

THE CONSEQUENCES OF FIDUCIARY ACCOUNTABILITY: *VIRES* AND VIRTUE

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In Defence of the Strictness of Fiduciary Accountability

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1. Introduction

The strictness of a fiduciary's obligation to account for profits is well-known. The objective here is to offer a defence of the strictness of that requirement against doubts that have been raised about it in various fora.

(a) Critiques from academic commentators

J Lowry & R Edmunds, 'The Corporate Opportunity Doctrine: The Shifting Boundaries of the Duty and its Remedies' (1998) 61 *Modern Law Review* 515, 517

(But see *Boardman v Phipps* [1967] 2 AC 46, 124 and Companies Act 2006, s 176(4).)

(b) Judicial doubts

How complete is the obligation to account where a breach of fiduciary duty has been made out? Should it be considered relevant that the fiduciary has acted in good faith or in the best interests of the beneficiaries?

See, e.g., *Strother v 3464920 Canada Inc* [2007] SCC 24 at [154]-[155], [2007] 2 SCR 177 (referring to D Hayton, 'Unique Rules for the Unique Institution, the Trust', in S Degeling and J Edelman (eds), *Equity in Commercial Law* (2005), 279, at 284, although McLachlin CJ has misunderstood Hayton's argument)

Importantly, however, see also *John Taylors v Masons* [2001] EWCA Civ 2106 at [41], [2005] WTLR 1519 and *Murad v Al-Saraj* [2005] EWCA Civ 959 at [82] & [121], [2005] WTLR 1573

(Note the jurisdiction to make equitable allowances: *Boardman v Phipps* [1967] 2 AC 46; *Warman International Ltd v Dwyer* (1995) 182 CLR 544.)

Thus, the question to be considered is whether, aside from the doctrine of equitable allowances, should the Supreme Court be prepared to recognise the possibility of a fiduciary not being required to account for all of the profits that he has been found to have made in breach of fiduciary duty?

2. Analysis

The central proposition that I seek to defend is that the law should not change in that way. I offer both positive and negative reasons for that view.

(a) Positive Justification for the Current Position

The fundamental purpose of fiduciary duties is to provide a subsidiary and prophylactic form of protection for non-fiduciary duties.

See Conaglen, *Fiduciary Loyalty: Protecting the Due Performance of Non-Fiduciary Duties* (Hart Publishing, 2010)

Fiduciary doctrine is based on a cynical view of human nature and the fact that inconsistent temptations create a risk of non-fiduciary duties being breached.

Bray v Ford [1896] AC 44, 51

The purpose of imposing a strict obligation to account for profits made where there is a conflict between duty and interest is to deter fiduciaries from acting in such situations.

Murad v Al-Saraj [2005] EWCA Civ 959 at [74], [2005] WTLR 1573

It increases the temptation that a fiduciary faces if courts are prepared to hear arguments that the fiduciary has acted objectively in the best interests of the principal – or even that the fiduciary honestly believed that he was so acting.

R Flannigan, ‘The Strict Character of Fiduciary Liability’ [2006] *New Zealand Law Review* 209, 210

That subverts the protective function that fiduciary doctrine is designed to serve.

(b) Defence of the Current Position

Langbein offers a cost-benefit analysis of the fiduciary conflict principle, which he says shows that the principle imposes too high a cost because it prohibits transactions that are beneficial to the fiduciary’s principal as well as non-beneficial transactions.

JH Langbein, ‘Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?’ (2005) 114 *Yale Law Journal* 929, 951

This view misrepresents the true basis for the fiduciary conflict principle, which is the reduction of risk rather than the identification of harm.

More importantly, however, Langbein’s cost-benefit analysis is skewed to his purpose. In particular, in assessing the cost element of the principle, Langbein ignores the possibility of authorisation being obtained. When that is taken into account, the true cost of the principle is much reduced, as it only creates cost where consent cannot be obtained, or cannot be obtained other than at very high cost.

The benefit side of the analysis is represented by the protection that fiduciary doctrine provides to non-fiduciary duties (see (a) above).

There is no reason to think that human nature has changed since fiduciary doctrine was formulated into its current doctrine.

Lindsley v Woodfull [2004] EWCA Civ 165 at [30], [2004] 2 BCLC 131

3. Conclusions

This suggests that the focus of the debate should not be on whether a new defence should be introduced, but rather on whether the existing mechanisms for getting authorisation are sufficient.

Thoroughly unempirical inquiries suggest that the current position in that regard is satisfactory.

If it is not, then perhaps the jurisdiction under the Administration of Justice Act 1985, s 48 could be extended to cover cases like this. Alternatively, and preferably, a default authorisation mechanism could be inserted into the Trustee Acts.

Either way, it is better to focus on the fitness for purpose of the authorisation mechanisms than on the solution mooted in *Murad v Al Saraj*. This encourages regularisation of the transaction by authorisation whereas the alternative approach encourages fiduciaries to take a risk on the basis that it might pay off in the long run. The latter attitude runs directly counter to the attitude that fiduciary doctrine seeks to instil in fiduciaries.

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