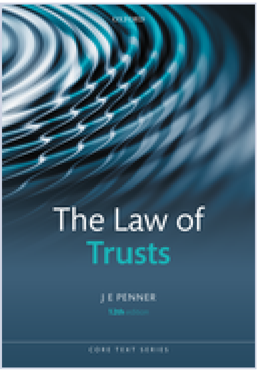

The Law of Trusts (12th edn)

J E Penner

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14. Fiduciary relationships

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Abstract

Titles in the Core Text series take the reader straight to the heart of the subject, providing focused, concise, and reliable guides for students at all levels. This chapter discusses the nature and scope of fiduciary relationships, the duties that govern them, and the remedies for breach. It begins by considering the fiduciary duty of loyalty and disentangling it from other duties of loyalty. Next, it considers the 'no conflict' principle; self dealing and fair dealing rules; the duty not to complete with one's principal; the profit opportunity doctrine; the no-profit rule; and the proprietary and personal nature of the liability to account.

Keywords: fiduciaries, fiduciary relationship, fiduciary duty, duty of loyalty, no conflict rule, no profit rule, authorised profits, self dealing rule, fair dealing rule

Summary

14.1 To begin with, review the descriptions of the fiduciary relationship (**3.28** et seq), the fiduciary duty of even-handedness (**8.3**), and custodial fiduciaries (**12.4**).

The good faith duty of loyalty (GFDL)

14.2 Before looking at fiduciary relationships proper and the central duty that governs it, we must distinguish a duty which is sometimes confused with it. The confusion arises because both are framed in p. 350 terms of ‘loyalty’. (It is questionable whether the term ‘loyalty’ is particularly apt to describe either duty (see Penner (2014c)).) The first is the ‘duty of loyalty’ owed, for example, by employees to their employers, and which has nothing to do with any fiduciary relationship. We shall call it the ‘good faith duty of loyalty’, or GFDL.

14.3 Employees owe their employers the GFDL. The basis of the duty is the fact that, in relying upon or ‘trusting’, in a colloquial sense, or placing faith in, the employee to deal with the employer’s property and carry out his employer’s instructions, the employer places the employee in a position that enables the employee to take advantage of the factual circumstances. That position differentiates him from a mere stranger to the employer. So, for example, both a stranger and an employee can steal property from the employer, but in the latter’s case this is also (again, colloquially, not legally) a breach of trust, or a breach of faith. In law this would amount to the employee’s breach of the GFDL.

Fiduciaries owe the GFDL to their principals

14.4 Fiduciaries also owe the same GFDL to their principals simply because, having legal or practical powers over their principal, the fiduciary likewise has had trust or confidence placed in her, and she is in a position to use her powers against her principal in a way that a stranger cannot.

14.5 So, how does one act in bad faith? It is akin to dishonesty. It reflects the state of mind of the person—their wrong against their employer or principal must be deliberate, knowing it is a wrong. *Klug v Klug* (1918) provides an illustration. There, one of two trustees, the beneficiary's mother, refused to agree to an advancement to her daughter, even though it was within the terms of the trust and the other (professional) trustee thought it right to make the advancement, because the mother disapproved of her daughter's marriage. This was an irrelevant consideration in deciding whether to exercise the power. In taking it into account, it is right to say that the mother was acting in bad faith even if, all things considered, she thought deliberately refusing to exercise the power for its intended purposes was an appropriate way of teaching her daughter a lesson. The case also shows that a person can be quite open about their acting wrongfully, which is why bad faith, though akin to dishonesty, is not identical to it. And an employee who announces to his employer that he is stealing the employer's computer as he walks out the door is still in breach of the GFDL.

Consequences of a breach of GFDL

14.6 The general principle which applies to a breach of the GFDL is that this can or will result in a termination or partial termination of the relationship. Where an employee breaches the GFDL, she is liable to summary dismissal. Where an agent purports to act on behalf of his principal, deliberately acting
p. 351 contrary to his principal's instructions, as between his principal and himself he will be acting without actual authority. (He may still be able to bind his principal vis-à-vis third parties if he continues to have 'apparent' or 'ostensible' authority, ie if third parties reasonably believe that the agent continues to represent the principal. So, for example, in *Bank of Credit and Commerce (Overseas) Ltd v Akindele* (2001) (discussed at length at **15.43** et seq) the bank's agents entered into transactions with a Mr Akindele which involved defrauding the bank. An agent has no actual authority to enter into transactions which defraud his principal. But the bank was unaware of the fraud at the time, and so the agents continued to have apparent authority upon which Mr Akindele could reasonably rely.) Furthermore, the agent will lose any entitlement to remuneration or commission from that point onward (*Imageview Management Ltd v Jack* (2009)). In *Murad v Al-Saraj* (2005) a joint venturer dishonestly failed to disclose his private arrangements with a seller of a hotel that was to be run for the benefit of the joint venture, ie that he was to receive a co-ownership share of the title to the hotel, not by contributing any money, but in discharge of a debt he claimed the seller owed him. The reasoning in the case can be criticised (Penner (2019a), 13.88–13.91, Chambers (2005b)), but the result can be justified on the basis that the defendant breached the GFDL. In all three judgments in the Court of Appeal, it was made clear that the defendant's breach was 'fraudulent', 'deliberate', 'dishonest', 'deceitful', and showed a 'lack of good faith' ([4], [12], [13], [14], [15], [46], [68], [84], [97], [125], [142], and [159]). In the case of a trustee, any act undertaken which breaches the GFDL will be a breach of trust, and so the trustee will be liable on that score in any case, but the specific

consequence of a GFDL breach will be that the trustee is removed, as having revealed herself as unfit to be a trustee (**8.61**). In *Klug*, the mother was essentially removed as trustee with respect to the exercise of the power of advancement.

The fiduciary relationship

The fiduciary duty of loyalty (FDL)

14.7 At its core, the fiduciary relationship is founded upon the fiduciary's voluntary undertaking to exercise powers which are conferred upon him by the principal, which will involve his making judgements about how specifically to exercise those powers, *judgements which require him to take into consideration only the principal's interests*. This is sometimes called the 'discretionary' theory of the fiduciary relationship (Conaglen (2007), 39–40; Miller (2011, 2013, 2014); Penner (2014a, 2014b, 2019b); Smith, (2014a, 2014b); Smith, S (2016); Valsan (2016); Sitkoff (2014); Weinrib (1975)). It responds to the fact that the voluntary obligation (or 'contract', loosely speaking), which underlies the relationship, is 'incomplete' in the important following sense: the actual exercises of the agent's powers to enter into contracts on her principal's behalf, or a trustee's making investment decisions regarding the trust assets, or a trustee's exercising a dispositive discretion under a trust, cannot be specified in advance under the objective legal
p. 352 terms of the agent's instructions or trust terms. The now classic judicial formulation of this view is found in Breyer J's judgment in the US Supreme Court decision *Varity Corp v Howe* (1996) (at 504, emphasis added):

> *[T]he primary function of the fiduciary duty is to constrain the exercise of discretionary powers which are controlled by no other specific duty imposed by the trust instrument or the legal regime.* If fiduciary duty applied to nothing more than the activities already controlled by specific legal duties, it would serve no purpose.

(See also *Perez v Galambos* (2009), [50]–[84], [83]–[84]; *Hospital Products Ltd v United States Surgical Corporation* (1984), 96–97 per Mason J).

14.8 So a fiduciary relationship is one in which the fiduciary has 'fiduciary powers' as just described. Although 'discretion' and 'discretionary' are the standard terms used to describe the 'leeway' the fiduciary has in exercising her powers, the better word for describing this 'leeway' is 'judgement', not discretion, at least in so far as the word 'discretion' suggests that the fiduciary has any sort of personal freedom in these cases. The fiduciary is required to choose that course of action which, in her judgement, is in the best interests of her principal. Because the literature tends to use the word 'discretion' and 'discretionary', we shall do the same, but always keep in mind that this refers to 'exercise of judgement' as just described.

The so-called 'duty to act in the principal's best interests'

14.9 This duty, or at least the way it is framed, seems almost designed to generate confusion. It suggests that there is an objective standard of 'best interests' which the fiduciary must meet. It has even been suggested that it entitles a trustee to commit 'judicious' breaches of trust, so long as these breaches are undertaken in the beneficiaries' best interests (*Armitage v Nurse* (1998), 251, per Millett LJ). As pointed out by Smith (see Smith (2014a), 143–145, 148–158), this is confused. What the duty requires is that the fiduciary exercise her fiduciary powers with only the principal's interests in mind, and because benefiting the principal is the point of the whole exercise, the fiduciary must act in the way that, in her judgement, best serves the principal's interests given the options for action that are available to her. There is, in general, no standard of 'due diligence' that applies, except in so far as the terms of the trust, the contract, or the general law specifies a duty of care or a duty of 'best efforts'. A fiduciary must act so as to reasonably discharge such latter duties in terms of pursuing information and so on, but there is no background mandatory or default rule or standard of law imposing a 'best efforts' duty with which a fiduciary must comply. Nor is there any applicable objective standard of 'best interests' which would make a fiduciary liable if the principal were able to show that, in hindsight, the fiduciary could have entered into a better contract for the principal or made a better investment decision or, finally, a 'better' distribution of the trust assets, whatever that might mean.

Contending interests versus conflicts of interests

4.10 Typically, people who have to use their judgements to make decisions have to face contending interests, especially in terms of the allocation of resources. The manager of a business has to weigh the
p. 353 interests of its shareholders as against its employees in deciding how much employees should be paid, for the more they pay the employees the less profit for shareholders. A dean of a law faculty has a budget and, in consultations with others, must use his judgement to allocate resources to teaching, to research, to administration, to IT improvements, to renovations of the classrooms, and so on. We can call these cases of 'contending' interests. These are not situations of conflict of interest (see Getzler (2014), 44). A conflict arises when A must exercise his judgement to make a decision for or on behalf of B, where only B's interests may be taken into account, but A's interests are implicated in the decision.

14.11 Of course sometimes the exercise of an agent's or trustee's powers can be objectively specified, and no judgement on the part of the fiduciary is necessary to determine when and how the powers ought to be exercised. An agent may be given precise instructions. A trustee may have no power to sell trust assets and invest the proceeds elsewhere. A trust may be a fixed trust, not involving any dispositive discretions. In such cases there is no need to invoke any fiduciary relationship to explain the nature of the agent's or trustee's duties and her liability for breach of those duties, for in these cases the agent or trustee has no *fiduciary* powers. In the case where the agent breaches his instruction, or the trustee breaches the trust by misapplying the trust property, there is obvious and straightforward liability in agency and trust law, based on an objective analysis of the facts in the sense that the agent's or trustee's liability in these cases is strict and his or her state of mind irrelevant (just like in a breach of contract case), and it only confuses matters if one treats any such breach as a breach of a fiduciary relationship. The same can be said for a breach of a trustee's duty of care in, say, making investment decisions. The liability for careless investments is determined upon an objective basis, and the motives or state of mind of the trustee is irrelevant to her liability.

14.12 Nevertheless, courts and commentators routinely describe the duties of trustees involving no requirement of judgement as 'fiduciary duties', one supposes simply on the principle that a trustee is a 'fiduciary' in the first sense of fiduciary (**3.28**), ie that a trustee holds all his rights and powers under the trust not for his own benefit, or personally, but for the benefit of others. But as Millett LJ makes clear in *Bristol and West Building Society v Mothew* (1996) (at 16, 18), just because A stands as a fiduciary to B, that does not mean that every duty he owes B is a fiduciary duty:

> *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. Unless the expression is so limited it is lacking in practical utility. In this sense it is obvious that not every breach of duty by a fiduciary is a breach of fiduciary duty … It is … inappropriate to apply the expression to the obligation of a trustee or other fiduciary to use proper skill and care in the discharge of his duties … 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. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of* p. 354 *his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal … [Where] the fiduciary deals with his principal … he must prove affirmatively that the transaction is fair and that in the course of the negotiations he made full disclosure of all facts material to the transaction. Even inadvertent failure to disclose will entitle the principal to rescind the transaction … The nature of the obligation determines the nature of the breach. The various obligations of a fiduciary merely reflect different aspects of his core duties of loyalty and fidelity. Breach of fiduciary obligation, therefore, connotes disloyalty or infidelity. Mere incompetence is not enough. A servant who does his incompetent best for his master is not unfaithful and is not guilty of a breach of fiduciary duty.*

14.13 Mitchell (2013), 311 (footnotes omitted), elaborates:

> *As Matthew Conaglen has written [Conaglen (2007), ch 2] the corollary of Millett LJ's argument is that the other duties which a fiduciary can owe to his principal are not fiduciary duties, because they are not duties of loyalty. These include the duty to perform an engagement according to its terms (which includes the duty owed by a trustee to adhere to the trust terms), the duty to act for a proper purpose, the duty to take relevant matters into account and to exclude irrelevant matters from account when exercising a power, the duty of skill and care, and the duty of confidence. At one time or another, these have all been described as 'fiduciary duties', but this is to misunderstand their content. It also makes it harder to understand the content of the duty of undivided loyalty and the remedial consequences of breaching this duty. Describing different duties as though they were a single duty can lead to the false conclusion that the remedies consequent on breach of the duties are always the same.*

14.14 As Millett LJ also points out, the duty of loyalty that applies here, which we shall call the 'fiduciary duty of loyalty' or FDL, has been elaborated in the form of a number of more particular duties, concerning profits from the trust, conflicts of interest, and transactions with the principal's property. We shall examine each in turn.

When is a person in a fiduciary relationship?

14.15 There is a straightforward answer to this question: a person is a fiduciary when she holds fiduciary powers in relation to another or others. Trustee and agents are typically fiduciaries (though not always (**14.11**)). Partners are fiduciaries to each other because they are agents for each other, entering into contracts, for example, for the benefit of the partners. Depending on the nature of the venture, joint venturers may hold fiduciary powers in relation to their co-venturers.

14.16 Company directors are fiduciaries to their companies in two respects. First, as members of the board of directors, they are like the legislators of the company, passing resolutions regulating the company's affairs; they must exercise these powers with only the best interests of the company in mind. Second, at least some directors will be agents for the company, negotiating and entering into contacts on the
p. 355
company's behalf. The fiduciary powers of company directors are governed by legislation under the Companies Act 2006, ss 172–177. They basically replicated the position at common law, with one material difference we will consider below (**14.61**), and this is provided for in the act itself:

> *178 Civil consequences of breach of general duties*
>
> (1) *The consequences of breach (or threatened breach) of sections 171 to 177 are the same as would apply if the corresponding common law rule or equitable principle applied.*
>
> (2) *The duties in those sections (with the exception of section 174 (duty to exercise reasonable care, skill and diligence)) are, accordingly, enforceable in the same way as any other fiduciary duty owed to a company by its directors.*

14.17 Employees are not fiduciaries just because they are employees (*Nottingham University v Fischel* (2000)), but employees may be given fiduciary powers, typically the powers of an agent to negotiate and enter into contracts on behalf of a company. Typically, but not necessarily, such powers will be given to senior executives, to hire and dismiss employees, to sell the company's products, and so on.

14.18 Another example of a typical case of fiduciary is the advising fiduciary. A solicitor is an advising fiduciary. An advising fiduciary does not have, in their capacity of advisor, any legal fiduciary powers—they cannot enter into contracts on behalf of their principal, for instance. But they do have 'factual' powers, in the sense that by providing advice they will influence the decisions of their principal. So a solicitor is an advising fiduciary when she gives legal advice to her client in respect of a legal transaction her client is considering entering into, or when she advises on the prospects of litigation.

14.19 It is not clear whether canvassing agents are fiduciaries. A canvassing agent is one whose task is to seek out information, in particular seeking out possible contracting parties for the person who hires them. A familiar example is a (real) estate agent. An estate agent finds potential buyers, but it is the client who enters into the contract of sale; the estate agent has no power to enter into a contract on his client's behalf. The agent has a clear *contractual* duty to pass on any information he discovers, and certainly has a contractual obligation not to provide false information. The issue that arises is that when an agent breaches these duties, he may do so to favour his own interests, for example lying to the client about the character of a proposed purchaser (*Stevens v Premium Real Estate* (2009)), or not disclosing that a potential purchaser is not at arms-length to them (*Yuen Chow Hin v ERA Realty Network* (2009)). In such cases, the agent's breach will typically favour their own interests, so if these duties are fiduciary duties then they will be liable as fiduciaries, not just liable for breach of contract. The court in *Premium Real Estate* divided upon which basis the agent should be held liable.

14.20 It is often said that the 'categories' of fiduciary relationship are not closed. What this means is that a person may fiduciary powers even though they are not a typical example of a fiduciary like an agent or
p. 356 trustee. In these cases the court must determine, whatever the arrangement is between the parties, whether one has fiduciary powers in relation to the other.

The 'no conflict' principle

14.21 The 'no conflict' principle is the basic principle governing fiduciaries. (See Conaglen (2007), especially ch 3, for a robust defence of the view that the 'no conflict' principle is the core of the law governing fiduciaries.) The principle can be stated as follows: where a fiduciary exercises any fiduciary power and, on examination, it turns out to be exercised by him in conflict of interest, that exercise of the power is liable to be set aside by the court. In other words, the fiduciary is liable to a rule which makes voidable, at the behest of his principal, any such exercise (Mitchell (2013); Smith (2014a); Penner (2014c)).

14.22 The principle is strict: it applies whether the fiduciary realised he was in a conflict of interest or not, and irrespective of whether the fiduciary was acting in good faith. What the no conflict principle reflects is the very well-known idea that a person cannot be a judge in his own cause, and similar ideas about biased reasoning. This has nothing to do with fault or ill will. Take the example of someone who has to referee a football match where his own child is on one of the teams. In such a case it is almost impossible to referee fairly—the most honest person is liable to overcompensate and judge his child's team unfairly, just to be sure that he is not taking his child's interests too much into account. A further part of the equation here is the human capacity for rationalisation, which points to a common human failing. People are liable to rationalise their behaviour as acceptable, in particular where it causes 'no harm' to another. Framing the principle in this way addresses the problem to which fiduciary relationships give rise: in cases where people take on the role of fiduciary they must act in the interests of their principal. Normally, this is not problematic. It requires no more than complying with one's voluntary undertaking to exercise one's discretion with as sound a judgement as one can muster. But where a conflict arises, all of this is undermined given the human inability to overcome bias and the ability to rationalise.

Conflict between duty and duty

14.23 Sometimes a fiduciary owes a duty to act for more than one principal, and this can give rise to a conflict, not of the fiduciary's interests with one or more of his principals, but between the duties he owes to his separate principals. This can arise especially in the case of advising fiduciaries such as solicitors. *Hilton v Barker, Booth & Eastwood* (2005) provides an illustration. Solicitors acted for parties on both sides of a property development transaction. Under their contract of retainer they owe a duty, which Lord Walker regarded 'as rooted in the fiduciary relationship between solicitor and client', to inform a client of
p. 357 any information relevant to any transaction on which they were giving advice. Here the solicitors failed to inform their client, Mr Hilton, a property developer, that entering into the contract with their other client posed a serious financial risk owing to the latter's past behaviour, which included an offence of fraudulent trading for which, amongst other offences, he had been imprisoned. The court found that, had they informed Mr Hilton of these facts, he would never have entered into the transaction with this other client of the firm, a transaction which, in the end, turned out to be a financial disaster for Hilton. The HL unanimously held that the fact that it would also have been a breach of their duty of confidentiality to their other client to impart this information provided no excuse. The solicitors had placed themselves in this position of conflict and failed to deal with it properly by refusing to act for one of the parties; they therefore put themselves in the position that they had no choice but to breach their contract of retainer to one of their clients, and were liable for any consequences of doing so. They were therefore liable to Mr Hilton for his entire loss resulting from his entering into the contract.

Resolving conflicts

14.24 What should a fiduciary do who finds himself in a position of conflict of interest? In *Public Trustee v Cooper* (2001), Hart J laid out three ways in which a conflict might 'in theory, successfully be managed'; Hart J speaks only of trustees, but his views apply *mutatis mutandis* to other fiduciaries:

> *One is for the trustee concerned to resign. This will not always provide a practical or sensible solution. The trustee concerned may represent an important source of information or advice to his co-trustees or have a significant relationship to some or all of the beneficiaries such that his or her departure as a trustee will be potentially harmful to the interests of the trust estate or its beneficiaries.*
>
> *Secondly, the nature of the conflict may be so pervasive throughout the trustee body that they, as a body, have no alternative but to surrender their discretion to the court.*
>
> *Thirdly, the trustees may honestly and reasonably believe that, notwithstanding a conflict affecting one or more of their number, they are nevertheless able fairly and reasonably to take the decision. In this third case, it will usually be prudent, if time allows, for the trustees to allow their proposed exercise of discretion to be scrutinised in advance by the court, in proceedings in which any opposing beneficial interests are properly represented, and for them not to proceed until the court has authorised them to do so. If they do not do so, they run the risk of having to justify the exercise of their discretion in subsequent hostile litigation and then satisfy the court that their decision was not only one which any reasonable body of trustees might have taken but was also one that had not in fact been influenced by the conflict.*

Finally, a fiduciary may always seek the consent of her principal to act despite the conflict, though this consent must be freely given and fully informed.

p. 358 **14.25** The 'no conflict' principle underlies all the more specific rules applying to fiduciaries (although for a different view with respect to the 'no profit' rule, see **14.92** et seq). These rules specify, or crystallise, the application of the no conflict principle in different circumstances. Those rules are:

An advising fiduciary's duty to reveal a conflict of interest

The self dealing rule

The fair dealing rule

The duty not to compete with one's principal

The profit opportunity doctrine

The no profit rule

We shall look at each in turn.

An advising fiduciary's duty to reveal a conflict of interest

14.26 Where an advising fiduciary advises her principal to enter into a transaction, and the fiduciary will benefit some way under the transaction, this advice is obviously given in conflict of interest. When this happens and the principal suffers a loss by entering into the transaction, the fiduciary will be liable to compensate her principal for the loss. The leading case that establishes the jurisdiction of equity to award compensation in such cases is *Nocton v Lord Ashburton* (1914). Nocton, a solicitor, advised Lord Ashburton to advance £60,000 on a mortgage as part of a scheme to develop land. Nocton derived personal advantages under the scheme of which he did not inform Ashburton. Later Nocton advised Lord Ashburton to release a property from the mortgage, which made the mortgage loan less secure, and which again unbeknownst to Lord Ashburton benefited Nocton. The scheme failed to be profitable, and the value of the property securing the mortgage fell far short of what Lord Ashburton had advanced. The HL unanimously decided that, although Nocton had not intended to defraud Lord Ashburton, he was in breach of his fiduciary obligations to him in advising him to act so as to benefit Nocton without disclosing it would do so, and the court affirmed the lower court's direction to inquire into the amount of Lord Ashburton's losses.

The Brickenden *rule*

14.27 In *Brickenden v London Loan & Saving Co* (1934) Lord Thankerson said (at 469) (by 'constituent' he means 'principal'):

> *When a party, holding a fiduciary relationship, commits a breach of his duty by non-disclosure of material facts, which his constituent is entitled to know in connection with* p. 359 ↵ *the transaction, he cannot be heard to maintain that disclosure would not have altered the decision to proceed with the transaction, because the constituent's action would be solely determined by some other factor, such as the valuation by another party of the property proposed to be mortgaged. Once the Court has determined that the nondisclosed facts were material, speculation as to what course the constituent, on disclosure, would have taken is not relevant.*

This statement has led to what has been called the 'Brickenden' rule. Where an advising fiduciary fails to disclose material facts relevant to his principal's decision to enter into a transaction which causes loss, the fiduciary will not be able to escape his liability to compensate his principal for the loss *by proving* that his principal would have entered into the transaction *even if* he had disclosed those facts. This is clearly a departure from the normal rule that if a defendant shows that on a 'but for' causation basis, the loss the claimant suffered was not caused by the defendant's breach of duty, the claimant cannot recover, since he would have suffered the loss even if the defendant had not breached his duty.

14.28 The rule is, as you can imagine, controversial, and it has been dealt with repeatedly, and differently, in common law jurisdictions. For a recent, extensive, survey of how the rule has been treated in these different jurisdictions, see the Singapore case *Sim Poh Ping v Winsta Holding Pte Ltd* (2020), [129]–[254]. The rule is cited as good law in Lewin (2020), 41-009, but doubt has been cast upon it.

14.29 In *Swindle v Harrison* (1997), Mrs Harrison, at the instigation of her son, mortgaged her house to provide capital to purchase the Aylesford Hotel, in order that together they could operate a family restaurant business. She contracted to buy the hotel and paid a £44,000 deposit, which would have been forfeited if she did not pay the remainder of the sale price and complete the purchase. Unfortunately, by the date of completion, she and her son were unable to obtain sufficient money to complete the purchase. Her solicitor, the engagingly named Mr Swindle, arranged for his firm to provide a bridging loan so that she could complete. Mr Swindle failed to inform her of certain pertinent facts, in particular his firm's profit on the loan. It was clear that, but for the bridging loan, Mrs Harrison would not have been able to purchase the restaurant, and she would have lost her £44,000 deposit. The restaurant business turned out to be a disaster, resulting in the loss of the entire sum she had raised on the equity in her home. Because the solicitor failed to disclose material facts to her in breach of his fiduciary duty, she was clearly entitled to rescind the bridging loan agreement; indeed, by the time of trial, that loan agreement had been rescinded by agreement. It was argued that the solicitors' firm was liable for any losses that would not have resulted 'but for the loan', ie all the losses resulting from the restaurant business.

14.30 The CA unanimously found against Mrs Harrison. Unfortunately, all three judges gave extensive judgments that used different terminology and provided different rationales for doing so. Essentially, however, all three agreed that the particular breach in question, the failure to inform Mrs Harrison of the profit Mr Swindle's firm was taking on the loan, was not the cause of the losses caused by her entering the
p. 360 restaurant business. Yet it is not clear this displaces the *Brickenden* rule, since the solicitors did not advise Mrs Harrison to enter the transaction, but merely offered her financial support in doing so.

14.31 In *Gwembe Valley Development v Koshy* (2003), a director, clearly acting in conflict of interest, made a massive profit on currency transactions contracts he arranged for his company. While he was liable, of course, to account to his company for those unauthorised profits under the no profit rule (**14.63** et seq), the court held that these contracts had not contributed to the ultimate failure of the development venture, so he was not liable to compensate the company for the resultant losses.

14.32 These cases suggest, but they do not *decide*, that the *Brickenden* rule has been abolished. In Canada (*Southwind v Canada* (2021, [82]) the SCC has affirmed obiter that the rule continues to apply. In Hong Kong (*IQ EQ (NTC) Trustees Asia (Jersey) Ltd and v Bruno Arboit* (2019)) and Singapore (*Sim Poh Ping v Winsta Holding Pte Ltd* (2020)) the rule is interpreted as one that should shift the burden of proof. The claimant must show that the fiduciary gave advice to the claimant to enter into the transaction, and that in doing so the fiduciary failed to reveal relevant information in her possession. At that point, the burden of proof lies on the defendant to establish on the facts that the claimant would have proceeded with the transaction anyway. We await a thorough review by an English higher court.

The self dealing rule

14.33 The self dealing rule makes voidable any transaction in which a fiduciary enters into a contract where her counterparty to the contract is her principal. In the case of a trustee, which is relatively rare as opposed to the case of company directors or agents, the rule applies where she purchases trust property or uses her fiduciary powers to sell her own property to the trust to hold as a trustee. The rule applies to any transaction in which the fiduciary has an interest in the transaction. So the rule applies to a company director who enters into a contract to buy goods for his company from another company in which he is interested (see eg *Aberdeen Railway Co v Blaikie Bros* (1854)). The rule also applies where someone close to the director, such as his spouse, has an interest, say where, a company executive purchase raw materials from a company owned by his spouse. Unless the transaction is specifically authorised, and explicit authorisations are strictly construed (*Wright v Morgan* (1926)), the transaction is voidable, that is the principal can have the court set aside the transaction.

14.34 The rationale, as explained by Lord Eldon in *Ex p Lacey* (1802) (see also *Ex p Bennet* (1805)), is that because the fiduciary acts both as vendor for his principal and purchaser for himself, or vice versa, he places himself in an obvious conflict of interest and it is impossible to determine whether he has served his principal's interests properly in securing the best price for them. In *Fenwick v Naera* (2015) the NZSC stated (at 78) that:

> *at its most basic level, the self-dealing rule is based on the no-conflict rule: having an interest or duty on both sides of a transaction.*

p. 361 ↵ It is thus abundantly clear how this rule is underpinned by the no conflict principle. The fiduciary is acting at both sides of the transaction—she wants the best deal for herself, but is also obliged to get the best deal for her principal. The principle in all its rigour was affirmed and applied in *Re Thompson's Settlement* (1986).

14.35 *Very importantly*, it is not the case that the fiduciary can escape the application of the rule by trying to prove that there was no conflict of interest in the sense that the transaction was *in fact* to the benefit of both the fiduciary and the principal. So consider a case where an executive of Co X is seeking a source for raw materials, and concludes, correctly, that the best source is a company which he himself owns, Co Y. Moreover, he is willing to cause Co Y to enter into a contract with Co X at a below market price for raw materials. It doesn't matter. The rule, though based on the no conflict principle, does not allow the fiduciary to prove that there was 'really no conflict', and that the interests of Co X and Co Y were not in conflict under the transaction, but were in fact *aligned*. If, in fact, this alignment were true, then the fiduciary should have consulted his principal and got authorisation for the contract, for it is the *principal's contract*. If the fiduciary fails to do so, it is his lookout. His principal can avoid, or rescind the contract, as of right (see below **14.37** et seq), because the fiduciary failed to disclose his conflict to him. This rule raises the general principle of the no conflict rule and its 'crystallisation' of the more specific rules governing fiduciaries, which is that if there is a 'crystallised rule', the defendant cannot evade the rule by saying that, in fact, in this case, the no conflict principle should not apply because the parties' interests are aligned.

14.36 If a fiduciary attempts to circumvent the application of the self dealing rule by collusively selling to a third party, the sale is liable to be set aside as if the fiduciary were a party himself. In *Re Postlethwaite* (1888) the court did not set aside a sale to a third party just because the fiduciary entertained a hope of purchasing the property himself from him. Sales to family members or spouses will be viewed suspiciously; arguably, all such sales to parties not at arm's length from the fiduciary should be subject to the rule. A fiduciary cannot avoid the application of the rule by terminating her fiduciary relationship with her principal in order to enter into the transaction (*Re Boles and British Land Co's Contract* (1902)).

14.37 Where a transaction is liable to be set aside under the rule, the transaction is voidable, not void at the outset, so an innocent third-party purchaser from the fiduciary of property acquired by the fiduciary under the transaction, before the principal acts to set the transaction aside, will take a good title; in these circumstances the fiduciary will be liable to account for any profits made on the resale, or if it is shown that the resale was at an undervalue, the difference between the sale price and the true value. Where the transaction is avoided while the property is still in the hands of the fiduciary, the principal may require the return of the property in return for the purchase price received, or may require a resale of the property on the open market—if the property fetches more on the open market than the price paid by the fiduciary the difference is the principal's, of course (see *Holder v Holder* (1968); Conaglen (2003)).

p. 362 **14.38** *Holder v Holder* (1968) is an exceptional case which may provide a limited exception to the last statement. In this case the purchaser from a testator's estate, although not proving the will, admitted at trial that by having performed certain minor acts in the administration of the estate he had become an executor, and therefore a fiduciary. Innocent of his fiduciary status, he purchased the property at fair value at a public auction. The CA refused to set aside the sale, and in this respect the case appears to be an extension from previous authority where sales were not set aside where a purchaser had retired from the trust 12 years prior to the sale (*Re Boles and British Land Co's Contract* (1902)), or where a purchaser was entitled to but did not take up the office of trustee (*Clark v Clark* (1884)). Harman LJ argued that the purpose of the rule was to prevent any sale by a person acting as both vendor and purchaser, but here the property was prepared for sale by the two proving executors of the will with no input from the purchaser (at 392):

> *I feel the force of the judge's reasoning that if the [purchaser] remained an executor he is within the rule, but in a case where the reasons behind the rule do not exist I do not feel bound to apply it.*

14.39 Danckwerts and Sacks LJJ both went further and questioned whether the rule should ever be applied automatically, doubting that it was beyond the court to determine whether the trustee had taken unfair advantage of his position. Vinelott J, *in Re Thompson's Settlement*, clearly preferred the traditional approach.

14.40 The self dealing rule does not apply to a fiduciary's exercise of a personal right he acquired prior to his undertaking a position as a fiduciary. In *Newman v Clarke* (2016) a man acquired a lease, which gave him a statutory right to acquire the freehold. Subsequently the freehold reversion was purchased by the trustees of a settlement as trust property, and the man was appointed one of the trustees. The fact that he became a trustee did not bring his subsequent exercise of his right to acquire the freehold under the self dealing rule.

The fair dealing rule

14.41 The fair dealing rule applies to purchases by a fiduciary of his principal's rights, his property, or his rights in shares, or for the assignment of his principal's rights under a contract, in cases where the fiduciary has fiduciary powers in respect of those rights. A clear example is where a company director enters into a contract to buy a title to land held by the company. The rule also comes into play when, for example, a capital beneficiary assigns (**2.35**) his capital interest under the trust to his trustee. The rule is to be distinguished from the self dealing rule, where the fiduciary is at both ends of the transaction; since there are two real parties to the transaction with their own interests at stake, the bargain is much more likely to be a real one. Therefore, the court will not automatically set aside the transaction at the principal's insistence, but will do so only if the trustee cannot show (and the onus is on him to do so) that
p. 363 he has taken no advantage of his position, has fully disclosed all relevant information to the beneficiary, and that the price was fair. (See eg the characterisation of Megarry VC in *Tito v Waddell* (No 2) (1977), cited

in *Re Thompson's Settlement* (1986); *Edwards v Meyrick* (1842).) Because of these conditions, a fiduciary proposing to enter into a transaction caught by the fair dealing rule is well advised to insist that his principal seeks out independent advice on the transaction.

The duty not to compete with one's principal

14.42 A fiduciary may not, of course, operate a business in competition with his principal (*Re Thomson* (1930)); the conflict of interest here is palpable. A recurring issue is the extent of a director's liability in the context of his departure from the board of directors. In *Island Export Finance Ltd v Umunna* (1986), Hutchison J decided that, whilst a director's fiduciary obligations did not cease utterly upon the termination of his post, the mere fact that he entered into competition with his former company following his departure did not make him liable, so long as he did not capture a 'maturing business opportunity' of the company, an idea we will discuss under the 'profit opportunity doctrine' (**14.46** et seq). Hutchison J said (at 482):

> *In this context counsel for the defendants rightly stresses the fundamental principles relating to contracts in restraint of trade. It would, it seems to me, be surprising to find that directors alone, because of the fiduciary nature of their relationship with the company, were restrained from exploiting after they ceased to be such any opportunity of which they had acquired knowledge while directors. Directors, no less than other employees, acquire a general fund of knowledge and expertise in the course of their work, and it is plainly in the public interest that they should be free to exploit it in a new position.*

14.43 Similarly, in *Balston Ltd v Headline Filters Ltd* (1987), Falconer J stated (at 412):

> *[A]n intention by a director of a company to set up business in competition with the company after his directorship has ceased is not to be regarded as a conflicting interest within the context of the principle, having regard to the rules of public policy as to restraint of trade, nor is the taking of any preliminary steps to investigate or forward that intention so long as there is no actual competitive activity, such as, for instance, competitive tendering or actual trading, while he remains a director.*

14.44 In *Plus Group Ltd v Pyke* (2002), the CA took a firm line on conflicts of interest in respect of individuals who serve as a director of different companies whose businesses compete. Sedley LJ said ([86]–[87]):

> *[T]he fiduciary must not only not place himself in a position (of conflict of interest); if, even accidentally, he finds himself in such a position he must regularise it [ie get the consent of his principal(s)] or*
> p. 364 *abandon it … [It is not the case that] a director can go ↵ cheerfully to the brink so long as he does not fall over the edge. [I]f he finds himself in a position of conflict he must resolve it openly or extract himself from it.*

The CA also affirmed that every decision on the principle governing conflict of interest is fact-specific. In *Plus Group*, a director was found not to have been liable for acting in conflict of interest for engaging in business with a client of the company of which he was formerly a director, where his dealings with the client began six months after he had been effectively expelled from the management of the company.

14.45 The CA in *Foster Bryant Surveying Ltd v Bryant* (2007) again emphasised the fact-sensitive application of the rules, while approving as perceptive and useful the following summary of the principles of the law in this area by Livesey QC, sitting as a deputy High Court judge in *Hunter Kane Ltd v Watkins* (2003) ([8]):

1. *A director, while acting as such, has a fiduciary relationship with his company. That is he has an obligation to deal towards it with loyalty, good faith and avoidance of the conflict of duty and self-interest.*
2. *A requirement to avoid a conflict of duty and self-interest means that a director is precluded from obtaining for himself, either secretly or without the informed approval of the company, any property or business advantage either belonging to the company or for which it has been negotiating, especially where the director or officer is a participant in the negotiations.*
3. *A director's power to resign from office is not a fiduciary power. He is entitled to resign even if his resignation might have a disastrous effect on the business or reputation of the company.*
4. *A fiduciary relationship does not continue after the determination of the relationship which gives rise to it. After the relationship is determined the director is in general not under the continuing obligations which are the feature of the fiduciary relationship.*
5. *Acts done by the directors while the contract of employment subsists but which are preparatory to competition after it terminates are not necessarily in themselves a breach of the implied term as to loyalty and fidelity.*
6. *Directors, no less than employees, acquire a general fund of skill, knowledge and expertise in the course of their work, which is plainly in the public interest that they should be free to exploit it in a new position. After ceasing the relationship by resignation or otherwise a director is in general (and subject of course to any terms of the contract of employment) not prohibited from using his general fund of skill and knowledge, the 'stock in trade' of the knowledge he has acquired while a director, even including such things as business contacts and personal connections made as a result of his directorship.*
7. *A director is however precluded from acting in breach of the requirement at 2 above, even after his resignation where the resignation may fairly be said to have been prompted or influenced by a wish to acquire for himself any maturing business opportunities sought by the company and where it was his position with the company rather than a fresh initiative that led him to the opportunity which he later acquired.*

p. 365

8. *In considering whether an act of a director breaches the preceding principle the factors to take into account will include the factor of position or office held, the nature of the corporate opportunity, its ripeness, its specificness and the director's relation to it, the amount of knowledge possessed, the circumstances in which it was obtained and whether it was special or indeed even private, the factor of time in the continuation of the fiduciary duty where the alleged breach occurs after termination of the relationship with the company and the circumstances under which the breach was terminated, that is whether by retirement or resignation or discharge.*
9. *The underlying basis of the liability of a director who exploits after his resignation a maturing business opportunity 'of the company' is that the opportunity is to be treated as if it were the property of the company in relation to which the director had fiduciary duties. By seeking to exploit the opportunity after resignation he is appropriating to himself that property. He is just as accountable as a trustee who retires without properly accounting for trust property.*

> 10. *It follows that a director will not be in breach of the principle set out as point 7 above where either the company's hope of obtaining the contract was not a 'maturing business opportunity' and it was not pursuing further business orders nor where the director's resignation was not itself prompted or influenced by a wish to acquire the business for himself.*
> 11. *As regards breach of confidence, although while the contract of employment subsists a director or other employee may not use confidential information to the detriment of his employer, after it ceases the director/employee may compete and may use know-how acquired in the course of his employment (as distinct from trade secrets—although the distinction is sometimes difficult to apply in practice).*

The profit opportunity doctrine

14.46 As we can see from points 2, 7, 8, 9, and 10 from the preceding quotation, a fiduciary is not entitled to capture a business opportunity which is the very sort of business opportunity which he is tasked to get for his principal. Again, the conflict of interest if he were to have to choose to pursue the opportunity for himself or for his principal is obvious. Because this rule typically operates in the context of companies and their directors it is often called the 'corporate opportunity' doctrine, though it applies to all fiduciaries, in particular business partners.

14.47 The leading case is *Regal (Hastings) Ltd v Gulliver* (1942). The defendants were directors of a company, Regal, which owned and operated a cinema. Two other local cinemas were available for lease, and the directors decided to create a subsidiary company that would acquire leases to these cinemas, and that Regal would then sell its holding in all three cinemas as a going concern. The landlord of the two cinemas was not prepared to grant the leases to the subsidiary unless either a personal guarantee was p. 366 given by the directors or the subsidiary had paid-up capital of £5,000. The directors were reluctant to provide personal guarantees, so the second route was chosen. However, the directors decided that, in their judgement, Regal could not put up more than £2,000 of the required £5,000. Four directors then each subscribed for shares worth £500, as did the solicitor to Regal at the request of the director; one director acquired £500 worth of shares for third parties. With £5,000 paid-up capital, the subsidiary acquired the leases.

14.48 As it turned out, Regal did not sell its interest in the three-cinema business; rather, the shareholders of Regal and the subsidiary sold their shares to a purchaser. The directors who had put up part of the capital for the subsidiary company received a handsome profit from their investment. The purchaser installed a new board of directors, and Regal, now under their control, launched this action against the former directors, calling for them to account for the profits they had made on their sale of the subsidiary shares. Regal succeeded in the HL. In the lower courts the directors successfully defended the claim, by arguing that the decision they made for Regal to invest no more than £2,000 in the subsidiary was bona fide—indeed it might have been a breach of trust to have risked more of Regal's money; therefore, the directors putting up their own money secured a benefit for Regal that it could not otherwise have obtained, and so there was no basis for holding them liable to account for the profits they had personally made.

14.49 The HL unanimously rejected this interpretation of the case. Lord Russell said (at 144–145):

> *The rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of bona fides; or upon such questions or considerations as whether the 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. The profiteer, however honest or well intentioned, cannot escape the risk of being called to account.*

This passage nowhere mentions 'conflict of interest', and it suggests that so long as the gain is made when acting as a fiduciary no recourse need be made to establishing a conflict of interest between a fiduciary and her principal. It is certainly correct that a claimant principal does not need to plead or elaborate on any conflict of interest (see **14.93**). But it is easy to see the underlying conflict in the circumstances: the director's had to use their *judgement* to decide whether *the company* could fund the cinema project, or whether *they should do so themselves*. No doubt they took the decision in good faith, but that does not resolve the underlying problem that their judgement about what their principal, the company, should do was made when their personal interests were at stake.

14.50 None of the non-director subscribers of shares in the subsidiary, including the solicitor, was
p. 367 accountable, because none was a fiduciary subject to the rule. The solicitor took up his shares at the request of the company (a request made, of course, through its directors), and Lord Russell said (at 152):

> *I know of no principle or authority which would justify a decision that a solicitor must account for profit resulting from a transaction which he has entered into on his own behalf, not merely with the consent, but at the request of his client.*

14.51 Note that the effect of the decision was to give the new purchasers of the company and subsidiary shares a windfall, because they were, by this action by Regal, able to secure the return of part of their purchase price to Regal's coffers—had the company itself just sold the cinema business, the purchasers would not have been able to make such a claim, because the 'injured company' which suffered by the directors' breach, would not have been in their hands. Recognising this, Lord Porter said (at 157):

> *This, it seems, may be an unexpected windfall, but whether it be so or not, the principle that a person occupying a fiduciary relationship shall not make a profit by reason thereof is of such vital importance that the possible consequence in the present case is in fact as it is in law an immaterial consideration.*

14.52 Lord Russell suggested that the directors' liability might easily have been avoided. Their decision to take up shares in the subsidiary could have been approved by the vote of a general meeting of the company, ie a general shareholders' meeting, and being in control of the company, they doubtless would have controlled the voting to ensure the result they desired. Such approval in the case of a company is equivalent to the informed consent of the beneficiaries under a trust. But as pointed out by Lowry (1997), the fact that company directors are typically able to control the voting at a general meeting makes the court's ringing endorsement of the application of the rule somewhat hollow, because if Lord Russell's suggestion is correct then any well-advised company directors who control by proxy a sufficient number of the company's shares may, by ensuring the approval of a general meeting, engage in profit-taking of this kind as they please. However, Lord Russell's view seems to conflict with the PC's decision in *Cook v Deeks* (1916), where such a resolution was held to be ineffective.

14.53 In *Industrial Development Consultants Ltd v Cooley* (1972). Cooley was the former chief architect of the West Midlands Gas Board. He joined Industrial Development Consultants (IDC) as its managing director, principally in order to procure work in the gas industry. He was approached by representatives of the Eastern Gas Board with respect to some large contracts for work to be done in the near future. The evidence indicated that the Eastern Gas Board would not have entered into contracts with IDC, as they disagreed in principle with 'the set-up' of IDC; the Board was willing, however, to enter into contracts with Cooley personally. Cooley secured his release from his position at IDC by lying to them that he was seriously ill, and secured the lucrative contracts for himself. Roskill J found that Cooley had clearly placed himself in actual conflict with IDC; it was his fiduciary duty to inform IDC of the Eastern Gas Board's plans and not to
p. 368 keep secret his dealings with the Board to his own advantage; the court declared that he held the profits of the contracts on trust for IDC. Roskill J realised that his decision secured for IDC a profit that it never would have obtained if Cooley had complied with his fiduciary duty, but he accepted (at 176) that:

> *It is an over-riding principle of equity that a man must not be allowed to put himself in a position in which his fiduciary duty and his interests conflict.*

14.54 The fact that Cooley and the directors in *Regal (Hastings)* were held liable even though they judged that they could not have captured the opportunity for their principals is important. One might argue, as some of the next cases we shall consider at least suggest, on a kind of 'no harm, no foul' principle, that the doctrine should not apply in these circumstances. But fiduciary law, quite rightly, holds that this does not excuse the fiduciary, because it undermines the no conflict principle. In this context, the point is that the fiduciary should not be able to establish on the balance of probabilities that she could not have captured the opportunity for her principal, because making such a judgement of possibility will necessarily be a judgement she makes in conflict of interest. In *Cooley*, for example, how is the court (or anyone) to decide whether Cooley might have captured the opportunity for his principal if he had tried harder to convince the Eastern Gas Board that his principal was a suitable counterparty?

14.55 In the middle of the last century, North American courts began to take the view that a genuinely good faith decision by a board of directors not to take up a corporate opportunity frees individual directors or other company fiduciaries to take up such opportunities themselves. For example, in *Peso Silver Mines v Cropper* (1966), the SCC held that a director was not liable to his company for acquiring mining properties and profitably exploiting them when they had previously been offered to the company and the board of directors had bona fide decided not to take up the offer. It is noteworthy that in *Peso* the court clearly approved (at 682–683) the following statement of Lord Greene, MR, from his judgment in the CA in *Regal (Hastings)*, a decision that was overturned in the HL:

> *To say that the Company was entitled to claim the benefit of those shares would involve this proposition: Where a Board of Directors considers an investment which is offered to their company and bona fide comes to the conclusion that it is not an investment which their Company ought to make, any Director, after that Resolution is come to and bona fide come to, who chooses to put up the money for that investment himself must be treated as having done it on behalf of the Company, so that the Company can claim any profit that results to him from it. That is a proposition for which no particle of authority was cited; and goes, as it seems to me, far beyond anything that has ever been suggested as to the duty of directors, agents, or persons in a position of that kind.*

14.56 In *Canadian Aero Services v O'Malley* (1971), Laskin J reviewed the English, Commonwealth, and US authorities, and said (at 48):

p. 369

> *In holding that … there was a breach of fiduciary duty by [officers of a company for pursuing and capturing a contract for surveying work which their company was actively ↵ seeking to acquire itself, even though the officers had resigned their offices prior to the award of the contract] I am not to be taken as laying down any rule of liability to be read as if it were a statute. The general standards of loyalty, good faith and avoidance of a conflict of duty and self-interest to which the conduct of a director or senior officer must conform, must be tested in each case by many factors which it would be reckless to attempt to enumerate exhaustively. Among them are the factor of position or office held, the nature of the corporate opportunity, its ripeness, its specificness and the director's or managerial officer's relation to it, the amount of knowledge possessed, the circumstances in which it was obtained and whether it was special or, indeed, even private, the factor of time in the continuation of fiduciary duty where the alleged breach occurs after termination of the relationship with the company, and the circumstances under which the relationship was terminated, that is whether by retirement or resignation or discharge.*

14.57 Notice the effect of this ruling: the bright line strictness of the rule is replaced by the very inquiry into a number of factors to determine the good faith and reasonableness of the fiduciary that a strict rule is meant to avoid. One of the main reasons for applying the rule stringently is so as not to make the rule turn on difficult inferences from facts difficult to establish, lest the fiduciary obligations of directors be weakened, in practice, as a result. For an argument that courts should abandon the bright line rule in favour of this sort of inquiry on a case-by-case basis, because of the greater fact-finding ability of the modern court, see Langbein (2005). One might argue that the substantial compensation that directors and senior officers of companies receive partly reflects the fact that they are denied the right to exploit corporate opportunities, even those that the company itself decides to refuse; thus they are compensated for the stringent application of the rule. By contrast, Langbein (2005) argues that the rule should be flexibly applied so as not to discourage entrepreneurial risk-taking.

14.58 In the USA, the courts have similarly developed a 'corporate opportunity doctrine', the purpose of which is to determine which opportunities for profit 'belong' to a company, from which directors may not personally profit (*Guth v Loft Inc* (1939); *Broz v Cellular Information Systems Inc* (1996)).

14.59 In something of a departure from the stringent application of the rule, the PC, in an appeal from Australia, *Queensland Mines Ltd v Hudson* (1978), decided that Hudson, a former managing director of a company who had resigned from the board to take up mining licences personally, which the company had decided, due to its financial difficulties, not to pursue itself, was not liable to account to the company for the profits he earned. The court reasoned that although the opportunity came Hudson's way in his role as a fiduciary to the company, the company board knew of his interest and had given their fully informed consent. This decision directly contradicts both *Regal (Hastings)* and the received wisdom generally, since it is not the directors but the shareholders in a general meeting who are capable of giving such consent.
p. 370 The PC also decided that the good faith rejection of the opportunity placed the opportunity 'outside' the scope of Hudson's fiduciary duty. However, as Sullivan (1979), at 713–714, points out:

> *This [ground for the decision] enables the directors when exercising their managerial prerogative to reject corporate opportunities to thereby remove those opportunities from the restrictions imposed by their fiduciary duties … The orthodoxy is that the director's legal powers of management are subject to the equitable obligations imposed by their fiduciary role; Queensland stands this on its head in allowing a managerial decision to delineate the scope of a fiduciary duty.*

14.60 This aspect of the decision is particularly significant since, if it represents the law, a board's rejection of an opportunity may now be challenged only on the basis that it was not in good faith, raising all the difficulties of proof that such a charge may entail. However, the CA's decision in *O'Donnell v Shanahan* (2009) shows a fondness for the strict application of the rule. The court emphasised a distinction between the rule as it applies to partners (see *Aas v Benham* (1891)) and company directors: the fiduciary duties of a partner may be limited by the terms of the partnership, restricting the ambit of the business opportunities which a partner must pursue only for the partnership; a director's duties are not similarly circumscribed. The nature of a director's duty is akin to a 'general trusteeship' on behalf of the company, and so any business opportunity that comes to a director in the context of his directorship must be pursued only for the company.

14.61 The strictness of the rule as it is applied to directors has been modified by the Companies Act 2006, ss 175(4)(a), 176(4), 177(6)(a). A director's duties to avoid conflicts of interest, not to accept benefits from third parties, and to declare interest in proposed transaction or arrangement are not infringed where the duty is not complied with but the failure to do so 'cannot reasonably be regarded as likely to give rise to a conflict of interest.'

Alternative remedies

14.62 Where a fiduciary competes with his principal, or captures a profit opportunity which he should have captured for his principal, the principal has alternative remedies. If for example, the fiduciary acquires title to assets by doing so, the principal can get a decree from a court of equity requiring the fiduciary to transfer title to them to her. It is in this sense that the courts will say that the fiduciary holds title to these assets on 'constructive trust' for his principal. For example, where the fiduciary incorporates a company to capture the opportunity in which the fiduciary holds all the shares, then the shares will be subject to this trust. But the principal can also elect for an account of profits. The court will require the fiduciary to provide all the necessary information about his dealings with respect to the opportunity he has pursued, and his profits from this enterprise will have to be surrendered to the principal. Note that this is a personal, money remedy. Following the exercise of taking the account of profits, the court will order the fiduciary to pay the money equivalent of the profits he has earned to his principal. Finally, it may be the p. 371 case that the fiduciary is a poor business person, and has earned less than the principal would have done had the fiduciary captured the opportunity for her. In this case the fiduciary can sue for compensation for loss. This is equivalent to common law damages assessed on a 'loss of a chance' basis, and this may be difficult to assess on the facts.

The no profit rule

Authorised profits

14.63 The profit opportunity doctrine is a sub-specification of the broader 'no profit' rule. The no profit rule should really be called the 'no unauthorised profit' rule to account for the fact that fiduciaries are perfectly entitled to charge for their services, as professional trustees and agents do.

The rule in *Cradock v Piper*

14.64 The only true exception to the rule disallowing unauthorised profits is the rule in *Cradock v Piper* (1850). Just like any other trustee, unless authorised by the trust instrument a solicitor-trustee cannot charge for any professional legal work done for the trust. Nor may he retain his own firm to do any such work, because he will indirectly benefit from the firm's revenue (*Christophers v White* (1847)), although he may employ a partner of his firm on the basis that he will receive no share of the profits (*Clack v Carlon* (1861)). Under the rule in *Cradock v Piper*, a solicitor-trustee is allowed his usual charges for litigation work done for the body of trustees, which include himself, so long as his being one of the parties has not added to the expense of the litigation. This limited exception for litigious work is illogical and has not been extended to other cases. The rule is of limited practical importance since any competent solicitor undertaking a trust will insist that the instrument contain an appropriate provision allowing him to charge for his professional services.

14.65 In *Keech v Sandford* (1726) a trustee held a lease for a minor beneficiary, which he sought to renew. The lessor refused to renew the lease in favour of the minor. The trustee took the new lease for his own benefit. Again, note, we have a case where the fiduciary's case was that he could not have obtained the benefit for his principal. King LC required the trustee to hold the lease on trust for the beneficiary. Lord King accepted (at 223) that the consequence of the rule's application was that:

> *the trustee is the only person of all mankind who might not have the lease; but it is very proper that the rule should be strictly pursued, and not in the least relaxed; for it is very obvious what would be the consequences of letting trustees have the lease, on refusal to renew to the cestui que trust.*

The implication of this passage, it is submitted, is that if a trustee were to be able to take the lease for p. 372 himself on the 'no harm, no foul' principle because he could not renew if for ↵ the beneficiary, then many more fiduciaries would come to find that it was 'impossible' to acquire the benefit for their principals and take it themselves. This clearly invokes the no conflict principle, because, as we have seen, in making judgements of whether something is possible here, the fiduciaries own interests are in play, since if he finds impossibility, he can personally benefit from that finding.

14.66 In *Protheroe v Protheroe* (1968) the CA, without a review of the relevant authorities, held that the rule in *Keech* applied to a trustee's purchase of the reversion upon a lease held by the trust so that it was automatically to be held on trust for the beneficiary. While on the authorities this would be a clear extension of the rule, Hayton (1996), 342, argues that the decision is right on a strict application of the no conflict rule, because the trustee would, as landlord, have interests in conflict with his role as fiduciary holder of the lease, or 'trustee-lessee', for the beneficiary.

14.67 The rule is boldly framed in the oft-quoted statement of Lord Herschell in *Bray v Ford* (1896) (at 51):

> *It is an inflexible rule of the court of equity that a person in a fiduciary position … is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict. It does not appear to me that this rule is, as has been said, founded on the principles of morality. I regard it rather as based on the consideration that, human nature being what it is, there is danger, in such circumstances, of the person holding the fiduciary position being swayed by interest rather than by duty, and thus prejudicing those whom he was bound to protect.*

Boardman v Phipps (1967)

14.68 *Boardman v Phipps* (1967) is, perhaps, the most famous case of fiduciaries being stripped of their profits. Although decided by the HL, it is difficult to describe it as a leading case because it is difficult to reconcile the analyses of the five judges, who all gave separate judgments. The case has also been very controversial. The best commentary on the case is Bryan (2012), and your author draws upon it.

14.69 The defendants in the case were Boardman, B, the solicitor who had acted on behalf of the trustees of the Phipps family trust, and Tom Phipps, P, one of the beneficiaries (B&P). The trust held a significant holding in a private company, which was ailing. B&P decided that with new and effective management the company could generate significant profits for the share-holders. There were three trustees of the Phipps trust: a Mr Fox, a Mrs Noble, and the elderly Mrs Phipps who was incapacitated with dementia. B&P dealt mostly with Fox, although Mrs Noble was informed about some of the following.

14.70 The events unfolded in three phases. In phase 1, Fox gave share proxies to B&P to attend shareholders' general meeting to seek information about the company and to elect P to the board, but they failed to elect P to the board, and were not satisfied with the information they received. In phase 2 B&P, p. 373 with Fox's approval, negotiated with the company directors for a splitting up of the business between the Phipps trust holding and the other major bloc of shareholders; this also failed. In phase 3 B&P proposed the idea of making an offer to buy out the other shareholders, so that with these shares and the Phipps trust shares they and the trust would have a controlling interest in the company. Fox was happy for B&P to pursue this plan, and he made it clear that the trustees would not buy any more shares of the company. B&P borrowed money and purchased sufficient shares in their own name to enable them, with the support of Fox using the trust shares, to take control of the company. They were able to sell off certain of the company assets, paying out large dividends while at the same time maintaining a high share price. Tom's brother, John Phipps, another beneficiary under the Phipps trust sued B&P to account for the shares they had purchased and dividends, as profits acquired in conflict of interest with 'the trust'. The HL, by a 3:2 margin, found B&P liable to account.

14.71 There were clearly some difficulties about analysing how B&P were held liable as fiduciaries, and the HL judgments did not really clarify them. Clearly B stood in a fiduciary position as a solicitor to the trustees; but that would not make him a fiduciary to the beneficiaries. Moreover, he was not acting as a solicitor in this endeavour with P. The case was argued and decided on the basis that P should be treated equally with B whatever the outcome, although P, as a beneficiary under the trust, obviously did not stand in a fiduciary relationship to the other beneficiaries just by being a beneficiary himself. At first instance, Wilberforce J held that B&P were agents acting on behalf of trustees, but this agency analysis was not pursued in detail in the HL, which is unfortunate because, as we shall see, it is the key to understanding B&P's liability.

14.72 In the HL Lord Guest held (117G) that B's liability was straightforward:

> *In the present case the knowledge and information obtained by B was obtained in the course of the fiduciary position in which he had placed himself. The only defence available to a person in such a fiduciary position is that he made the profits with the knowledge and assent of the trustees. It is not suggested that the trustees had such knowledge or gave such consent.*

Notice that this statement makes no mention of any conflict; it is just a straight application of the no profit rule.

14.73 On the question of whose consent was required to authorise B&P's purchase of the shares, Lord Guest held it was the trustees, and Lord Cohen said that it was the consent of the complaining beneficiary. Lord Cohen did not wholly rely upon the no profit rule, as if any use of information acquired in the course of dealing on behalf of trust which generated a profit for the fiduciary automatically had to be accounted for, invoking the no conflict rule. He stated (at 103G–104A):

> *[I]n my opinion, Mr Boardman would not have been able to give unprejudiced advice if he had been consulted by the trustees [about acquiring further shares for the trust] and was at the same time*
> p. 374 *negotiating for the purchase of the shares on behalf of himself ↵ and Mr Tom Phipps. In other words, there was, in my opinion, at the crucial date … a possibility of a conflict between his interest and his duty.*

14.74 Lord Upjohn (in dissent), also focused on the no conflict rule (124C):

> *The phrase 'possibly may conflict' requires consideration. In my view it means that the reasonable man looking at the relevant facts and circumstances of the particular case would think that there was a real sensible possibility of conflict; not that you could imagine some situation arising which might, in some conceivable possibility in events not contemplated as real sensible possibilities by any reasonable person, result in a conflict … it has been assumed that it has necessarily followed that any profit made by [a fiduciary] renders him accountable to the trustees. This is not so.*

14.75 Viscount Dilhorne (in dissent) reasoned that when Fox firmly insisted the trust would purchase no further shares, the trustees no longer sought to rely upon Boardman as an advisor as to the shares' value, and that from then on B&P and the trustees acted in a sort of joint venture to get the value out of the company. The essence of Viscount Dilhorne's argument was that a fiduciary can be released from his fiduciary role by his principal(s) (ie the acting trustees) if done in full knowledge of the circumstances, as he believed was the case here; thenceforward the principal is no longer relying on the trustee to make his decisions for him, or rely on his advice. Joint venturers can be in a fiduciary relationship to their co-venturers (**14.15**) and that will be determined by the agreement between them; presumably Viscount Dilhorne impliedly found that B&P were entitled to the profits they obtained under their arrangement with Fox.

14.76 It is submitted that the following analysis makes best sense of B&P's liability. In phase 1, B&B were acting as canvassing agents (**14.19**), to gather information about the company and how its current directors were running it. Trustees are perfectly entitled to instruct agents to gather information and vote the trust's shares if the trustees decide that this would be in the best interests of the beneficiaries, here to try to raise the value of the trust shares. In Phase 2 they acted on behalf of the trustee to negotiate a splitting up of the business, but they were not given any authority to conclude any agreement to do so. That agreement would have had to be entered by the trustees. In both phases 1 and 2 B&P were acting on behalf of the trustees as gratuitous agents, ie not paid contractual agents.

14.77 Phase 3 was the problem: as Viscount Dilhorne argued, Fox and B&P understood their relationship had altered to a kind of partnership/joint venture but this demands an answer to the question: was proper consent given to this alteration in the relationship? There was no clear, common holding by the various judges of what consent the defendants needed to obtain, but your author submits that the following is correct.

14.78 Where there are two or more trustees they must, unless the terms of the trust provide otherwise, act unanimously in the exercise of any of their fiduciary powers to engage agents or enter into a joint venture. In phase 1 there were three trustees, one of whom was incapacitated. The trustees, therefore, could not
p. 375 exercise any of their fiduciary powers unanimously because one of them could not exercise any judgement at all. Thus any exercise of a fiduciary power by the other two trustees was by definition unlawful and invalid. The only solution was to remove the incapacitated trustee under a power provided by the trust terms or by application to the court. (But remember that where the trustees have a duty not requiring the exercise of their judgement to exercise a power (eg to pay the income beneficiary the money representing the trust income) or a duty to perform some other task (eg to keep the trust accounts) the trustees must perform that duty as best they can until such time as the incapacitated trustee is removed.) In such

circumstances, the only consent that would have made the competent trustees' acts lawful would be the unanimous consent of the beneficiaries, which consent would authorise what would otherwise be a breach of trust. But their invalid appointment did not affect the liability of B&P, as they were acting as agents, and might be called '*de facto* agents' or 'agents *de son tort*', in parity of reasoning with *de facto* trustees or trustees *de son tort* (**13.110**).

14.79 To make matters worse, the only person who arguably gave fully informed consent to the new 'joint venture' arrangement was Fox, in January 1957, whilst the incompetent trustee was still alive. Moreover B, who was a solicitor, and P had full knowledge that one of the trustees was incapacitated. Therefore, since the beneficiaries did not consent to the new arrangement, to the defendants' switching from acting as agents for the trustee-shareholders to joint venturers with them, the necessary consent in the circumstances was not obtained.

14.80 The incompetent trustee (who was also the life tenant) died whilst the 'joint venture' was well underway, but B&P did not provide significant information to the beneficiaries, who were now absolutely entitled to the trust assets including the shares in the company, until the agreement under which B&P the defendants were to purchase their shareholding was concluded. For an indication that Boardman belatedly realised that he had not got the necessary consent, see the letter he wrote that was quoted in the HL judgment at 97G–98D.

14.81 Therefore B&P were rightly held liable to account for their profit as *de facto* agents who had not got the consent of their principals, the trustees, to extinguish their duties as agents and become personally entitled under the new 'joint venture' arrangement. Note how the no conflict principle applies in this case: In seeking to turn the agency into a joint venture, B&P were clearly intending to favour their own interests from then on. Whilst there is nothing in principle wrong with changing an agency relationship into a joint venture relationship, an agent cannot do that unilaterally; this requires the fully informed consent of the principal(s); that B&P failed to get, so having failed to get consent to the joint venture arrangement, they retained their role as agents, and it was as agents that this profit opportunity came their way; thus they had to account for the profit. It was irrelevant to the result that under the joint venture the interests of the trustees/beneficiaries and B&P would have been aligned, rather than in conflict. That is so, but the joint venture was never validly created. Although the claim was completely unmeritorious that was irrelevant to the result too.

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The award of an allowance

14.82 At all levels the courts said that B&P had acted in good faith throughout. Although stripped of their profits, B&P were awarded an allowance in respect of their work and skill in raising and realising the value of the shares, and the order was that the calculation of this payment should 'be on a liberal scale'.

14.83 In *O'Sullivan v Management Agency and Music Ltd* (1985) remuneration including a profit element was allowed for management and production companies that had procured a contract from an artist through undue influence, but where their efforts of were clearly in part responsible for the artist's financial success.

14.84 In *Guinness plc v Saunders* (1990) a director who had negotiated on behalf of a company in a takeover bid sought an allowance from the court for his efforts. The HL questioned whether the court should ever authorise exceptional remuneration to a director, since the company articles specifically provided for the payment of directors—the exercise of the courts power to award an allowance 'may be said to involve interference by the court in the administration of a company's affairs when the company is not being wound up' (per Lord Goff at 701). The court would definitely not do so in this case where the director had plainly put himself in a position of conflict of interest by agreeing to provide his negotiation services for a fee the size of which depended on the price his company would pay in the takeover.

Incidental profits

14.85 A typical example of an incidental unauthorised profit is a commission a trustee receives by directing the trust business to a particular company. In *Williams v Barton* (1927), a trustee had a contract with a brokerage firm under which he received a commission on work for clients that he had introduced to them; he was accountable to the trust for the commission he earned by directing trust business to the firm. In *Swain v Law Society* ((1981), CA; rev'd (1983), HL), a solicitor claimed that the Law Society was acting as a fiduciary vis-à-vis solicitors when it procured liability insurance for the profession, and so it held its share of a broker's commission on trust for the members of the Society. The argument succeeded in the CA, but it was decided in the HL that the Law Society was acting under a statutory duty to secure insurance cover and not as a fiduciary for the members; there was, however, no doubt that had the Society been acting as a fiduciary the commission would have been an incidental profit for which it would have been accountable to the members.

14.86 Another example is directors' fees. Trustees must safeguard the trust investments and it will be appropriate and sometimes necessary for a trustee to be appointed to the board of directors of a company in which the trust has a large shareholding (**8.17** et seq). The general rule is that their directors' fees are incidental profits of their position for which they must account to the trust (*Re Macadam* (1946)), unless of course their retention of the fees is authorised. The decision in *Re Dover Coalfield Extension Ltd* (1907) is
p. 377 problematic. In that case, two directors of the Dover company were appointed to the board of the Kent company, in which Dover held shares. In order for the appointments to be effective, the directors were required to hold a certain minimum number of shares in Kent. Sufficient shares were transferred from Dover into their names as trustees for Dover; although the beneficial interest remained with Dover, their legal title to the shares was sufficient to qualify them as directors. The CA held that the directors were not liable to account for their directors' fees. The basis of the decision is unclear, although the judgments seem to rest on two grounds: first, since they became directors of Kent at Dover's request, this amounted to an authorisation from Dover to retain their fees; secondly, because the appointment to Kent was obtained before they acquired Dover's shares in Kent, and the fact that 'they did the work' as directors, the contract between the directors and Kent was a bona fide agreement for their services, ie so that they were not on the board simply as trustee-monitors of Dover's interests.

14.87 In *Re Gee* (1948), Harman J, after reviewing the authorities, explained the law as follows (at 295):

> *[A] trustee who either uses a power vested in him as such to obtain a benefit (as in Re Macadam) or who (as in Williams v Barton) procures his co-trustees to give him, or those associated with him, remunerative employment must account for the benefit obtained. Further, it appears to me that a trustee who has the power, by the use of trust votes, to control his own appointment to a remunerative position, and refrains from using them with the result that he is elected to a position of profit, would also be accountable. On the other hand, it appears not to be the law that every man who becomes a trustee holding as such shares in a limited company is made ipso facto accountable for remuneration received from that company independently of any use by him of the trust holding, whether by voting or refraining from so doing. For instance, A who holds the majority of shares in a limited company becomes the trustee of the estate of B, a holder of a minority interest; this cannot, I think, disentitle A to use his own shares to procure his appointment as an officer of the company, nor compel him to disgorge the remuneration he so receives, for he cannot be disentitled to the use of his own voting powers, nor could the use of the trust votes in a contrary sense prevent the majority prevailing.*

14.88 In *Re Gee*, the trustee-director was not liable to account for his remuneration as a director because the company resolutions to appoint and pay him were unanimously voted by the shareholders, and since there was only a minority of shares held on trust, the resolutions did not turn on the voting of the trust shares—even if the trust shares had been voted against the resolutions, that would not have changed the result.

Secret profits and bribes

14.89 One important subset of incidental profits is what are sometimes called ‘secret’ profits; while the term might be regarded simply as a synonym for unauthorised commission or profits, including, for
p. 378 example, the commission in *Williams v Barton*, it is useful to restrict the term to bribes and hidden commissions that the trustee knowingly obtains in bad faith. These latter cases are cases of the fiduciary’s breach of the GFDL, not the FDL. As we shall see, this has often failed to have been recognised, especially in clear cut bribe cases.

14.90 In *A-G for Hong Kong v Reid* (1994), Reid, the acting Director of Public Prosecutions, accepted bribes to obstruct the prosecution of criminals. Reid was liable to account for the bribe money to the Crown. Lord Templeman said (at 331, emphasis added):

> Where bribes are accepted by a trustee, servant, agent, or other fiduciary, loss and damage are caused to the beneficiaries, master, or principal whose interests have been betrayed. *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 Mr Reid in return for bribes cannot be quantified.*

In the emphasised passage, Lord Templeman appears to treat anyone who is subject to the GFDL as a fiduciary, which is just wrong, as we have seen (**14.4**–**14.7**).

14.91 In *Islamic Republic of Iran Shipping Lines v Denby* (1987), a solicitor accepted a 'commission' of $200,000 from the opposite side for securing the settlement of a legal action brought by his client. Leggatt J said (at 370), '[w]hat he received was, quite simply, a bribe', and he was liable to pay the sum to his client. We shall return to the nature of bribes and the liability for taking them (**14.96**).

The nature of the no profit rule

14.92 Smith has argued that the 'no profit' rule is a 'free-standing' rule, separate from the 'no conflict' rule. Smith (2013a), 261–262, says:

> *[The no profit rule] is a direct implication of the fact that a fiduciary acts, within a sphere of activity, for and on behalf of the principal. The implication is that whatever may be extracted from that sphere of activity is attributed, as between the fiduciary and the beneficiary, as a matter of primary right, to the beneficiary; including that which was extracted without authority, should the beneficiary so choose.*

14.93 Smith is correct to note that the no profit rule is 'direct' in the sense that a principal does not have to prove any specific conflict of interest in cases where she invokes the rule to strip her fiduciary of a profit. But, pace Smith, in your author's view this does not sever the connection between the no profit rule and the no conflict principle, because the no profit rule responds to the way that an opportunity to profit, if a fiduciary was allowed to pursue it, would give rise to cases as in *Keech* and *Cooley* where the fiduciary must *judge* whether the profit is really impossible to obtain for her principal. What appears to motivate Smith's claim seems to be the idea that, for example, in Boardman, the trustees'/beneficiaries' interests and B&P's interests not in actual conflict, indeed were aligned under the joint venture, and everyone profited handsomely. The same point can be made about *Regal (Hastings)*.

p. 379 **14.94** Where Smith and your author differ turns on two considerations. For Smith, the no profit rule applies to any gain the fiduciary made within the 'scope' of the fiduciary relationship. That is correct, but it would appear not to apply to all gains, the clearest example being a bribe. It is hard to see how taking a bribe *could* fall within the scope of the fiduciary relationship. The same thing, your author would say, applies to 'incidental profits' (**14.85** et seq). The idea is that neither of these gains are ones which the fiduciary is tasked to acquire for the principal as a feature of the fiduciary relationship. Now, Smith can certainly counter this thought with the argument that your author has construed the scope of the fiduciary relationship too narrowly; rather, Smith would contend that any profit opportunity that comes the way of the fiduciary on a 'but for' causal basis—ie that the profit would not have come the fiduciary's way but for his appointment as a fiduciary—is captured. It would be fair to say that this attitude is expressed by many judges and commentators. That would almost always bring in incidental profits and bribes. You must judge which is the better view. The second difference between us is about whether it is correct to say that because the claimant does not have to plead or prove a 'conflict of interest' where the rule applies, this shows that the 'conflict principle' does not form part of the rationale for the rule. Again, this is a matter of judgement upon which you will have to decide for yourself, in particular by judging whether your author has coherently related the principle to the rationale of the judgments in *Regal (Hastings)* (**14.49**), *Keech* (**14.65**) and *Boardman* (**14.68** et seq), all classic 'no profit' cases.

A penalty not a punishment

14.95 It is sometimes felt that because the rule can give rise to harsh results, as is sometimes felt about the result in *Boardman*, that the rule can, in some cases, amount to a kind of private law punishment. But this is misconceived. It is better regarded as a kind of penalty for not playing by the rules (Penner (2021a)). You are stripped of the profit, however innocently you acquire it, not to punish you, but because you acquired it outside the rules. It is no different in principal from disallowing a goal in association football because the striker was offside.

Should the liability to account be personal or proprietary?

Bribes

14.96 A person is bribed when he is offered a benefit to act disloyally in relation to another. A hitman who receives money from A to kill B is not being bribed. He is just being paid to commit a wrong against B. A bribe can be made to anyone subject to the GFDL, and it is a breach of that if the bribee (the person bribed) acts on it to wrong the person to whom he owes the GDFL. This has nothing to do with the fiduciary relationship or a breach of the FDL. Stripping the bribee of the bribe is a private law penalty because, bribes p. 380 are not gains by the disloyal person to which the person owed a GFDL was antecedently entitled, in contrast to the case where a fiduciary takes up a profit opportunity which she ought to have captured for her principal. Bribes should never be pursued nor taken by anyone, ever, and when the person to whom the GFDL is owed strips the gain from the bribee, this is not a claim over property she otherwise should have received. This is a clear case of gain-stripping for committing a particular kind of wrong, a disloyal breach of obligation. As between the bribee and the one to whom she owes a duty of loyalty, the latter is entitled to the value of the bribe only for the reason that the bribee is disentitled from taking or keeping it.

14.97 Because of the confusion of the GFDL and the FDL, in bribes cases, as in perhaps, *Reid* itself, the courts have sought to find the bribee was a fiduciary of some kind. This happened in *Reading v A-G* (1951). A sergeant in the British Army stationed in Egypt assisted smugglers by riding in their lorries wearing his uniform so that they would not be stopped at check points. The British authorities seized £20,000 of the money he was paid for these services. In an action to recover the money Reading argued that while he had obtained it wrongfully, the Crown had no right to retain it; the HL held that as a non-commissioned officer he stood in a fiduciary relationship to the Crown and therefore he was liable to account to the Crown for any profits he obtained by the misuse of his position. Only on the very strained rationale that Reading, by wearing his uniform, had the practical power to affect the Crown's practical interests, by affecting the reputation of the Crown in Egypt, could Reading be regarded as a fiduciary. Much the better explanation is simply that the terminology of fiduciary was fictitiously applied to Reading in order to provide a basis for stripping him of his ill-gotten gain, ie to treat it as an 'unauthorised profit'.

14.98 So how should the law deal with bribees? Take the case of a non-fiduciary who is bribed, but who breaches his GFDL, like a warehouse security guard who takes a bribe to admit the burglars. It is idiotic to bend the rules of fiduciary law to impute to him a fiduciary status (which he 'undertakes' by committing the wrong—that is nonsensical) and then say he has to 'account' for his 'profit' as if the bribe was something that, within the scope of his employment, he had a liberty, power or duty to acquire for his employer. Much better to be upfront about this and acknowledge this as a private law penalty. Or, depending on the proper scope of the law of restitution, this could be conceived of as a claim for 'restitution for wrongs' (see Jones (1968)).

Other unauthorised gains

14.99 Where a trustee is liable to account for an unauthorised profit, one might understand this as a claim that the trustee has failed to bring trust property into the account. That is, his liability to account is simply a recognition of the fact that the property is trust property in his hands for which he has not properly accounted, ie included in the trust accounts as an addition to the trust funds, and thus the beneficiary's claim amounts to a claim to specifically enforce the trust over that property. It would follow from this
p. 381 analysis that the particular profit, as trust property, is held on trust for the beneficiary from the moment the trustee receives it—as the beneficiary's interest in the trust is an interest in a fund, the interest will comprise all those items of property that from time to time are 'captured' by the trust. In your author's view this is the best explanation of the result in *Keech*, *Cooley*, *Regal (Hastings)*, and other cases under the 'profit opportunity doctrine'. Goode (1991) refers to these gains which can only be pursued on behalf of the fiduciary's principal as 'deemed agency gains'.

14.100 It is important to realise that on this view the property should be regarded as being held under an express trust, the express trust under which all of the other trust property is held. Such a profit would stand on the same footing as would the proceeds of the sale of any of the trust property, or the income from trust property, which a trustee might wilfully or inadvertently have paid into his own bank account. Such property, just like capital proceeds or income, is captured by and is within the terms of the express trust. On this view, then, there is no question of the court's imposing a constructive trust on the particular profits or the income earned on it, and of course the profit can be traced into the proceeds of substitutions. The trustee will, of course, also be personally liable to the trust for the value of the property if it has disappeared or cannot be traced, because that will be how he will satisfy the account if he cannot do so with the actual property itself or its traceable proceeds.

14.101 But this perspective cannot apply easily to all fiduciaries, because as I have rather pounded into the reader's head, not all fiduciaries are trustees (**2.34**; see further Penner (2014d)). Indeed, not all fiduciaries are even accounting parties, much less trustees. An accounting party is someone who is obliged to render an account. Apart from trustees, accounting parties are generally so as a matter of contract. A book publisher has to account to an author for the sales of the book, for this is the basis upon which the author receives his royalties. But the publisher is not a trustee, holding the proceeds of book sales on trust to give the author his cut. The publisher is just personally liable to 'account for', ie pay over, the right amount based on the sales figures. Neither, in this case, is the publisher a fiduciary to the author. The publisher is not acting as an agent, entering into book sales on the author's behalf. The publisher sells its own books, and the author is merely contractually entitled to be paid on the basis of the publisher's sales. So a liability to account is not purely the province of fiduciaries, nor is the liability to account necessarily proprietary. A true agent may sell his principal's property but not be obliged to hold those proceeds on trust. As we have seen, this issue commonly arises in the case of collecting agents (**5.86** et seq). Now we can see that not all fiduciaries are accounting parties. A solicitor is a fiduciary to his client, but unless he is dealing with his client's property—holding its money in his client account for example—he is not an accounting party because his service is to provide legal advice, not to manage his client's property or sell his client's goods on his client's behalf.

14.102 The essence of the fiduciary relationship does not lie in the stewardship of property—it lies in the p. 382 fiduciary's discretionary powers to alter his principal's legal position. And so, in determining whether the fiduciary holds any unauthorised profit on trust, or rather is personally liable to pay over the value of such a profit, we should look to the basic rationale of the fiduciary's liability for unauthorised profits. We will return to this following a review of the way that the courts have dealt with the issue.

14.103 Prior to the UKSC decision in *FHR European Ventures v Cedar Capital Partners* (2014) it was unsettled whether a fiduciary held an unauthorised profit on trust, and there was authority going both ways. As we have seen, in *Reid* the UKPC decided that the recipient of a bribe held it on trust for his principal. But the reasoning in the case was criticised, in your author's view persuasively (see Penner (2019), 13.111—13.116; Crilley (1994); Swadling (1997)).

14.104 Nevertheless, in *FHR*, Lord Neuberger, giving the unanimous judgment of the court, followed *Reid*. The defendant was an agent who negotiated the claimant's purchase for about €200m of a hotel in Monaco. The defendant was entitled to receive on the sale a commission of about €10m under a brokerage agreement with the hotel owner, and at trial the judge found that the defendant had not sufficiently disclosed the right to the commission to the claimant, so finding that this was an unauthorised profit for which the defendant was liable to account to the claimant, and this finding was not appealed. The UKSC held that the defendant held this commission on trust for his principal. It is important to note that, unlike Reid, this was not a case of a bribe, although in his judgment Lord Neuberger did not seem to distinguish between bribes and undisclosed commissions.

14.105 The reasoning in the decision is less than satisfactory. The court quite rightly showed that there were lines of authority going both ways, and so the court had to decide on the basis of principle and, perhaps, policy. But the discussion of principle was not thorough, and it seems the court adopted the rule that any unauthorised profit should be held on trust because of its simplicity and clarity. But it is one thing for equity to require a fiduciary to hold on trust a profit acquired by misappropriating his principal's property, or the income arising on it, and quite another thing to do the same for any property acquired in an unauthorised fashion, especially in the case of someone like Reid who was not an accounting party at all, much less a trustee; in the case of a non-accounting party like Reid, there was no prior basis in his relationship with the Attorney-General of Hong Kong that would of itself justify his having to hold anything he received and was accountable for on trust for the Attorney-General. Furthermore, if the evil in the case which needed a remedy was bribery (amongst the opening lines of Lord Templeman's judgment one finds (at 330H): 'Bribery is an evil practice which threatens the foundations of any civilised society') then it is one which can be and is committed by non-fiduciaries; it is a breach of the GFDL.

14.106 Moreover, consider this sort of case: a fiduciary agent who is liable to account personally on a regular basis, say half-yearly, receives an unauthorised commission from a third party. Realising he cannot keep it for himself, he records it in his accounts and pays it over at the next accounting date.

p. 383 According to *FHR*, he does wrong here. Because it is unauthorised, he cannot account for it like any other gain he makes for his principal, but must treat this particular gain as special, segregating it and holding it on trust. On what principle of justice does this make sense?

14.107 What, after all, is the rationale for stripping the fiduciary of his unauthorised profit? It cannot be to compensate the principal for a loss, because in most cases (there are exceptions that we shall consider in a moment) the principal does not suffer any loss when his fiduciary acquires an unauthorised profit, earning a commission or directors' fees or taking a bribe: the rule applies across the board to all unauthorised profits. Rather, the rationale is to strip the fiduciary of any gain he earns in conflict of interest: this is typically called a 'disgorgement' remedy, and its purpose is to ensure that the fiduciary who places himself in a situation of conflict of interest cannot benefit thereby. It is a rule put in place to prevent fiduciaries from personally profiting in an unauthorised fashion, not to generate any extra resources for the principal. The goal of the rule is that fiduciaries never earn profits of this kind in the first place, not to create a new source of revenue for their principals when they do.

14.108 Understanding this 'prophylactic' nature of the rule explains why it is often questioned why the principal should have the right to the profit anyway—should it not be forfeited to the state, as proceeds of a wrong? Why shouldn't the Attorney-General as representative of the Crown have the right to claim the profit? The most compelling justification for according the right to the principal is simply that, as a matter of private law rights, he is the only appropriate plaintiff, because he has been wronged by the fiduciary's act, and although the principal suffered no loss, if given the incentive of claiming the profit, he will be likely to enforce the claim and strip the fiduciary of the profit. Understood this way, the rationale for stripping the fiduciary's profit follows the maxim 'No one should profit from his own wrong', and the principal's claim is one for 'disgorgement' or 'restitution'; it is, in short, a private law penalty (**14.95**).

14.109 It is submitted that the primary remedy against the fiduciary should be personal, not proprietary. Consider the consequences in the context of insolvency. If B has the obligation to pay A money, and B goes bankrupt, then A is an unsecured creditor; if B has breached his fiduciary obligations to A and has earned a profit from a third party in doing so, our goal should be to ensure that B does not profit from his wrong against A. In order to accomplish that there is no need for A to acquire a proprietary interest in those profits, for that simply allows A to gain a priority over B's other creditors when B, *ex hypothesi*, has not appropriated or interfered with A's property. Where a trust is automatically imposed on B's unauthorised profit, A gains an unjustified advantage merely because the obligation that was breached was a fiduciary one; it is difficult to say that A's right to the profit is any more compelling than C's common law right to be paid by B for the property C has provided B under a contract, thereby increasing the value of B's estate, or D's common law right to be compensated for B's running him down with his car, because in this case B's wrong has caused D to suffer an actual (monetarily quantifiable) loss at B's hands. C and D have no proprietary claim, of course. (See further Swadling (2005a).) This is compounded by the 'bent' tracing rules that apply in the case of a wrongdoer (**12.14–12.15, 12.64**).

p. 384 **14.110** A useful thought experiment is always to ask what should happen if the 'unauthorised profit' or bribe is stolen before the principal has a chance to claim it. If the money is really trust money, then the principal's claim should lapse with the theft, because the theft was of his property; if you think the principal should be able to sue the false fiduciary for the value of the bribe regardless, then it was the taking of the bribee's money that occurred, not any 'theft' or 'misappropriation' of any particular 'trust asset'. (And note, you cannot have it both ways.)

Further reading

Bryan (2012)

Conaglen (2007)

Crilley (1994)

Edelman (2010)

Ho (1998)

Miller (2011, 2013, 2014)

Millett (1998a)

Penner (2012, 2014c, 2014d, 2019b, 2021)

Smith (2003b, 2013a, 2014a, 2017)

Swadling (1997)

Valsan (2016)

Weinrib (1975)

Must-read cases: *Keech v Sandford* (1776); *Re Gee* (1948); *Boardman v Phipps* (1966); *Regal (Hastings) Ltd v Gulliver* (1942); *Holder v Holder* (1968); *A-G for Hong Kong v Reid* (1993); *FHR European Ventures v Cedar Capital Partners* (2014)

Self-test questions

1. What is the good faith duty of loyalty (GFDL) and to whom does it apply?
2. What is the fiduciary duty of liability (FDL) and to whom does it apply?
3. What is the 'discretionary theory' of fiduciary powers? What does 'discretion' mean under this theory?
4. What is the no conflict principle, and how does it relate to the following doctrines?

    An advising fiduciary's duty to reveal a conflict of interest

    The self dealing rule

    The fair dealing rule

p. 385 ↵ The duty not to compete with one's principal

The profit opportunity doctrine

The no profit rule

5. What is the '*Brickenden* rule', and should it be maintained?
6. Ernest is a director of Nuform, a sports clothing company. In 2018 in the course of his duties Ernest discovered a Thai supplier who could manufacture sport clothing at a significantly lower price than Nuform's current suppliers. Without informing the board of Nuform, Ernest incorporated Superwear Ptd Ltd, and entered into a contract with the Thai supplier in direct competition with Nuform. Nuform discovered these facts in 2021. Discuss Ernest's liability in relation to his director's fees, 'equitable compensation', an account of profits, and the award of an allowance for skill and effort.
7. Cheng Han is a 'finder', someone who brings parties together so that they can enter into lucrative business deals. Jean tells Cheng Han that she's interested in investing in technology start-ups. Cheng Han researches the possibilities and finds Jeremiah and Benjamin, two young engineers who have just patented a process to desalinate water efficiently. Cheng Han tells Jean he has found something, and tells her he will bring the start-up people together with her on the basis that she will pay him a commission of 5 per cent of the value of any investment she makes. Jean agrees to these terms. Cheng Han tells Jeremiah and Benjamin that he will bring an investor to them, on the basis that they will pay him a commission of 5 per cent of the value of any investment the investor makes. They agree to his terms. Cheng Han does not disclose his commission agreement with Jean to Benjamin and Jeremiah, nor to Jean his commission agreement with Benjamin and Jeremiah. Cheng Han introduces Jean to Benjamin and Jeremiah, and without Cheng Han's involvement, they negotiate for Jean to make an investment of $10m. Jean, Benjamin, and Jeremiah discover the other's commission agreement with Cheng Han, and both sides refuse to pay him his commission. Advise Cheng Han. Would your answer differ if Cheng Han advised Benjamin and Jeremiah in their negotiations with Jean?
8. Andrew is a farmer, who farms his own land and also manages and farms the land of Frank. Andrew recently purchased a load of seed cheaply, and now realises it is more than he can use on his own farm. He plants a ton of the seed on Frank's land, and charges Frank the going price, making a profit of £600. An agent of Superseeds Ltd rings up Andrew at his manager's office on Frank's farm and asks whether Frank will grow a new genetically modified tomato Superseeds has developed. Frank has a policy against growing genetically modified crops, and Andrew offers to grow the tomato on his own farm. The crop does spectacularly well, earning Andrew a profit of £20,000. Finally, Andrew offers to purchase half of Frank's acreage. He provides Frank with the accounts of his management of Frank's farm; they are in such disarray that it is impossible to determine how profitable the operation is, but Frank sells anyway. Advise Frank.
9. **p. 386** Arthur is the director and chief operating officer of Smartco, a clothing manufacturer. In 2015, he purchased, on behalf of the company, £15,000 worth of fabric from a company in which both he and his wife have a major shareholding. Later in the same year, he moved the head office of Smartco to Guildford, in Surrey, where he lives, so as to reduce his need to commute. The move cost the company approximately £150,000. In early 2017, Smartco acquired a controlling interest in Splash Ltd, a swimwear manufacturer, and Arthur used the Smartco shares in Splash to vote himself on to Splash's board of directors, taking £10,000 director's fees. As a director of Splash, Arthur discovered it was undervalued, and purchased the remaining shares of Splash for himself. Following a reorganisation of Splash largely brought about through Arthur's efforts, its shares have increased in value by 50 per cent. Advise Smartco.

10. In what circumstances, if any, should a fiduciary hold any unauthorised profit on constructive trust for his principal?

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