"[T]o say that a Man is a Fiduciary only Begins Analysis"[1] — The Shifting Boundaries of Fiduciary Liability

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Introduction

Equity is in a state of flux. Firmly held views — indeed, those held for generations — have recently been placed under the judicial microscope. In particular the notion of fiduciary liability is under examination. The concept of the fiduciary has been extended to a venturer and co-venturer,[2] manufacturer and distributor,[3] banker and customer,[4] liquidators,[5] stockbrokers[6] and even employees.[7] The Canadian courts have also extended the notion of fiduciary obligations to hold that a parent owes a fiduciary obligation which extends to not committing incest.[8] Australian courts have recently expanded the notion of fiduciary obligations to the relationship between the government and its indigenous people.[9] One of the central

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1 *SEC v Cheney Corporation* 318 US 80 (1943), at 85.

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2 *LAC Minerals Ltd v International Corona Resources* (1989) 61 DLR (4th) 14; *Dempster v Mallina Holdings Ltd* (1994) 15 ACSR 1. On joint venturers see Corcoran and Tucker "Joint Venturers as Fiduciaries", [1989] 2 *C & B LJ* 34

3 *Watson v Dolmark Industries* [1992] 3 NZLR 311.

4 *Commonwealth Bank of Australia v Smith* (1991) 102 ALR 453; cf. *Bowkett v Action Finance Ltd* [1992] 1 NZLR 449.

5 *Re Bruton Pty Ltd* (1990) 2 ACSR 277; *Re Excel Finance Corp Ltd* (1993) 41 FCR 346

6 *Daly v Sydney Stock Exchange* [1982] 2 NSWLR 421.

7 *Reading v A–G* [1951] AC 507; *Timber Engineering v Anderson* [1980] 2 NSWLR 488; *Warman International Ltd v Dwyer* (1992) 46 IR 250

8 *M(K) v M(H)* (1992) 96 DLR (4th) 289.

9 *Mabo v State of Queensland* (1992) 175 CLR 1; in Canada see the decision of *R. v Sparrow* (1990) 70 DLR (4th) 385.

reasons for this expansion within Equity has been the influx, increase and general acceptance of Company Law[10] and the Law of Restitution.[11]

This article seeks to extract and reconsider, in the light of these developments, the fundamental principle of equity that fiduciaries are to be held strictly liable, (irrespective of their *bona fides*, and without regard to whether or not the company or trust could itself afford to exploit the particular opportunity in question), if they breach their fiduciary duties by personally profiting from their position. The traditional view was succinctly stated by Deane J in *Chan v Zacharia*[12] who said that a fiduciary, in these circumstances:

> "must account... for any benefit or gain which has been obtained or received in circumstances where a conflict or significant possibility of conflict existed between his fiduciary duty and his personal interest in the pursuit or possible receipt of such a benefit or gain."[13]

The antecedence of this principle is *Keech v Sandford.*[14] The essential reason for the rule was to procure loyalty in service by the holder of the fiduciary duty. What was being protected was the vulnerability of the client to the solicitor, the partner to the co-partner and the company to the director. This rule has been so regularly stated by the Courts[15] that

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10 In cases of company directors taking up a business opportunity that might have been taken by the company (even where the company rejected the opportunity). The leading equity textbook suggests that there is a "more benign attitude to directors": H G Hanbury & J E Martin, *Modern Equity*, 14th ed London: Sweet & Maxwell, 1993, at 590. Compare, for example, *Regal (Hastings) Limited v Gulliver* [1967] 2 AC 134 with *Queensland Mines Limited v Hudson* (1978) 18 ALR 1. See also Goode "The Recovery of a Director's Improper Gains: Proprietary Remedies for Infringement of non-proprietary Rights" in E McKendrick (ed) *Commercial Aspects of Trusts and Fiduciary Obligations*, Oxford: Clarendon, 1992.

11 See, for example, *Lipkin Gorman v Karpnale Limited* [1991] 2 AC 548. This case bolsters the argument in favour of strict liability claims for knowing receipt of trust property: see P Birks "Misdirected Funds: Restitution from the Recipient" [1989] *LMCLQ* 296. See also P Birks "The English Recognition of Unjust Enrichment" [1991] *LMCLQ* 473 and Watts "Restitution", [1991] *New Zealand Recent Law* 419. More generally see Goff and Jones *The Law of Restitution*, 4th ed London: Sweet & Maxwell, 1994; P Birks *An Introduction to the Law of Restitution*, Oxford: Oxford, 1989; A S Burrows *The Law of Restitution*, Sydney: Butterworths, 1993.

12 (1984) 154 CLR 178.

13 Id, at 199. As to whether directors can be properly regarded as trustees in this context see *Selangor United Rubber Estates Ltd v Cradock (No. 3)* [1968] 1 WLR 1555, at 1575 in which Ungoed-Thomas J said "...even though the scope and operation of such obligation differs in the case of directors and strict settlement trustees, the nature of the obligation with regard to property in their hands or under their control is identical... That is why a misapplication of it is equally in each case a breach of trust." See, also, *Belmont Finance Corporation v Williams Furniture* [1980] 1 All ER 397. See also L S Sealy "The Director as Trustee" [1967] *CLJ* 83 who criticises the notion that the director is a fiduciary.

14 (1726) Sel Cas t King 61; 25 ER 223.

15 See *Aberdeen Railway Co v Blaikie Brothers* (1854) 1 Macq. 461; *Bray v Ford* [1896] AC 44; *Regal (Hastings) Ltd. v Gulliver* [1942] 1 All ER 378; [1967] 2 AC 134; *Phipps v Boardman* [1967] 2 AC 46.

until recently it was viewed as a sacrosanct cornerstone of the equitable rules governing the liability of company directors and trustees alike. Such deference may arise from Lord King's admonition that the rule "should be strictly pursued, and not in the least relaxed."[16] In essence the rule was an absolute proscription.[17]

Recent cases have, however, challenged this orthodoxy,[18] no doubt influenced by Professor Jones' seminal article, written in the immediate aftermath of the House of Lords decision in *Phipps v Boardman*.[19] Professor Jones puts forward a staunch defence of Lord Upjohn's minority judgment.[20] Lord Upjohn reasoned that equity's strict rule made harsh law, and this was nowhere more apparent than on the facts before him. His Lordship argued that:

> "[T]o extend the doctrines of equity to make the appellants accountable in such circumstances is... to make unreasonable and inequitable applications of such doctrines."[21]

So, certainly in the latter half of this century, some judges have moved towards a position of considering the purity of the fiduciary's motives.[22] This seems to receive endorsement by Danckwerts LJ in *Holder v Holder*.[23] His Lordship rejected the reasoning of Lord Eldon in *Ex p. Lacey*,[24] who had argued that a breach of fiduciary duty must necessarily attract strict liability since, given the subjective nature of the concept of bad faith, it is impossible to determine a trustee's *fides*. Danckwerts LJ dismissed this

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16 (1726) Sel Cas t 61, at 62; 25 ER 223, at 223.

17 As stated by R Teele "The Necessary Reformulation of the Classic Fiduciary Duty to Avoid a Conflict of Interest or Duties", (1994) 22(2) *ABLR* 99, at 100: "[The rule] was strictly enforced, allowing no defence other than fully informed consent after disclosure. The fiduciary was held liable even if there was only a remote possibility of conflict between personal interest and duty. The classic fiduciary standard can therefore be described as an absolute proscription".

18 For recent divergence from the accepted wisdom see *Island Export Finance Ltd v Umunna* [1986] BCLC 460, and *Balston Ltd v Headlines Filters Ltd* [1990] FSR 385 discussed infra. See J P Lowry, "*Regal (Hastings)* Fifty Years On: Breaking The Bonds of The *Ancien Regime*", (1994) 45 *NILQ* 1.

19 Supra, at n 15. G Jones "Unjust Enrichment and the Fiduciary's Duty of Loyalty", (1968) 84 *LQR* 472.

20 Id, at 483–487.

21 [1967] 2 AC 46, at 133–134.

22 See, for example, *Manufacturers Trust Co v Becker* 338 US 304, 70 SCt 127 (1949); the judgment of Lord Greene in the Court of Appeal's decision in *Regal (Hastings) v Gulliver*, unreported, Court of Appeal, 15 February 1941; *Peso Silver Mines v Cropper* (1966) 56 DLR (2d) 117; *Consul Development v DPC Estates* (1975) 49 ALJR 74; *Queensland Mines v Hudson* (1978) 52 ALJR 399. These decisions are discussed infra. See also the cases cited at n 15 supra.

23 [1968] Ch 353.

24 (1802) 6 Ves 625, at 626.

contention, stating that it:

> "... seems less persuasive in the light of Lord Bowen's famous dictum that "the state of a man's mind is as much a fact as the state of his digestion,... and the almost daily experience of any judge engaged in ascertaining the knowledge and intentions of a party to proceedings."[25]

Such a position reflects the tension in equity between the capitalist principles of profit making (although not at any expense), on the one hand, and the strict rules governing liability which are inexorably imposed by equity, on the other. As a result of this recent tension, the Commonwealth courts have tended to relax the duty. The suggested proposition is that, as commercial situations get more complex, the strict rule exemplified in the earlier cases cannot be justified. It is evident that the courts in England, Australia, and Canada have demonstrated a willingness to ignore the confines of what was previously an absolute proscription. Furthermore, they have moved towards requiring some connection between the business of the company and the alleged conflict of interest. Arguably, they are considering the commercial morality of the conduct and proceeding from there to determine if liability should be attached. The approach of the courts has been to formulate an 'expanded business opportunity' test based on the bona fides of the commercial fiduciary. This doctrine, first put forward by Austin,[26] has recently gained significant credence.[27] This new approach is very different to the inflexibility of the strict rule.

In this article we shall begin by considering the reasons for the strict rule exemplified in the early cases and then go on to delineate how the strictness of the *Keech v Sandford* approach has ameliorated in recent years. This demonstrates that the correct approach of the courts is to supplement the equity judge's discretion with a formulation to determine the liability of the commercial fiduciary on the basis of intent. Such intention should be considered in the light of any undertakings made and contemplated by the corporate entity.

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[25] Supra, n 21, at 398.

[26] R P Austin "Fiduciary Accountability for Business Opportunities", 141 in P D Finn, *Equity and Commercial Relationships*, Sydney: Law Book Company, 1987. He comments at 159; "What is involved, of course, is not a radical departure from the present authorities. All that is needed is for courts to recognise that a special formulation is appropriate as a test of the circumstances in which a full-time executive commercial fiduciary is permitted to take a profit-making business opportunity for his own benefit. The special test could equally well be termed an aspect of the general fiduciary duty or a new doctrine, the difference between these descriptions having no significance beyond the metaphysical."

[27] See decisions such as *Peso Silver Mines Ltd v Cropper* (1966) 58 DLR (2d) 1; *Es-me Pty Ltd v Parker* [1972] WAR 52; *Canadian Aero Services v O'Malley* (1974) 40 DLR (3d) 371; *SSC & B Lintas v Murphy* (1986) 2 BCR 31; *Island Export Finance v Umunna* [1986] BCLC 410 and *CBA Finance Holdings v Hawkins* (1984) 1 BCR 609.

The Morality of Profit Making in Equity

Equity regards profit making as a requirement of the fiduciary relationship in the sense that the ultimate duty of a fiduciary is to make a profit for the principal. This is clearly seen, for example, in cases concerning the fiduciary's duty of investment.[28] However, this duty is moderated when it comes to the fiduciary making a *personal* profit, even if the fiduciary simultaneously makes a profit for the principal. In such circumstances, equity overrides the profit making duty by inserting strict liability: a duty to account for all personal profits received. This rule has been correctly placed in the realms of the doctrine of *prophylaxis*.[29] Such a doctrine predicates itself on the notion of protection. What is left unclear, however, is the necessary issue of whom the duty protects. This might be thought obvious — surely it is the principle that requires protection. That this is a fallacy is exemplified by the facts of one seminal case, in the sphere of company law, which aids us in identifying to whom this protective role is owed.

X Company owned a cinema in Hastings. The directors wished to expand their operations in order to facilitate the sale of the whole undertaking as a going concern. A subsidiary company was formed in order to take a lease of two further cinemas. The landlord of those cinemas was not prepared to grant the leases unless either the directors executed a personal guarantee, or the paid up share capital of the company was a minimum of £5000. X Limited was unable to inject more than £2000 and, given the reluctance of the directors to grant personal guarantees, they changed the original scheme. It was decided that the company itself would subscribe for 2000 shares and the outstanding 3000 shares would be taken up *inter alia* by the directors. Later the whole undertaking was sold by way of take-over. The directors made a profit of £2 16s 1d (£2.80) per share. In the process, of course, the other shares in the company made a similar profit. The purchasers of X Limited brought an action on the basis that the directors had made a profit in breach of duty. The House of Lords, reversing the High Court and Court of Appeal, held that the directors had to account for their profits to the company.

The interest in this case is that the company itself had made a large profit by the sale so that, in effect, everyone concerned benefited financially. X Limited made a profit on the shares in the subsidiary as, incidentally, did the other investors/directors. Without the cash injection by the directors, X Limited would not have been able to make such large profits. In terms of the fiduciary's duty of investment, then, this would have met

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[28] *Cowan v Scargill* [1985] Ch 270; *Harries v Church Commissioners for England* [1992] 1 WLR 1241. These cases hold that, in most circumstances, equity looks askance at ethical investment.

[29] See P Birks *An Introduction to the Law of Restitution* Oxford: Oxford, 1989, at 332–333.

the criteria applied by the courts, *ie.* maximising the investment return. What the facts serve to illustrate is that everyone here was protected. Indeed, it might be suggested that the new owners brought the action in order to get back in their right hand what they had paid out in their left hand.[30] In so doing, they were adopting a similar profit making motif and were rewarded with a windfall.

The case is, of course, *Regal (Hastings) Limited v Gulliver*.[31] What becomes immediately apparent from its result is one of two alternatives. First, that rigid adherence to principle inevitably leads to undue harshness in its application. This has been suggested by several commentators.[32] Second, that the concept of protection, as originally formed, has a much wider emphasis in its effect and operation. We suggest the latter on the basis of prior authority although one must be aware that one is applying eighteenth century principles to twentieth century scenarios.

Previous authority shows that whilst we might be protecting the principal, we are more concerned with protecting society. Goff and Jones, in summarising the relevant authorities, provide the following analysis:

> "A fiduciary's duty of loyalty is 'unbending and inveterate'; equity's rule is 'inflexible... and must be applied inexorably by this court.' '*The safety of mankind*' requires that the court should not be required to determine whether a fiduciary acted honestly or whether the beneficiary did, or did not, suffer any injury because of the fiduciary's dealings, for 'no court is equal to the examination and ascertainment' of these facts (our emphasis)."[33]

That the policy is so framed is evident from the approach of Lord Templeman in *Attorney-General for Hong Kong v Reid*[34] who summed up the position thus: "Bribery is an evil practice which threatens the foundations of any civilised society."[35] Two justifications are therefore apparent. First, we are protecting 'mankind' not just the principal. Secondly, the court is not the appropriate body to examine the *fides* of the fiduciary. Fiduciaries, then, should be models for society at large and any deviation from the path of morality should be quashed. This seems obvious from

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30 Lord Porter, *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134, at 157.

31 Id.

32 See, for example, Professor Finn who argues that "[O]ne of the hazards of a judge-made system of law is that a mechanical application of the doctrine of precedent can produce a body of law devoid of any satisfactory, or reasonable, unifying principle. Such has been the fate of the case law that has built up upon the actual decision in *Keech v Sandford*.": P D Finn, *Fiduciary Obligations*, Sydney: Law Book Company, 1977, at 261. See also, Lowry, supra, n 18.

33 Goff & Jones supra, n 11, at 645.

34 [1994] 1 AC 324.

35 Id, at 330. See, also, the judgment of Judge Swan in *Irving Trust Co v Deutsch* 73 F 2d 121, at 124 (1934) who proceeded on the basis that if equity did not maintain a harsh a constant surveillance then infidelity would be all the more tempting.

the earliest cases such as *Keech v Sandford*.[36] Here, a trustee renewed for his own benefit a lease which the landlords had refused to renew in favour of the trust. This was conduct perfectly in accord with the principles of Land Law, *ie.* the free alienability of land. Not so in the courts, though. Lord King held that the lease (a right *in personam* at that time) should be assigned to the infant beneficiary with an account of the profits received by the trustee using the following words:

> "This may seem hard, that the trustee is the only person of all mankind who might not have the lease; but it is very proper that 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 use."[37]

The message is clear: fiduciaries must be seen to act "at a level higher than that trodden by the crowd"[38] otherwise moral decadence results. Having located where the protection duty falls, then decisions which might have seemed unjust and inequitable on their surface become readily explainable and, indeed, understandable. The majority decision in *Boardman*, where the fiduciary solicitor made a profit together with the beneficiaries as a result of a conflict of interest, is on the same lines as *Regal*. Cases that take a different line, such as *Queensland Mines Limited v Hudson*,[39] can therefore be viewed as proceeding on an incorrect basis.

However, whether this view continues to be sustainable in the modern world is open to question both in terms of authority and in the context of its socio-economic perspective. In terms of authority, even in *Regal* and *Boardman*, there is some deviation from the strict duty. In *Regal*, the solicitor to the company, Garton, and the fifth director were able to avoid liability. Garton avoided liability because he had gained the consent of the board of directors. However, it is not entirely clear both from this case and subsequent authority[40] whether such consent is, or should be, sufficient. The board presumably was made up of wrongdoers (in terms of equity) and so should not their consent be considered tainted? Indeed, if one is protecting mankind generally, then the logical approach must be that no defences can be permitted, so that liability must be absolute.

The strict duty employed by the majority in *Boardman* (correctly on the basis of authority) was mitigated by an allowance being made to remunerate Boardman's time and expertise. Whilst this equitable allow-

36 Id, n 14.
37 Id, n 16.
38 Cardozo CJ, *Meinhard v Salmon* 62 American Law Reports 1 (1928), at 464.
39 (1978) 52 ALJR 399.
40 In particular, the House of Lords in *Boardman* provided contrary *dicta* on the question of whose consent was required in order to avoid liability.

ance was rejected by the House of Lords in *Guinness plc v Saunders*,[41] cases subsequent to *Boardman* have pursued an inconsistent line between the strict duty and a modified form of liability. For example, liability was avoided by a fiduciary executor, *inter alia*, because of his *uberrimae fides*;[42] liability was avoided by a company director who took up a corporate opportunity because the company were not pursuing it and the director had already left the company;[43] liability was avoided by a company director who, just after his resignation, agreed to take up a corporate opportunity that formerly belonged to the company.[44] These cases are discussed further below.

One must also question whether such standards are required in the market place and modern commercial practice. The earliest cases in which the equitable rules were applied relate to the usual eighteenth and nineteenth century uses of equity, that is in the context of the family trust. Equitable rules now have a much wider purview and take into account the amalgam of pension schemes and corporations. The problem today lies in balancing corporate entrepreneurialism against strict rules. The knee-jerk reaction to 'scandals' like the Maxwell pension fund, the collapse of the Bond or Qintex empire, the failure of the Rothwells Merchant Bank, Tricontinental, the State Bank of South Australia or BCCI is to suggest a tightening of the reins and reinforcing strict duties.[45]

Forms of business opportunities have always been highly prized assets, indeed worshipped by the business and political classes. Nevertheless, values have become more starkly polarised. In the modern context, in other words, morality has a different ethos. Within this ethos, the strict rules can have no place; society regulates itself.[46] The rise of the regulatory agency as part of the privatisation programme of British industry is

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41 [1990] 1 All ER 652, esp at 667–668 *per* Lord Goff. His Lordship argued that the right to an equitable allowance "... has to be reconciled with the fundamental principle that a trustee is not entitled to remuneration for services rendered by him to the trust except as expressly provided in the trust deed. Strictly speaking, it is irreconcilable with the rule as so stated. It seems therefore that it can only be reconciled with it to the extent that the exercise of the equitable jurisdiction does not conflict with the policy underlying the rule. And, as I see it, such a conflict will only avoided if the exercise of the jurisdiction is restricted to those cases where it cannot have the effect of encouraging trustees in any way to put themselves in a position where their interests conflict with their duties as trustees". His Lordship also seemed to doubt whether such an allowance could ever be granted to a company director. It seems unlikely, therefore, that such an allowance will ever be granted again and Boardman consequently must be considered to be a mere aberration.

42 *Holder v Holder*, supra, n 23.

43 *Island Export Finance v Ummuna*, see supra n 18. Of course, this stands in direct conflict with *Boardman* and *Regal*.

44 *Balston Ltd v Headlines Filters Ltd*, see supra, n 18. This case stands in direct conflict with *Keech v Sandford*.

45 See, for example, The Report of the Goode Committee on Pension Law Reform, 1993, Cmnd 2342 (I and II).

46 Cadbury Report, United Kingdom, *Committee on the Financial Aspects of Corporate Governance Report*, December 1992.

part of this new matrix. It should come as little surprise that the English Law Commission recently reconsidered fiduciary duties in the context of regulatory rules.[47] Such a self-regulatory perspective was also taken by the Cadbury Committee.[48]

Business practice and ethos has always fostered the entrepreneur but, as Mrs Thatcher (as she then was) was heard to argue, there is no such thing as 'society' today. The 1980s witnessed the destruction of the old norms. Within the new corporate society, where welfare is put out to tender to the highest bidder, strict equitable rules seem misplaced. If the morality of today is not so much the gentleman's agreement but rather the blunt instrument of the market place and contract,[49] then it might be argued that the fiduciary's duty is to maximise profit making *even if* in the process that fiduciary personally makes a profit. Such a thesis is close to the Posnerian thesis of efficient breach of contract.[50] Examined in this light, one might argue that the £5.2 million paid to Ward for his services in the Guinness' take-over of Distillers is entirely justifiable.[51] After all, Guinness made a good deal, in part due to Ward's expertise.[52]

On the other hand, there must not be profit making at any cost. For example, the above analysis might justify Maxwell's alleged plundering of his company's pension scheme. The alternative argument bases itself similarly on modern commercial practice and business ethos. However, rather than arguing in favour of limited, if any, duties, we argue that there must be limits on profit making. Equity has always looked askance at unconscionable practices and, in this respect, can and should retain a regulatory, policing role in this new world. We can easily move away from the strict prophylactic rules because this no longer represents the ideal in the sense that law must respond to professional and political practice. For these different reasons, we advocate the role that equity should adopt is the *bona fides* test based on what is seen as a maturing business opportunity.

If one accepts that contention, then there is one further argument that must be dealt with, albeit shortly. That is the second justification given above for the application of the strict rule: the court is not the appropriate body to adjudicate on the *fides* of the fiduciary. Such a principle completely undermines the policing role that equity adopts in relation to

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47 The Law Commission *Fiduciary Duties and Regulatory Rules* (Law Comm No 124, 1992)

48 Sir Adrian Cadbury has stated that "In sum, the Committee is looking to market regulation to bring about compliance with its recommendations" in Sheikh & Rees, (eds), *Corporate Governance and Corporate Control*: London: Cavendish, 1995, at 392

49 See I Harden, *The Contracting State*, Philadelphia: Open University Press, 1992.

50 R A Posner, *Economic Analysis of Law*, 2nd ed, Boston: Little Brown, 1977.

51 See *Guinness plc v Saunders* [1990] 1 All ER 652.

52 On this topic see L Aitken "Reconciling 'Irreconcilable Principles' — A Revisionist View of the Defaulting Fiduciary's 'Generous Equitable Allowance'" (1993) 5 *Bond L Rev* 49, at 50.

intermeddlers[53] and similarly in relation to such doctrines as the *bona fide* purchaser and 'clean hands'. Indeed, it might be argued that one of the most important roles of a judge at first instance is to consider the oral evidence and evaluate the truthfulness of such witnesses. Consequently, this is no bar to adopting the *fides* test of liability.[54]

Losing the Language of the Constructive Trust

Whilst we advocate the *fides* role for equity, we are concerned that we do not fall into the gaping whole that requires such a wrongdoing fiduciary to be subject to the "harsh obligations of constructive trusteeship".[55] Partly because of the influence of Lord Denning,[56] and partly because it is the easiest way of describing liability, some would have it that such a fiduciary is "liable to account as a constructive trustee". It is sometimes assumed that such liability also carries with it a proprietary remedy.

We submit that lawyers should at all costs lose the language of constructive trusteeship. We do this for a number of reasons. First, this suggests that there is some form of coherent underpinning to the constructive trust. That this is a fallacy is made obvious by the remarkable number of diverse scenarios where it is said that a constructive trust is imposed. Whilst it might be argued that the underlying principle is unconscionability, this will not wash in many cases. For example, in cases relating to the imposition of a constructive trust in favour of a cohabitee's share in property, the English courts have forsaken the notion of unconscionability as the ruling principle in favour of rather different, stricter rules.[57]

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[53] See the five categories of "knowledge" advocated in *Baden Delvaux & Lecuit v Societe General pour Favoriser le Developpement du Commerce et de l'Industrie en france SA* [1983] BCLC 325, at 407, and the implicit acceptance of wrongdoing as the basis of liability, compare to Birks.

[54] See also, Danckwerts LJ in *Holder v Holder, supra,* n 23.

[55] See *Re Montagu's Settlement Trusts* [1987] Ch 264.

[56] See, for example, *Hussey v Palmer* [1972] 3 All ER 744; *Eves v Eves* [1975] 3 All ER 768.

[57] This is known, in some quarters, as the "new model" constructive trust. For general principles, see *Burns v Burns* [1984] Ch 317; *Grant v Edwards* [1986] Ch 638; these cases were inaccurately "codified" by the House of Lords in *Lloyds Bank PLC v Rosset* [1991] 1 AC 107. Recent English authority suggests that this application of the "constructive trust" may well in any event be better expressed as estoppel: *Grant v Edwards* [1986] Ch 638 *per* Browne-Wilkinson V-C. See also the academic discussion: D L Hayton "Equitable Rights between Cohabitees" [1990] 54 *Conv* 370; P Ferguson "Constructive Trusts: A Note of Caution" (1993) 109 *LQR* 114; D Hayton "Constructive Trusts of Homes — A Bold Approach" (1993) 109 *LQR* 485; also, considering whether the Law of Restitution might be an appropriate option in such cases, see S Gardner "Rethinking Family Property" (1993) 109 *LQR* 263, at 284. The major Australian authority in this area is still *Baumgartner v Baumgartner* (1987) 164 CLR 137. See also *Hibberson v George* (1989) 12 Fam LR 725 and *Miller v Sutherland* (1990) 14 Fam LR 416.

Second, to say that a person is a constructive trustee (once again) only begins the enquiry. It certainly does not tell you whether the claim is personal or proprietary because such an enquiry depends on totally different principles.[58] This depends on whether or not the plaintiff has a proprietary base.[59]

Whilst the boundaries between personal and proprietary have been strained in some contexts of late, it is crucial that this distinction remains for otherwise unsecured creditors will be prejudiced. The notion that, when a fiduciary makes an unwarranted profit, that creates the proprietary base on the basis that that person should have paid the money over to the principal is fundamentally flawed, *inter alia*, because this is an unwarranted application of the equitable maxim "equity treats as done that which ought to be done".[60] Commonwealth authority explicitly accepts the notion that the constructive trust is neither personal nor proprietary.[61] If the term "constructive trust" does not make apparent the answer to this important enquiry and, indeed, does not even influence the principles to be applied in cases where it is said to be involved, then the terminology is redundant. Where it is employed, it often leads to confusion.

Company Directors as Profit-Makers: Pursuing the Issue of *Bona Fides*

It is manifestly apparent from the decisions in *Regal* and *Boardman* that the approach adopted by the House of Lords towards the imposition of liability for breach of fiduciary duties is capacity based. The focus is narrowly centred on the particular legal relationship existing between the parties. This is clearly discernible in Lord Russell's speech in *Regal* in which his Lordship forcefully stated the rule applicable to company

[58] Compare to *A-G v Reid*, although infra, at n 60.

[59] This is the point taken by P Birks "Personal Restitution in Equity" [1988] *LMCLQ* 128, following on from R M Goode "Ownership and Obligation in Commercial Transactions" (1987) 103 *LQR* 433, at 438–447. In the American context, see E L Sherwin "Constructive Trusts in Bankruptcy" (1989) *U Ill L Rev* 297; D M Paciocco "The Remedial Constructive Trust: A Principled Basis for Priorities over Creditors" (1989) 69 *Can Bar Rev* 315. The argument has a greater resonance within the issue of equitable tracing and, more particularly, its future: Cowan, Edmunds & Lowry "Equitable Tracing and the Swollen Assets Theory" [1995] *Contemporary Issues in Law* 1.

[60] See *Attorney-General for Hong Kong v Reid* [1994] 1 All ER 1. This is supposedly bolstered by the maxim that "equity treats as done that which ought to be done". The case has been heavily criticised (apart from implicitly by Birks and Goode, ibid) inter alia: Crilley "A Case of Proprietary Overkill", [1994] *RLR* 57; Cowan, Edmunds & Lowry "*Lister & Co v Stubbs*: Who Profits?", (1995) *JBL* forthcoming; A Jones "Bribing the DPP: Should he Profit from Abusing his Position", [1994] *Conv* 156.

[61] *LAC Minerals Limited v International Corona Resources Limited* (1989) 61 DLR (4th) 14; *Muschinski v Dodds* (1985) 160 CLR 583; *Baumgartner v Baumgartner* (1987) 164 CLR 137.

directors as follows:

> "I am of the opinion that the directors standing in a fiduciary relationship to Regal in regard to the exercise of their powers as directors, and having obtained these shares by reason of the fact that they were directors of Regal, and in the course of the execution of that office, are accountable for the profits which they have made out of them. The equitable rule laid down in *Keech v Sandford*... applies to them in full force."[62]

Accordingly, given the trustee status of directors, they are liable to account for a secret profit irrespective of whether or not there is dishonesty, fraud or bad faith. Liability arises *ab initio* irrespective of the equity of the case. The issue is whether such staunch adherence to the strict rule continues to be appropriate given the commercial realities within which modern companies operate. Certainly within the Commonwealth, the merits of a test based upon *fides,* coupled with a consideration of the business that the company was undertaking and what was in its contemplation, enabling, as it does, the Court to divest itself of the strait-jacket imposed by the narrow prophylactic rule, have long been recognised. In this respect, the decision of the Supreme Court of Canada in *Peso Silver Mines v Cropper,*[63] affords a clear example of the justice which can result from judicial enlightenment. The facts are analogous to those in *Regal,* in that Peso's board was offered the opportunity to buy 126 mining claims, some of which were on land which adjoined the company's own mining territories. The board *bona fide* declined the offer on the basis of the then financial state of the company, and also because some of the directors doubted the value of the claims and therefore considered them to be too risky a proposition. Some time later, the company geologist formed a syndicate with the defendant and two other Peso directors to purchase and work the claims. When the company was taken over, the new board brought an action claiming that the defendant held his shares on constructive trust for the company. The action was unsuccessful and the British Columbia Court of Appeal rejected the *Regal* and *Boardman* approach. Bull JA, having examined the strict rule, stated:

> "That the principles, and the strict rules applicable to trustees upon which they are based, are salutary cannot be disputed, but care should be taken to interpret them in the light of modern practice and way of life."[64]

The Supreme Court dismissed the appeal by the company. Cartwright J, who delivered the judgment, adopted and followed *dictum* by Lord

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62 [1967] 2 AC 134, at 149.
63 (1966) 58 DLR (2d) 1.
64 (1966) 56 DLR (2d) 117, at 155.

Greene in the Court of Appeal's decision in *Regal* where he said:

> "To say that the company was entitled to claim the benefit of those shares involve this proposition: Where a board of directors considers an investment which is offered to the 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."[65]

The need for a broader approach towards determining liability for breach of fiduciary duty, was again picked up in the Canadian Supreme Court in *Canadian Aero Service Ltd. v O'Malley.*[66] Laskin J considered that the Court should give cognisance to all the circumstances surrounding a particular breach including the director's *fides*:

> "The general standards of loyalty, good faith and avoidance of a conflict of duty and self-interest... must be tested in each case by many factors... 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..."[67]

In essence what Laskin J was offering was a more imprecise test whereby an officer of the corporation would be made liable to account for the profits earnt from a business opportunity which in fairness belonged to the corporation. He was thus defining the 'expanded' or 'maturing business opportunity test.' This provides that directors cannot take up an opportunity within the scope of the business of the company as carried on or as planned to be carried on. If they do, then their *fides* can be impugned. It is this test which is exemplified implicitly in the two Australian decisions; *Consul Developments Pty Ltd v DPC Estates Pty Ltd*[68] and *Queensland Mines Ltd v Hudson.*[69]

In *Consul Developments Pty Ltd v DPC Estates Pty Ltd* Grey was the manager of the respondent company, which was engaged in property development. He disclosed confidential information to Clowes, an articled clerk to the solicitor who controlled the respondent company. Grey informed Clowes that the company was not interested in the proposal

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[65] Unreported, Court of Appeal, 15 February, 1941. Cited by Cartwright J supra, n 63 at 8–9.
[66] (1973) 40 DLR (3d) 371.
[67] Id, at 391.
[68] (1975) 132 CLR 373.
[69] (1978) 18 ALR 1.

because of a lack of finance. Grey and Clowes agreed to share out the profits from the development between themselves. A company controlled by Clowes purchased the properties. It was argued that these were held on constructive trust due to knowing assistance in a dishonest or fraudulent design.[70]

It was held by the High Court of Australia that Clowes was not a constructive trustee as the requisite knowledge of the dishonest or fraudulent design had not been breached. It was held that *actual* knowledge of a dishonest and fraudulent design was required. On the other hand, a calculated abstention from inquiry for fear of learning the truth was sufficient.[71] In this case there was no actual knowledge nor was there any calculated abstention. The decision also recognises that the scope of the undertaking given by an articled clerk is not so wide as to preclude that person from engaging in business opportunities and interests that fall within the business of Clowes' principal solicitor.[72] In essence, the particular property development was not within the contemplation of the respondent and, importantly, there was no evidence of a dishonest intent to receive property to which another was, in equity, entitled.

In *Queensland Mines v Hudson* the respondent had been the managing director of Queensland Mines. In 1960, Hudson, using the name and resources of Queensland Mines, conducted negotiations with the Tasmanian Government for a mining exploration licence for the Savage River area on the West Coast of Tasmania. These negotiations were carried out whilst Hudson was the managing director of the appellant. The company decided not to pursue the opportunity due to a lack of capital and the significant risks involved in the development. In 1961, Hudson resigned as managing director but stayed on the board of the company. Simultaneously, he used his own resources to prove the value of the mineral deposits in his own name. Rich deposits were located and Hudson transferred them to an American company who paid him a significant royalty. Queensland Mines sought to make Hudson liable to account.

The Privy Council held that Hudson had no liability to account. Queensland Mines were fully informed that Hudson was seeking this opportunity. Furthermore, they had rejected the opportunity when it was originally presented to them. Hudson had also incurred significant potential personal liability in the event that the mineral deposits had proved inadequate.[73]

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70 There is a wealth of authority on this principle of liability stemming from *Barnes v Addy* (1874) LR 9 Ch App 244, at 251–252.

71 (1975) 132 CLR 373, at 408–413.

72 As stated by R P Meagher, W M C Gummow and J R F Lehane, *Equity: Doctrine and Remedies*, 3rd ed, Sydney: Butterworths, 1992, at 140: "[T]he majority of the High Court must be taken to have proceeded on the basis that the scope of the undertaking of an articled law clerk (or, perhaps, the particular articled law clerk) was not so wide as to prevent him from engaging in business activities outside the practice of law in competition with similar business interests of his master solicitor".

73 For a discussion of this case see R Deutsch "Directors as Fiduciaries", [1979] 8 *Sydney Law Review* 668.

These decisions reflect the trend of the North American authorities.[74] There, a director will be liable[75] if the occasion for the opportunity to make the profit arose from the office of director; or the profit-making opportunity was in the company's business, actual or contemplated; or there was a real sensible possibility of conflict; or the director misappropriated an asset belonging to the company.[76]

Following from this American precedent, the Commonwealth courts are developing the notion of a maturing business opportunity doctrine. In determining this, the *bona fides* of the director becomes material. The following questions are considered (*inter alia*): did the director take something which the company would have pursued? Were there valid reasons for the company not taking up the opportunity? Was the company contemplating the opportunity of exercising the option which was taken by the director? A similar trend is currently emerging in the English courts and is likely to become relevant in the determination of these disputes in Australia and Canada.

For example, in *Island Export Finance Ltd. v Umunna*,[77] Hutchinson J. endorsed the approach taken by Laskin J in *Canadian Aero Service Ltd. v O'Malley*[78] and said:

> "It would... be surprising to find that directors alone, because of the fiduciary nature of their relationship with the company, were restrained from exploiting after they had ceased to be such any opportunity of which they had acquired knowledge while directors. Directors, no less than 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."[79]

A similar approach, again in a case involving a director allegedly exploiting a so-called business opportunity, can be seen in *Balston Ltd. v Headline Filters Ltd.*[80] The defendant (Head) had been an employee and

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[74] See *Guth v Loft Inc* 23 Del ch 255 (1939), *Rosenblum v Judson Engineering Corp* 99 N.H. 267 (1954); *Weiss v Kay Jewelry Stores Inc* 470 F 2d 1259 (1972); *Austrain v Williams* 103 F Supp 64; *Kaplan v Fenton* 278 a. 2d 834 (1971). See also L C Ipsen "Trends in the liability of corporate fiduciaries" (1988) 24 *Idaho Law Review* 443.

[75] Austin supra, n 26, at 158.

[76] See also American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations*, 1992, Pt V, chapter 2. For a discussion of this see P J Ryan, "Strange Bedfellows: corporate fiduciaries and the general law compliance obligation in section 2.01(a) of the American Law Institute's Principles of Corporate Governance", (1991) 66 *Washington Law Review* 413.

[77] [1986] BCLC 460.

[78] (1973) 40 DLR (3d) 371.

[79] Supra, n 77 at 482. Professor Farrar has commented that this may represent the development of a flexible doctrine in accordance with Commonwealth jurisdictions whereby the nature of the opportunity will now receive due consideration, thus departing from the preoccupation with the capacity of the individual concerned. See J H Farrar et al, *Farrar's Company Law*, 3rd ed London: Butterworths, 1991, at 424.

[80] [1990] FSR 385.

director of Balston for some seventeen years. Immediately before resigning from the company, he agreed to lease certain commercial premises in order to start up his own business. At that stage, he had not decided upon the nature of the business he would enter. However, shortly after his resignation, one of Balston's customers contacted Head after being told that the company would be discontinuing its supply to him of a certain type of filter tube. Head therefore began manufacturing the filters and supplied them to the customer. Balston sought to hold him to account. Falconer J held that it was not a breach of fiduciary duty for a director to start up a business in competition with his former company after his directorship had ceased, even where the intention to commence business was formed prior to the resignation. On the evidence, Head had not attempted to divert to himself a maturing business opportunity, an opportunity which was in the contemplation of Balston Ltd.[81]

The crucial issues now for the court to consider are the parameters of the concept of a maturing business opportunity. These will determine whether the director has acted *bona fide*. As part of this notion, it will be necessary for the court to decide what is in the contemplation of the company, now and in the future. The evidence will derive *inter alia* from the minutes of the board meetings, the objects clause, the strategic plan of the corporate entity, the financial structure of the company (from which sector are the profits being obtained).[82] This type of evidence will facilitate deliberation of the future direction of the business and will, it is suggested, avoid some of the problems that have occurred in North America on this issue.[83] There the expanded line of business test is criticised because the courts have prevaricated as to the weight which should be given to the objects clause as against the actual scope of the entity's present day and future operations.[84] The test has also been condemned on the basis that it cannot apply to large public companies which can legitimately pursue any form of business.[85]

81 As R Tomasic and S Bottomley, *Corporations Law in Australia*, Sydney: Federation Press, 1995 comment at 371: "Reconciling the... decisions on the conflict of interests rule obviously depends upon the circumstances of the particular case as well as upon the preparedness of the court to depart from the strictness of the rule on conflicts of interests as expressed in cases such as *Cook v Deeks* and *Regal Hastings v Gulliver.*"

82 As Austin comments, supra n 26, at 162: "Contemplated lines of business will have to be proved in the normal way, by evidence of conversations, minutes of meetings and so on. The company's present line or lines of business cannot be determined by reading its objects clause (assuming that it has one). It will be a matter of looking at what the corporation actually does, the periodicity of those activities, and their place in the company's financial structure, to see whether they have the characteristics of a line of business or (to use the phrase more familiar to Australian Lawyers) a course of business."

83 For an account of the problems see V Brudney and R C Clark, "A New Look at Corporate Opportunities", (1981) 94 *Harv L Rev* 997.

84 Id, at 1012.

85 Id, at 1025.

For the Commonwealth courts to avoid these types of problems, the evidence required to determine what is a 'maturing business opportunity' will need to be clearly formulated. If this does not occur, then the entrepreneurial behaviour of Mr Hudson in developing an opportunity which contributed millions to the economy of Australia will not reoccur (or indeed the same behaviour by Mr Cropper that contributed to the Canadian economy). On this issue, a company will not be able to assert that they could pursue any opportunity which would produce a positive return on shareholder's funds. Corporations may decline to enter a particular line of business because of any number of reasons: the lengthy establishment time (despite the lure of a significant yield down the line); the need for immediate cash flow; the need to respond to shareholders' requirements for a dividend stream; to satisfy the demands of institutional investors; the capital investment required to retrain staff etc. For these reasons the company may not pursue an opportunity which a director may possibly decide to chase. If this is the case, then it surely should not be open to the company to recover the profits made ultimately by the entrepreneurial director.

This expanded line of business test also dovetails with the notion that the law must be economically efficient.[86] The absolute proscription as stated by *Keech v Sandford* is no doubt economically efficient, because there is no need to contract to protect the vulnerable party against disloyalty (thus contracting costs are reduced); the law of fiduciary obligations will protect the company, the solicitor's client, the co-partner, the co-venturer and the beneficiary. However, it is submitted that the 'maturing business opportunity' test coupled with the overriding need for the *bona fides* of the director is still sufficiently definite to maintain that efficiency. In particular, this will be the case if the courts specify the factors which attach liability to a fiduciary.

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86 See R A Posner, *Economic Analysis of Law*, 2nd ed, Boston: Little Brown, 1977; A G Anderson, "Conflicts of Interest: Efficiency, Fairness and Corporate Structure", (1978) 25 *UCLALR* 738; S Shavell, "Risk Sharing and Incentives in the Principal and Agent Relationship", (1979) 10 *Bell J. Econ.* 55; M B Barta, "Is the imposition of fiduciary responsibilities running from managers, directors and majority shareholders to minority shareholders economically efficient?", (1990) 38 *Cleveland State L Rev* 559; R Cooter and B J Freedman, "The Fiduciary Relationship: Its Economic Character and Legal Consequences", (1991) 66 *NYUL Rev* 1045.

Conclusion

> "[O]ne cannot but be conscious of the danger that the over-enthusiastic and unnecessary statement of broad general principles of equity in terms of inflexibility may destroy the vigour which it is intended to promote in that it will exclude the ordinary interplay of the doctrines of equity and the adjustment of general principles to particular facts and changing circumstances and convert equity into an instrument of hardship and injustice in individual cases."[87]

The adoption of the *fides* test coupled with the 'maturing business opportunity' doctrine as a means of determining liability is attractive both in terms of principle and policy. It would allow for the retention of the prophylactic role performed by the strict rule by substituting a conditional prohibition for the current absolute against profit taking. In terms of policy, it would allow the *bona fide* director to more aggressively perform his or her entrepreneurial role as we enter the 21st century. Somewhat belatedly, it would also give due effect to the warning articulated by Lord Selbourne LC that:

> "It is equally important to maintain the doctrine of trusts which is established in this court, and not to strain it by unreasonable construction beyond its due and proper limits. There would be no better mode of undermining the sound doctrines of equity than to make unreasonable and inequitable applications of them."[88]

This inroad into the strictness of fiduciary duties also has the support of statutory developments. In England, the prohibition against directors having an interest in a contract with the company,[89] is relaxed by s 317 of the *Companies Act* 1985 coupled with Article 85 of Table A. The position is that generally, a director who has such an interest is released from liability provided that disclosure is made to the board.[90] In Australia, s 232 of the *Corporations Law* regulates conflicts of interest. Under s 232(5) and (6) an officer (including a director) or an employee is not entitled to make improper use of information acquired by virtue of the position, or to improperly use the position to gain a personal advantage, or to cause detriment to the company. Importantly, the sections reflect the emerging trends in the equitable decisions on fiduciary duties. They require a causal connection between the profit and the position[91] and by definition they re-

87 *Chan v Zacharia* (1984) 154 CLR 178, at 205.
88 *Barnes v Addy* (1874) 9 Ch App 244, at 251.
89 *Aberdeen Railway Co v Blaikie Bros*, supra n 15.
90 See *Runciman v Walter Runciman plc* [1992] BCLC 1084; noted Lowry, [1993] *JBL* 279.
91 See the comments by Teele, supra n 17, at 101.

quire that there be *improper* use of the information or the position. It is not sufficient for the person to have been in a potential conflict of interest, it must have been *improper* for the person to use that information or position to their own advantage. In addition to s 232(5) and (6), there are also provisions dealing with the provision of loans to directors,[92] requiring directors to exercise care and diligence,[93] and requiring disclosure where there may be some form of conflict.[94] All of these provisions are more attuned to contemporary conditions and reflect that the governance of directors' duties is now a question of regulation[95] or by Codes of Conduct[96] than by strict applications of equitable doctrines more suited to a time where regulatory agencies and parliament were absent or failing in their duty. Indeed it could be argued that the intervention of equity is only necessary where there are inadequate measures in place via the common law or statute and this is no longer true in the context of corporate misfeasance as statute has, to a large degree, replaced the justification for equity's intervention.[97]

In addition to these developments, the riposte that judges are ill-equipped to determine issues of intention has long been devalued.[98] Further, the recognition of a conditional prohibition based upon the critical question of *bona fides* would continue to net the unscrupulous fiduciary who usurps for his or her own benefit a corporate opportunity. Importantly, the adoption of such a test would more easily accommodate and reconcile the decision in *Cook v Deeks*,[99] in which the purported ratification by the three controlling directors of their breach in appropriating to themselves a contract which "belonged in equity" to the company was disallowed by the Privy Council. With *Regal (Hastings) Ltd.* it will be recalled, the breach was ratifiable. The *fides* issue was no doubt critical in the judges reasoning in these cases. If this assumption is correct, then the adoption of a *fides* test (by examining what was in the contemplation of the company) is by no means a radical alternative. The added benefit is that in those cases where the alleged impropriety is not as diaphanous as *Cook v Deeks*, the court can proceed on the basis of achieving a just and

92 *Corporations Law* s 234. For the English provisions see ss 330–333 of the *Companies Act* 1985.

93 *Corporations Law* s 232(4). In England, see s 214 of the *Insolvency Act* 1986. See, also, *Re Macro (Ipswich) Ltd* [1994] 2 BCLC 354; noted Lowry, [1995] *LMCLQ* forthcoming.

94 *Corporations Law* s 231.

95 In Australia the Australian Securities Commission performs this function.

96 In England see the Cadbury Report, United Kingdom, *Committee on the Financial Aspects of Corporate Governance Report*, December 1992.

97 This goes back to the original jurisdiction of equity. That being where the remedies at law were either inadequate or non-existent. See the comments by Meagher, Gummow and Lehane, supra n 72, at 3.

98 See *Edgington v Fitzmaurice* (1885) 29 Ch D 459.

99 [1916] 1 AC 554. See, also, *Industrial Development Consultants v Cooley* [1972] 2 All ER 162.

equitable result and avoid awarding windfall receipts to expedient litigants. Equity and the principles of corporations law can co-exist, but this will only be done:

> "by recognising that there is a business opportunity doctrine which operates as a special supplement to those fiduciary rules in the case of full-time executive commercial fiduciaries."[100]

[100] Austin, supra n 24, at 185.