Beware the long reach of fiduciary obligations

Most people in the commercial world, even if not lawyers, are aware of what a contract is and may even have heard of a duty of care. Many may even appreciate that a breach of either can give rise to a legal liability. Fewer, however, are familiar with the concept of the fiduciary obligation and the rights and duties which flow from it. This is perhaps surprising given that fiduciary obligations can arise in a variety of everyday commercial situations and breach can give rise to drastic remedies. These may apply notwithstanding elements which may feel unfair, with the courts taking an almost moralistic tone, in turn giving rise to results which may seem harsh. Recent court decisions have highlighted the benefit of appreciating the importance of this slightly unusual area.
WHAT IS A FIDUCIARY DUTY?

In the recent Scottish Appeal Court case of Dryburgh v Scott’s Media Tax [2014], the Court described the duty as one to: ‘… act in good faith in the interests of (the principal), to act for a proper purpose, and not to allow… personal interests to conflict with those of (the principal)’. The concept is based on notions of trust, confidence and good faith. All very well in a utopian society, but for those operating in the hard knocks world of modern commerce, perhaps less familiar. Parties generally operate in accordance with what the contract says, whether good, bad or indifferent for the other party – indeed, wresting the best financial result is likely to be critical. Attempts to introduce a general duty of good faith into contracts have proved unpopular because of the level of uncertainty it brings. In Dryburgh, the Court said: ‘A fundamental position applies to all fiduciary relationships, a fiduciary must not place himself in a position where his interests and his duties may possibly conflict’.

Critically, a fiduciary has an obligation not to obtain, undisclosed (of which more later), a profit or benefit of any kind from their position, the classic example being the secret profit or commission. In essence, anything which the fiduciary gets which is not disclosed may be subject to challenge.

WHO IS SUBJECT TO FIDUCIARY OBLIGATIONS?

Perhaps the most obvious fiduciary is a trustee. Most people know that the law of trusts is a complex one with many special rules and obligations, which flow from the fiduciary relationship created by the trust. Similar rules and obligations can arise in other areas too, however, and not simply those where someone is labelled a trustee. While the courts are at pains to emphasise that each case must turn on an examination of the facts to determine if the special fiduciary rules apply, it is well established, but not necessarily well known, that they also apply in relation to company directors and anyone who in law is an agent, whether or not actually labelled as such.

The Companies Acts impose various obligations on directors. It may not be as well understood, however, that the position also brings with it fiduciary obligations. Those obligations can be difficult to reconcile in practice, where legal theory does not sit easily with the realities of modern corporate structures. In Dryburgh, for example, the Court was dealing with, in effect, a one-man company. That company entered into a transaction in which the director had an interest. On the subsequent insolvency of the company, the insolvency practitioner said that the transaction was challengeable because it wasn’t in the company’s best interests. Naturally, the company hadn’t challenged it themselves – why would they? In law, however, the director and the company were separate entities and in entering into the transaction the director had put his own interests in conflict with those of the company for whom he was ‘acting’ as a director. The Court held that the director:

‘… was under an obligation, as an aspect of overall fiduciary responsibilities, to inform (the company) about the existence of the conflict of interests and the possible claim against him’.

As the director did not consider the conflict, he, and the company, continued to be unaware of it and the company’s failure to challenge arose.

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inform his principal of the facts giving rise to the breach of duty so that the principal can either authorise the breach or take action to remedy it.’

So, the fiduciary must ensure they do nothing to place themselves in a position of conflict with their principal. If they do, they can’t just wait and see what happens; they have a positive obligation to divulge the breach to the principal.

Leaving aside the one-man company scenario, what is the reality of those obligations in larger organisations where there may be multiple directors each with separate and distinct roles and responsibilities? This was considered in the case of Commonwealth Oil & Gas v Baxter [2009], which involved a non-executive director, who wasn’t involved in the running of the company and indeed had minimal knowledge of it. The Court held that this was irrelevant:

‘... that he was a non-executive director does not mean that he did not owe to the company the same fiduciary duties as its executive directors owed to it’.

Nor does it make any difference that the director is charged only with a particular task. Take, for example, the director charged with manufacturing in Europe. If that director then comes across something in the Middle East which has nothing to do with manufacturing and he deals with it in his own capacity, or as a director or agent of another, in so doing has he placed himself in conflict with the first company? The answer is yes – the fact that the director is not tasked with that area is irrelevant as far as the courts are concerned. This is of considerable significance in relation to the remedies which can apply.

**REMEDIES**

Most business people are familiar with the concept that if there has been a breach of contract or a breach of duty damages or compensation may flow. The general rule is that damages will compensate for loss – they are intended to put the ‘victim’ back to the position they would have been in but for the breach. The same is true for breach of a fiduciary duty; damages can be claimed and, if they are, the standard rules apply. The law, however, goes much further than that. If in breach of a fiduciary duty you have received a benefit, you may be compelled to hand it over, whatever it may be and whether or not the principal could ever have acquired it themselves. Rather than remedying a loss, therefore, here the law is more correctly said to be removing an ill-gotten gain. The significance of the full extent of the remedies available on breach of a fiduciary duty emerges very clearly in the recent case of Philip Towers v Premier Waste Management [2011] where the Court said that liability:

‘... does not depend on proof of fault or proof that the conflict of interest has in fact caused the company loss... (the fiduciary) will be liable to the company for breach of duty regardless of the fact that (the fiduciary) acted in good faith or that the company could not or would not take advantage of the opportunity’.
The seven judges in the Supreme Court case of *FHR European Ventures v Cedar Capital Partners* [2014] went further and said that liability to account for the profits or benefit on the part of a fiduciary:

‘... 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 benefitted by his action... Liability arises from the mere fact of profit having... been made’.

**IS THERE A WAY OUT?**

The consequences of breaching fiduciary obligations, therefore, can be very dramatic. What if the fiduciary discloses the conflict and the profit? We saw earlier in *Dryburgh* that:

‘A fiduciary who has committed a breach of duty is under an obligation to inform his principal of the facts giving rise to the breach of duty so that the principal can either authorise the breach or take action to remedy it’.

So, it is open to the principal to approve the benefit obtained and waive their right to challenge it. In the context of fiduciary obligations, however, the obligation to disclose and get approval is not as simple as it seems. It is not enough that the principal knew about it, or should have known about it. In *Parks of Hamilton v Campbell* [2014] the Appeal Court in Scotland said that the obligation on the fiduciary in such circumstances is to volunteer information – it is a positive obligation – and the disclosure must normally be made to the principal themself and not to their agent:

‘... the principal must understand fully what the proposals are; in particular, he must understand his legal rights under the fiduciary relationship and in what way those rights are to be given up. Once again it is essential that the principal himself should be aware of all of these factors and apply his mind to them. The knowledge and understanding of an agent for the principal are not sufficient... the application of fiduciary duties is an important matter and the principal must understand that he is authorising the abrogation of such duties’.

These are very high tests to meet.
CONCLUSION

The concepts discussed in these cases are not new – their origins go back centuries. How they play out in reality, however, is rarely examined. What is clear is that the courts will take the most exacting – moralistic even – approach to this topic with potentially grave consequences for those caught up in the action. It must be doubtful if everyone who has heard of a fiduciary duty – or read of it even – really appreciates the full import of the obligations which come with it. Many may not even realise they have the obligations in the first place – will a transaction always be understood as ‘agency’ in advance? The remedies too are drastic – no need to prove fault or establish loss as would be usual. Nor does it help if the principal would not have benefitted even if proper advance disclosure had been made. If the agent gets a ‘secret profit’ they must hand it over in full regardless. Worth thinking about.

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