obligation can be used to disseminate the standards of loyalty it imposes, it cannot realistically be used to impose the practical behavioural standards of the non-fiduciary duties of office holders on all other fiduciaries. The core misunderstanding is that while many parties grasped the nature of the fiduciary obligation as imposing an ad hoc ethical standard on many commercial relationship, they failed to grasp

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http://webarchive.nationalarchives.gov.uk/20121204121011/http://www.bis.gov.uk/policies/business-law/corporate-governance/kay-review/kay-review-responses last accessed July 2018.

[137] Sadly this report is consistently referenced by the sources to a web location at the website of Fair Pensions. As this organisation and its website no longer exist this report could not be located in the preparation of this thesis and is believed no longer to be available.

[138] [1985] Ch 270

[139] Interim Report of the Kay Review, Feb 2012 available at http://webarchive.nationalarchives.gov.uk/20121204121011/http://www.bis.gov.uk/policies/business-law/corporate-governance/kay-review last accessed July 2018.

[140] *Ibid.* para 7.17-7.21.

the limited and relationship specific nature of the obligations imposed, and properly understand its core ethic. The fiduciary duty is not designed to promote all ethics, it is designed to promote the equitable values of loyalty, trust and confidence.

At the same time as many responses were addressing social responsibility issues, a large number of the initial responses, especially from corporate entities, emphasised their commitment to the recently adopted concept of stewardship, in the FRC Stewardship Code,[141] sometimes conflating it with the fiduciary standards. At least some of whom were either subtly or directly indicating that they did not feel any more regulatory intervention was necessary in this area. One or two responses[142] advanced detailed economic analyses to the effect that this was the case. In their initial response the AMIC[143] also raised the important point that the real fiduciary mismatch was in the fact that fund managers prioritise and assess their own performance in terms of overall fund performance, not in terms of income security and maximisation for the beneficiaries. This indicates something of a divide between the non-profit responses and those from commercial entities, with the former seeking new regulatory intervention in pursuit of specific social goal, and the latter preferring the present system of self-regulation of ethics discussed above in this chapter.

Only Governance for Owners LLP[144] really grappled with the exact nature of the fiduciary obligation, submitting that in their opinion conflicts of interest were pervasive and damaging in the equity management chain and that the ability to contract or modify fiduciary duties was too freely available and widely utilised. Hermes Capital[145] also recognised the latter point.

In the smaller number of submissions which came in after the interim report,[146] only a limited minority addressed the fiduciary duty issued now raised directly by Kay. Again this was mostly from respondents concerned with socially responsible investment. However, the Investment Managers Association,[147] like the AMIC before them, sent in a response which demonstrated a relatively complete understanding of fiduciary duties and their implications for investment decisions, without getting caught up in the confusion over the fiduciary and non-fiduciary duties of fiduciary office holders. Most of the corporate respondents to the interim report avoided the issue entirely. It was primarily those concerned with social responsibility

[141] *Supra* n46
[142] *Supra* n138, Black Rock's submission is a notable example.
[143] *Ibid.*
[144] *Ibid.*
[145] *Ibid.*
[146] Responses to the Interim Report of the Kay review available at http://webarchive.nationalarchives.gov.uk/20121204121011/http://www.bis.gov.uk/policies/business-law/corporate-governance/kay-review/responses-to-review-interim-report last accessed July 2018
[147] *Ibid.*

who appeared to have either somewhat misunderstood the concept or deliberately chosen to use the word to refer to the wider set of obligations.

Of significance is the manner in which the fiduciary obligation is universally understood to be related to some form of ethical values and behavioural standards on the part of financial professionals. The problem we see reflected in the Kay Review arises when this is too broadly understood and attempts are made to use the duty not simply as a guardian of existing and clearly defined ethical values which govern fiduciary relationships, and instead to use it as an enforcer of any desirable ethical value that society might see fit.

5.6.3 The Subsequent Law Commission Report and Responses

It is no surprise then that when the Law Commission considered the matter, they ultimately did not recommend any substantive changed in the law relating to fiduciary duties. In the conclusion to Chapter 10 of their final report, which discussed the fiduciary duties to which investment intermediaries are subject, the Law Commission roundly rejects Professor Kay's recommendations for the fiduciary duties.[148] It stops slightly short of saying he misunderstood the duties, but does say that there were:

> "Substantial differences between the approach currently taken by the courts and the aspirations set out in Recommendation 7 of the Kay Review."[149]

Ultimately the Law Commission could not see the fiduciary obligation as usefully fulfilling the function Kay had envisioned. Arguably, given the contentions set out in the Chapter and in this thesis, the Law Commission could be said to rather minimise the legal and psychological effect the fiduciary obligation is capable of having on the ethics of commercial actors, but they are right to assert it cannot be seen as a panacea.

This was reflected in the responses to the Law Commission's Consultation Paper.[150] Of the 93 responses,[151] only 15 supported reform of the fiduciary obligation by statute. Only one of these 15 responses was from a commercial entity. 42 responses agreed with the Law Commission's preliminary conclusion that no reform was required. 36 responses did not answer the relevant question. This means of the 57 responses which expressed a view on

[148] *Supra* n137, p10.76-10.81.
[149] *Ibid.* p10.76.
[150] Available at http://www.lawcom.gov.uk/project/fiduciary-duties-of-investment-intermediaries/#related last accessed July 2018. The relevant question on fiduciary duties was Question 18 which in essence asked whether the law relating to fiduciary duties required reform, but asked in the negative, so a positive response was agreement that the law did not need reform.
[151] All available in a single download at http://www.lawcom.gov.uk/project/fiduciary-duties-of-investment-intermediaries/#related last accessed July 2018.

whether the fiduciary obligation should be reformed to expand its function, 75% agreed with the Law Commission that it should not. It should also be noted that a far greater number of these 57 responses were from commercial entities operating in the field of investment management than responded to the Kay review, and far fewer were non-profits or individuals. Thus the responses here arguably better reflect the commercial view on the fiduciary duty, while the responses to the Kay Review itself were drawn from more from the views of lay people in wider society.

5.6.4 How can 'fiduciary standards' be used more effectively?

The fiduciary duty may not be ideally placed to enforce standards of corporate social responsibility and ethical investment. These are problems which flow from the relationship between society and business, and not issues which normally arise in the relationship between the fiduciary and beneficiary. However, neither should fiduciary obligations inhibit such practices where they represent the wishes of the beneficiaries, or where ethical aims and practices have been clearly advertised and explained as an objective of trust, especially in the case of institutional trusts. *Cowan v Scargill*[152] and *Harries v Church Commissioners*[153] were discussed many times in the course of the Kay review because they are relevant to this question.

In *Cowan* the court ruled that it was unlawful for the National Union of Miners to use the investments of its pension scheme trust to benefit the mining business. It ruled the trustees must pursue the interests of the trust, which meant maximising profit. This ruling made consideration of other 'ethics' in investment practice a breach of duty. However this was mitigated somewhat in *Harries*. The Bishop of Oxford sought a declaration that the trustees of the funds of the Church of England should divest from investments in South Africa during Aparthied, and from other investments which would harm the purpose of the trust which was the promotion of the Christian faith. While upholding the existing policy of the trustees, the court did reinterpret *Cowan* so as to say that an ethical investment policy is acceptable in pursuit of an object of the trust, so long as there was no risk of significant financial detriment.

The approach in *Harries* is more appropriate than that in *Scargill*. Where a trust has a stated objective, or a relationship between a fiduciary and a beneficiary is established with a particular purpose, ethical investment practices in pursuit of that purpose are in no way disloyal. Even if the investments may not be the most profitable available, there is no damage

[152] *Supra* n140
[153] [1992] 1 WLR 1241

to the trust and confidence in the relationship as all parties are fully aware from the outset that such considerations will guide the behaviour of the fiduciary. The fiduciary duties operate to promote a form of ethical management by imposing an obligation of loyalty in private and commercial relationships. It would be strange indeed if that prohibited other forms of ethical behaviour where all parties to the relationship went into the relationship on the understanding those aims would be pursued. Going even further, arguably it would be disloyal of the fiduciary not to pursue those other ethical objectives. The law in this area should be urgently clarified to ensure that the fiduciary duty is not wrongly interpreted as hostile to broader ideals of ethical management. Kay was right to push for this clarification and the Law Commission could have done more to support his conclusions in this area.

Similarly, an important aspect of the wider adoption of fiduciary standards as proposed by Kay is that the duties can be used directly to promote longer term strategic thinking. While again it may not be possible to say that the duties mandate responsible investment strategies, they should remove or reduce the incentive to take short term risks when properly applied. There is a cause for fiduciary concern in the way professional investment managers currently conduct their business. As many such professionals work on a fee arrangement that rewards them for producing short term returns, there is a potential for conflict in the advice they give to clients. The danger is that rather than offering the best commercial advice for the client, a fiduciary standard of behaviour, investment managers will adopt the course of action with clients' money which best suits their own business objectives.

This is both a conflict of interest and has the potential to give rise to a secret profit. Industry management bodies like the FCA must be more willing to question this kind of behaviour, especially retroactively, to determine whether a course of action taken by an investment manager was really the best strategy for the client or was a means to promote the managers own business. Censure must follow this kind of behaviour. If this cannot be accomplished by industry Codes of Conduct or soft law measure then the fiduciary duties could be imposed to hold fund managers accountable for decisions they made which were not in the best interests of the client. While some latitude must be given to the business discretion of investment professionals, they should not be permitted to avoid scrutiny entirely when there is a potential conflict between interest and duty. It would not require frequent or excessively intrusive intervention by the fiduciary obligation before investment managers became considerably more cautious and responsible in their approach to the management of clients' money.

5.6.4 Conclusions

Ultimately the recommendations of the Law Commission Report largely focused on steps that professional organisation could take in their soft law regimes, such as those mentioned above in this chapter.[154] This is much more in line with the type of approach that it appears is now favoured by business people. Therefore the Kay Review and the Law Commission Review which followed accomplished some useful and interesting clarification of fiduciary law, discussed in more detail in Chapter 1 of this thesis, but at the same time it demonstrated that the professional understanding of the obligation is already relatively sophisticated, but not especially positive towards an expansion of the jurisdiction. It could be theorised that this episode represents both the best and the worst of the fiduciary duty as a regulatory tool.

On the one hand it shows the ethical force of the fiduciary obligation, the desire for such ethics to be part of business regulation, and relatively widespread understanding of what is required by the fiduciary duty amongst those who are actually subject to it. At the same it shows its limitations in that it is poorly understood by lay people in wider society, and the desire to introduce a greater level of ethical behaviour to commercial relations can run far ahead of what is possible or even desirable in terms of regulation. And while there is an industry wide acceptance of the baseline standards of integrity and necessary relational loyalty seen in the professional responses to these reviews, there does also seem to be an attempt to try and minimise, or at least clarify and confine the scope of such obligations. Including a desire that they should be possible to exclude entirely in certain circumstances, the effectiveness of which is discussed in more detail in Chapter 4 of this thesis. As noted in passing above, the observation in the submission of the AMIC is most astute. The real fiduciary conflict is between a management and shareholder class that assess performance in terms of fund performance, and the ethical obligation to promote the interests of the trust not merely in maximising performance, but in doing so in a loyal manner, which requires the manager to subrogate his own interests to those of the fund. The strong impression one gets from the review responses, coupled with the preference for voluntary self-regulation, is that the feeling among professionals is that, “what is good for the fiduciary is good for the fund, and vice versa”. The subtlety of the fiduciary duty is in recognising that this is only true until the point at which those interest diverge, and then the incentive to pursue self-interested behaviours becomes substantial and dangerous. Thus the concern is that among the professional classes the fiduciary obligation is seen as a useful set of standards in that it provides investors with security and maintains the appearance of consistent standards of professional integrity, which is good for business. The warning of the obligation itself and the lesson of corporate governance regulation is that such a view, without the genuine ethical

[154] *Supra* n137, Chapter 12.

foundation which develops personal scruples amongst the regulated, is less likely to prevent instances of dishonesty and breach of duty. This may not be a tension that can be easily resolved. One final lesson that can be learnt from the Kay Review however, is that there are not really any better alternatives on offer. It is striking in the responses and the way that the review proceeded, that Kay emphasised fiduciary duties as a means of promoting certain ethical standards because no other suggestions than the status quo were offered by consultees. Ultimately the fiduciary obligation may not be a perfect regulatory instrument, but there have not been many alternative suggestions as to replacements which can unite so many competing functions in so flexible and so forceful a manner.

Conclusion

"*What is the purpose of the ongoing use of fiduciary duties in English business law, with particular reference to breaches of duty in relation to bribery, secret profits, conflicts of interest and unconscionability?"*

The introduction to this thesis set out three questions in relation to the use of fiduciary duties in English business law. These are as follows:

1. What theory or theories underlie the imposition of the fiduciary obligation, and how do these translate to the business environment? What are the intended regulatory aims in using the fiduciary duty to regulate commercial actors and are they valuable?

2. Is fiduciary law sufficiently certain to provide effective business regulation without damaging commercial certainty and efficiency? Can acceptable answers or ways forward be identified in existing situations of legal controversy?

3. How effective is the fiduciary obligation in regulating the behaviour of commercial actors? Can this be measured or is the effectiveness of this jurisdiction essentially to be taken on trust?

In the preceding chapters we have seen that the circumstances in which the fiduciary duties function to regulate the behaviour of commercial actors are numerous and varied. They range from relationships with significant elements of informal personal relationship, such as a solicitor working with a beneficiary to make money for themselves as well as their trust,[1] and a London based property expert taking advantage of a less sophisticated wealthy contact,[2] to purely financial relationships, such as a complex fraud which took in sophisticated investors,[3] or two companies collaborating to pursue a property investment.[4] As such it will be no surprise to anyone familiar with the complexities of equitable jurisdictions that even when questions are set out in as general terms as those posed by this thesis, there are not straightforward

[1] *Phipps v Boardman* [1967] 2 AC 46
[2] *Murad v Al Saraj* [2004] EWHC 1235 (Ch)
[3] *Sinclair v Versailles* [2012] Ch 453
[4] *Ross River Ltd & another v Waverly Commercial Ltd & Ors* [2013] EWCA Civ 910

answers. While there are a wealth of examples, discussions and debates from which to draw conclusions and make inferences about the nature of the fiduciary duties, few definitive answers emerge. However, taking each question in turn, there are broad principles which can be clearly identified, and significantly, there can be suggested some questions which, once answered definitively by future judicial and parliamentary intervention, can significantly clarify this complex area of law.

Question 1 – What theories underlie the imposition of the fiduciary obligation, and how do these translate to the business environment?

Analytical Foundations of Fiduciary Law:

The basic legal foundation of the fiduciary obligation was laid out in the introduction to this thesis. The "distinguishing obligation of a fiduciary is the obligation of loyalty".[5] A person is a fiduciary "because a particular rule applies to him […] he is a fiduciary or confidant for its purposes".[6] However it is immediately clear that these defining principles raise as many questions as they answer. When does a person, especially a business person, owe an obligation of loyalty to others in their legal relationships? When does a particular rule apply to an individual, specifically those preventing secret profits and bribes, preventing conflicts of interest, and ensuring the confidentiality of information received?

It is these following questions which are important, and the answer provided to them by this review is that it is essentially dependent on the facts of any given case. It is not possible to answer those questions in the abstract, only with reference to a specific relationship between two parties. This is because the fiduciary obligation is serving a kind of ethical purpose. It seeks to impose a positive ethic of loyalty into those relationships in which such an ethic is necessary for them to function in the manner in which they are intended to function. Loyalty in the context of the fiduciary obligation is intended to ensure the fiduciary acts positively, in the best interests of his trust, to promote the interests of that trust.[7] Imposing such an obligation is by necessity fact sensitive, it means different things in different relationships. Not least because the extent of interests placed in the trust of the fiduciary varies from relationship to relationship, especially in a business context. Therefore, while there are defined categories of fiduciary relationship, with correspondingly more well defined and

[5] *Bristol West & Building Society v Mothew* [1998] Ch 1
[6] Finn, PD; *Fiduciary Obligations*, (1977, Law Book Company) pp 2
[7] Enforcement of this positive obligation directly poses significant problems, see discussion of *Cowan v Scargill* and *Harries v Church Commissioners for England*, s175 of Companies Act below

specific duties, this is not the limit of the fiduciary obligation and duties. They can apply in ad hoc fiduciary relationships as required. The exact content, scope and application of the duties is therefore flexible and fact dependent. The fiduciary obligation is therefore not itself susceptible to either precise or abstract definition by its very nature. It exists only in context.

Certain principles which point towards a fiduciary relationship can be readily identified and defined within the law. There must be an obligation of loyalty,[8] there should usually be an objective undertaking to act on behalf of another,[9] and there will normally be a particular vulnerability in the general or specific interests of the principle to the actions of the fiduciary person in the relationship.[10] However, the presence of each of these factors is not in and of itself determinative, nor in fact are the presence of all three factors together. The confluence of these three features of a relationship, loyalty, undertaking and vulnerability, is why doctors have been found to be fiduciaries under Canadian law, and yet they are not classed as such in English law in relation to their actions in the ordinary course of their medical practice.[11]

What can actually be observed in the law is a mixed application of these principles, along with the equitable concept of unconscionability. The imposition of the fiduciary obligation in English law only occurs in such cases as there is a need for it due to the existence of a relationship of trust and confidence between the parties giving rise to an obligation of loyalty. The duties are imposed to the extent necessary to protect that loyalty in the relationship, because in such relationships allowing the fiduciary to make a secret profit, or to give legal validity to transactions tainted by conflict of interests will normally be unconscionable for a court of law at equity. Legal sanction of such actions may also serve to undermine the trust and confidence placed in that relationship, which is itself also unconscionable.[12] Where there is a relationship in which the trust and confidence invested in the relationship give rise to an obligation of loyalty in the eyes of the law, which may be due to undertaking, vulnerability or some other factor, then equity takes the view that it is necessary to stringently uphold that loyalty. It does so by proscribing actions which carry the taint of disloyalty and refusing to recognise, uphold or enforce transactions that are so tainted. The means by which this is done are the fiduciary duties themselves, in particular the core duties prohibiting secret profits and conflicts of interests.

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[8] *Bristol v Mothew, Supra* n5.

[9] *Ibid*. see also *Phipps v Boardman, Supra* n1.

[10] See *Reading v AG* [1951] AC 507, and comments in Law Commission Consultation Paper No. 124, *Fiduciary Duties and Regulatory Rules* (1992) HMSO Cm 124 at 2.4.3 et seq.

[11] *Norberg v Wynrib* [1992] 2 SCR 226

[12] *Keech v Sandford* (1726) Sel Cas t King 61

An example of the complexity of this application can be seen in the case of *Reading v AG*.[13] The case concerned an army sergeant who had taken bribes to assist in smuggling. After successfully prosecuting him the crown has seized the money. This seizure was upheld on the grounds that the money must be held on trust for the master by the servant in such a case. The complex reasoning on the "fiduciary relation" in the case came from the Court of Appeal judgment upheld by the House of Lords.[14] While accepting that this case was not a traditional case of fiduciary duty, and appearing to imply that there was no general fiduciary duty in existence, Asquith LJ states that where a master entrusts to the servant a task in which he acts as a representative for the master then he will be bound to the fiduciary duties in order to ensure the performance of the task is undertaking in a good faith manner which promotes the interests of the master within the scope of that task.[15] Thus accepting a bribe in the sergeant did is likely always going to become prohibited activity, because the very ability to accept the bribe demonstrates that such a task had been entrusted and that its performance had not been in good faith. In a real sense, it is the influence of not only the legal and factual circumstances of the relationship which lead to this determination, but also the underlying equitable values of the fiduciary obligation and the specific actions of the servant in transgressing those values which lead to the imposition of the duty. Had the sergeant never taken the bribe which induced him to act as a representative of the Crown in a dishonest manner, he may never have been subject to a fiduciary duty in the performance of his ordinary military obligations.

Thus the duty is highly complex, but in pursuit of a clear and simple legal ethic and purpose. It is a factual assessment of the trust and confidence invested in a relationship which in turn leads to a legal assessment of the level of loyalty owed as an equitable obligation by the fiduciary to the principal. The loyalty owed in turn defines the scope and application of the duties, which are the only visible legal consequences of the fiduciary obligation which are applied to the fiduciary. In normal circumstances a principle will set out clearly in a recognised legal form such as a contract or a trust, the nature of the interests entrusted to the fiduciary and obligations arising from that trust. This will determine the scope and application of the fiduciary duties in that relationship. However, a legal actor can in a way unexpressed, or even unintended, by the scope of his legal agreements act in such a manner as to take ownership or responsibility over the interests of another in circumstances where their interests are vulnerable to that action. These actions can give rise to ad hoc fiduciary obligations, which are hard to define in abstract analytical terms, but which clearly exist with the same ethical and

[13] [1951] AC 507
[14] [1949] 2 KB 232
[15] *Ibid.* p236

regulatory significance as the more clearly recognised and defined categories of fiduciary relationship.

Regulatory Objectives of the Fiduciary Obligation

As a consequence of this analytical foundation it is possible to challenge the utility of the fiduciary obligation on three different theoretical grounds. Firstly, the overall regulatory objectives of the obligation could be open to question. This could either take the form of challenging the desirability or legal necessity of protecting the trust and confidence placed in the relationship, or similarly challenging the enforcement of loyalty and single-minded pursuit of the best interests of the trust. Secondly, the efficacy of the specific proscriptive fiduciary duties as a means of achieving such protection and enforcement can be questioned. Finally, the whole area of law can be and frequently is subject to the accusation of incoherence and uncertainty to such a degree that it is in need of significant reform to function properly in the modern law. The latter two challenges are addressed by the two remaining questions posed below in this Conclusion.

The first question of the value of the objectives of the fiduciary obligation seems to have a fairly straightforwardly positive answer, especially in the context of business law. Trust, confidence and loyalty are essential in investment relationships. In fact the more pressing question at this time seems to be how far to go in using the fiduciary obligation to promote and pursue such objectives. The Kay Review led by advocated for an extension of fiduciary standards through the business community as a means of fostering sound and prudent long term investment strategy, as well as increased corporate social responsibility.[16] The theory behind this being to attempt increase the sense of obligation that asset managers throughout the equity chain felt towards the initial investor or shareholders in institutional funds. This would then influence their decision making to be more focused on the long term security of those assets and the welfare of the economy and society in which they were held rather than on short term returns. There are many potential criticisms of this approach, particularly as to whether fiduciary duties are an appropriate vehicle for such legal intervention, and indeed there was no resulting change in the law.[17] However, the core concept of the fiduciary duty as

[16] *Final Report of the Kay Review of UK Equity Markets and Long-Term Decision Making* 2012 http://webarchive.nationalarchives.gov.uk/20121204121011/http://www.bis.gov.uk/assets/biscore/business-law/docs/k/12-917-kay-review-of-equity-markets-final-report.pdf last accessed July 2018.
[17] *Supra* n10.

the guarantor of trust, confidence and loyalty in investment relationships has obviously a large number and wide variety of potential regulatory benefits.

This review has demonstrated that the concepts and values behind the fiduciary obligation are an organising concept in business relationships in English law. The presence of fiduciary standards of behaviour in the conduct rules of professional organisations, governance codes and regulatory instruments shows the importance and the ubiquity of the central values of the fiduciary obligation.[18] The continued use and promotion of the concept of stewardship shows the ongoing desire to achieve the aims set out by Kay in business regulation, as well as the core aims of the fiduciary obligation laid out above.[19] Indeed one of the foundations of modern corporate governance theory, the agency cost theory, identifies essentially the same issue in need of regulation as the fiduciary obligation.[20] There is always a danger when ownership is separated from control that the agent will behave in a self-interested manner. This harms not only the interests of the investor, who sees lower returns, and the trust, which may perform in a sub-optimal manner due to inefficient decision making, but also the entire market for investment, as an untrustworthy and inefficient market is likely to be unattractive to future investment. There seems little question that the regulatory objectives of the fiduciary obligation are valuable in the business context.

Indeed this is rarely the source of challenges to the fiduciary obligation, which are focused primarily on the coherence and clarity of the legal jurisdiction, and its efficacy, especially in the light of potentially negative side effects. These concerns are discussed in the following sections.

Question 2 – Is the law on the fiduciary obligation sufficiently certain for commercial application?

This is the question which arguably poses the greatest challenge to fiduciary law, especially in the business law context. In this thesis we have seen how there are both substantial theoretical and analytical challenges levelled at the fiduciary obligation in terms of

[18] See for example; Solicitors Regulation Authority Code of Conduct 2011, Version 19 October 2017 available at http://www.sra.org.uk/solicitors/handbook/code/content.page last accessed July 2018; Pensions Regulator Statement on Prohibition Orders 2016 available at http://www.thepensionsregulator.gov.uk/doc-library/statements.aspx#s21966 last accessed July 2018 and; Financial Conduct Authority Handbook available at https://www.handbook.fca.org.uk/ last accessed July 2018.

[19] See Milman, D; *Governance of Distressed Firms* (2013, Cheltenham: Edward Elgar) p20, and; Reisberg, A; "The Notion of Stewardship from a Company Law Perspective" (2011) 18.2 Journal of Financial Crime 126

[20] That is, the problem of self-interested managers extracting 'rents' from their company by pursuing their own self-interest.

the proper understanding of its function,[21] and there is the addition challenge of a perceived lack of understanding of the jurisdiction on the part of the business community itself. It has been noted that a small number of the respondents to both the Kay Review[22] and the subsequent Law Commission report on the subject[23] advocated for clarification of the jurisdiction, either in the form of guidance or via the means of codification in legislation. Clearly the perceived uncertainty is capable of damaging the effectiveness and utility of the jurisdiction. Uncertainty as to the effects of the law is often said to potentially lead to either discouraging investment or inefficient decision making as a result of an inability to properly predict and account for legal outcomes.

These challenges are not without some merit. It has been observed above that the fiduciary duties are complex and unlike ordinary legal norms in the way they are applied. In many cases the legal interventions the fiduciary obligation is meant to create are by its very nature, bespoke to the circumstances of the fiduciary relationship in question. This will sometimes lead to apparently inconsistent, and even occasionally potentially contradictory results. It also undoubtedly will make the nuances of the legal rules relating to fiduciary duties difficult to understand for the non-expert or ordinary business person. However, it could be convincingly argued that there are many legal rules which are likely more complex and nuanced than is ordinary understood by the ordinary legal actor.[24] In this sense the more relevant question may be whether there is sufficient understanding of the fiduciary obligation within the legal community for sound advice and decision making on the subject to be given to clients. What is required for fiduciary duties to be effective is that the business community has confidence in the fiduciary obligation as a guarantor of the security of their investment in relationships of trust and confidence.

It is therefore fair to say that there is little issue with at least the significant majority of the law on the fiduciary obligation from a certainty perspective. Most fiduciary duties arise in relationships which fall within the defined classes of fiduciary relationship where the law is generally well understood, and in some cases the duties are now subject to codification.[25]

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[21] See generally Chapter 2.

[22] All submissions are contained in a single document compiled and released by the Kay review under the title *Responses to the Review's Initial Call for Evidence* available at http://webarchive.nationalarchives.gov.uk/20121204121011/http://www.bis.gov.uk/policies/business-law/corporate-governance/kay-review/kay-review-responses last accessed July 2018.

[23] All responses available in a single download at http://www.lawcom.gov.uk/project/fiduciary-duties-of-investment-intermediaries/#related last accessed July 2018.

[24] It seems questionable that many members of the public could accurate describe the eligibility requirements of a claim in the Tort of Negligence for personal injury arising out of "nervous shock", or many members of the business community appreciate the finer points of the "boiler plate" clauses they sign in many of their large commercial contracts, for example.

[25] Companies Act 2006, s176

Where difficult cases arise in such circumstances the results usually establish clear and functional principles which can be easily followed.[26] The lingering uncertainties mostly arise out of complex remedial questions, ad hoc fiduciary relationships and questions of the exact scope of the jurisdiction in borderline cases.[27] It has been the contention of this thesis that in most of these controversies there are principles and rules of application which can be extracted that are simple enough to understand, even if the results of individual cases may occasionally turn on slightly subjective factual assessment. What is required to reach such conclusions is a clarity in judicial reasoning as to the precise objective which is being pursued in the use of the fiduciary duties in such circumstances. The fiduciary obligation turns on equitable ideas about required standards of behaviour in the context of legal relationships. As such it instils legal ethics by refusing to sanction behaviour which is unconscionable. By identifying the source of the unconscionability in borderline cases, these difficult borderline fiduciary jurisdictions can be clarified. The imposition of a proprietary remedy in cases of bribes flows as a consequence of the fact that it is unconscionable for the courts at equity to recognise the fiduciary as the owner of the bribe.[28] In a relationship established to pursue a joint venture the court cannot endorse a transaction conducted to the benefit of only one of the parties if the relationship is one which was based on a fiduciary level of trust and confidence, a factual question based on definable characteristics.[29] The court is bound by conscience to provide relief where a company director uses their position to make preparations to start a competing business while still in post, but not to prevent a director doing so using their own skill and expertise after they have made a clean break from their former employment.[30] In many of these cases the answer provided may not be perfectly precise, but the use of these legal rules is functional and can be clearly understood.

Certainly there are viable alternative approaches to the fiduciary obligation. In addition to possible further codification, there are proposed approaches based on analytical simplification,[31] reversion to more direct remedial trust and restitutionary principles,[32] and economic liberalisation of the jurisdiction to better promote the simple sovereignty of

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[26] See for example, *Bolkiah v KPMG* [1999] 2 WLR 215 on conflicts of interest in solicitors' firms, *Bristol West & Building Society v Mothew* [1998] Ch 1 on the difference between a duty of care and skill and the fiduciary duties of a solicitor, *Nestle v National Westminster Bank* [1992] EWCA Civ 12 on the investment duties of trustees, or even the rules in *Regal (Hastings)* [1967] 2 AC 134 and *Phipps v Boardman* [1967] 2 AC 46 which are now well established in relation to directors and trustees who self-deal with trust property. .

[27] See Chapter 4 for detail discussion of such cases.

[28] *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45

[29] *Ross River Ltd & Otrs v Waverly Commercial Ltd & Otrs* [2013] EWCA Civ 910

[30] Contrast *Queensland Mines v Hudson* (1978) 18 ALR 1 with *Peso Silver Mines v Cropper* [1966] SCR 63

[31] See for example Worthington, S; *Equity* (2nd Ed 2006; Oxford: Oxford University Press)

[32] See for example Birks, P; "Equity in the Modern Law: An Exercise in Taxonomy" (1996) 26 *University of Western Australia Law Review* 1

contract.[33] In essence each of these proposals has the same strength, they are simpler, but also the same weakness. The fiduciary obligation set an ambitious regulatory target and it draws much of its strength from its flexibility. It can apply in a wide variety of factual circumstances to provide flexible regulation which still provides strong remedies. Codification work well in simpler and more uniform relationships. The position of directors under the Companies Act 2006 lends itself to such a regime by virtue of the value in having commonality of such standards and the standard terms on which such a relationship is based in regard to the responsibilities and level of autonomy granted to the fiduciary. This is not true of every conceivable relationship which the fiduciary obligation provide useful legal security to investors. Codification or simplification in many cases would simply amount to abolition. The jurisdiction would cease to impose any legal requirements on difficult and borderline cases. It is the position of this thesis that the flexible and bespoke approach is more desirable, even if it creates some uncertainties or analytical difficulties. Difficult cases will always be difficult to decide with complete consistency and coherence. However, the relatively widespread use of the fiduciary duties as a cause of action observed in Chapter 5, along with the presence of fiduciary standards throughout the English law business culture discussed above, seem to point to a perceived value in the jurisdiction and relatively sophisticated understanding of the concepts in the business community despite any such academic difficulties.

Question 3 – Is the fiduciary obligation effective law in the business context?

Ultimately the response provided by this thesis to this question is a firm yes. The fiduciary duty is based on a clear legal ethic, which is the proposition that a fiduciary should be required to subordinate his interests to those of his beneficiary or principal in accordance with the requirements of their relationship. He is required to do this to such an extent that even the appearance that his own interest conflicts with that of his principal, or that he has benefitted from his position, are a wrong, a breach of duty, which requires remedy. The fact that breaches can be permitted by the principal on full disclosure but cannot be explained or defended by the fiduciary on the basis of no harm caused demonstrates that it is the integrity of the relationship which is being protected first, and the duties are not primarily remedial in function.[34]

[33] See for example Langbein, J; "Questioning the Trust Law Duty of Loyalty: Sole Interest of Best Interest?" (2005) 114 Yale LJ 929

[34] See also Conaglen, M; *Fiduciary Loyalty: Protecting the Performance of Non-fiduciary Duties* (2010, Hart:Oxford)

This ethic underpins the function of the duty. Claims are pursued when a beneficiary feels his fiduciary has been disloyal in the management of his affairs, and they are entitled to an account, and to avoid transactions, receive compensation or the disgorgement of gains where appropriate, to restore him to the position which is appropriate to his trust. The questions of imposition and breach are necessarily fact based, which provides the flexibility but also creates uncertainty as to the consequences of breach. This is also why fiduciary duties are imbued with a quasi-moral character, to some extent in their application but also particularly in the perception of their function. Actors view the duties with special significance, in part due to the threat of severe remedy and strict liability, but also due to the potential for reputational damage and questions of professional conduct which accompany a finding of breach.

Fiduciary duties are used as a cause of action with reasonable regularity and form the basis of a successful claim more often than not.[35] They are considered an essential part of professional conduct in a number of financial services and advisory professions, they also form the basis of fiduciary standards in a variety of soft law legal measures.[36] They provide important protection against bribery and dishonesty both in providing a direct remedy and in discouraging self-interested behaviour through strict liability and strong remedies.[37] A successful claim for breach of fiduciary duty can lead to proprietary claims and even tracing actions based on claims of dishonest assistance by third parties.[38] This provides an incentive to pursue actions in some cases where common law claims would be too difficult or expensive given the risk that there can be little return if a fiduciary is in financial difficulty. All of these functions are valuable and demonstrate the contribution the fiduciary obligation is making to English business law.

Discouraging self-interest even potentially has wider and less tangible benefits, including in promoting good management from a wider societal perspective. Where a fiduciary manager is discouraged from self-interested behaviour at the expense of the enterprise then they also have less incentive to pursue questionable or socially damaging business practices in pursuit of financial gain. While this may occur in specific cases it will not be universally true of all situations. In some contract based and managerial fiduciary relationships the fiduciary may have a financial interest in the profits of an enterprise. Even where they do not, they and others will still often assess their professional performance by reference to this metric. While such tangential benefits may exist, these are not within the direct scope of fiduciary regulation

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[35] See Chapter 5 for evidence and discussion.
[36] *Supra* n18
[37] See Chapters 3 & 5 for full discussion.
[38] See Chapter 5

and the fiduciary duty may not be the most appropriate vehicle for attempting direct regulation of such matters but this may be an avenue worth pursuing in further research and legal reform.

The difficulty of regulation in this area is that what is desired is that fiduciaries as managers should behave in accordance with ethical values. Not only the ethics that the nature of their financial responsibilities to their beneficiary impose, but also with integrity in the eyes of wider society and in accordance with the principles of good stewardship. This is a complicated problem. Exactly how the law and society might wish each fiduciary to behave is dependent on the individual choices they face a result of their role. There is no universally applicable rule which will govern this question, rather what is desired is fiduciaries who make the right choices. The law is too blunt an instrument for the genuine creation of inward ethical values on the part of legal actors or for their enforcement. However, in seeking to create a 'fiduciary culture' the fiduciary duties promote the adoption of these intangible values by individuals.

It is hard to see how detailed codification of fiduciary duties could achieve the objectives of regulation in this area more effectively than the flexible obligation. The creation of a fixed rule by its nature encourages the development of avoidance strategies and limits the scope of possible application. Similarly, the place of the fiduciary obligation in the jurisdiction of Equity is entirely appropriate. The inherent flexibility of Equity, given the availability both of judicial discretion and legal conscience, makes it the proper venue for the development of rules which seek to enhance or foster more ethically driven compliance with regulatory measures. This lessons of this thesis point towards embracing the equitable nature and function of the fiduciary obligation as the best means of clarifying and developing its function.

Rapid expansion of the scope of the fiduciary obligation is not recommended, as at its heart fiduciary regulation is about rules which apply flexibly according to the facts of specific relationships. To attempt to alter this core function risks disturbing the delicate economic balance between socially valuable regulation and efficient and free enterprise. Part of the strength of the fiduciary obligation is that it commends itself as economically valuable in protecting the interests of investors. However, neither should the wider role and function of the obligation be ignored. Fiduciary concepts should certainly never be seen as preventing business people from voluntarily adopting ethics commended to them by wider society. The future of the fiduciary duties may lie in encouraging beneficiaries and principals to define the ethics and values they expect from their fiduciaries in their relationship and enforcing those standards of behaviour. Further research in this area may assist in reconciling the specific nature of the duties to this more general role. Given the challenges posed by the financial crisis and other substantial social pressures bearing down on Western society, there may be untapped potential within the fiduciary obligation to contribute to better business regulation.

The core objective of the fiduciary obligation is valuable. It defines duties which can apply in any relationship of trust and confidence, which are based on loyalty and protect the integrity of that relationship, not only by remedying wrong but by seeking to prevent its occurrence in the first place. It is difficult to conceive of a regulatory system to accomplish this which would not by necessity require a high degree of flexibility, as well as high standards of liability and considerable remedial force. The fiduciary duty is ambitious in its objectives and significant in its effects. Some level of complexity in its application is to be expected, and a price it is worth paying.

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