The nature and function of fiduciary duties

Discussion of the concept of a fiduciary duty is bedevilled by confusion almost from the very beginning. By a 'fiduciary duty' do we mean: (i) all and any of the duties that A is subject to because he occupies a position (such as being a trustee, or an agent, or a solicitor) which the law labels as being a 'fiduciary' position; or (ii) the duty (or duties) that mark someone as being a fiduciary, so that if A owes B that duty (or duties) we are justified in saying that A is a fiduciary for B? In *Pitt* v *Holt*,[1] the UK Supreme Court used the term 'fiduciary duty' in sense (i) when it ruled that a disposition of property by a trustee could only be set aside (or rescinded) under the 'rule in *Hastings-Bass*' if the trustee committed a 'breach of fiduciary duty' in making that disposition.[2] In *Bristol & West Building Society* v *Mothew*,[3] Millett LJ used the term 'fiduciary duty' in sense (ii) when he observed that 'not every breach of duty by a fiduciary is a breach of fiduciary duty.'[4]

We will use the term 'fiduciary duty' in sense (ii) and call the duty (or duties) that marks someone out as being a fiduciary the FID-duty. According to Lionel Smith, A will owe B the FID-duty if A holds certain discretionary powers which give him some measure of control over B's life, and A is required to exercise those powers in what he perceives to be B's best interests.[5] However, this seems too narrow:[6] it would seem to imply that the trustees of charitable trusts or discretionary trusts in favour of huge classes of people are not fiduciaries when they plainly are.[7] A better view, and one which builds on Matthew Conaglen's work in this area,[8] is that A is a fiduciary if: (i) A is subject to certain non-fiduciary duties; (ii) there is a danger that the prospect of making a profit P might lead A to breach one of those non-fiduciary duties; and (iii) in order to prevent this happening, the law requires A to give up P should A obtain that profit. In other words, the FID-duty, when it exists, is a duty to give up gains you have made as a result of acting in a way that could potentially have resulted in your breaching a non-fiduciary duty. Anyone who is subject to this duty is a fiduciary.

Where Conaglen goes wrong is in supposing that the danger in (ii) is that A will *deliberately* breach a non-fiduciary duty in order to obtain P, and that when it comes to (iii) the law seeks to *deter* A from doing this by requiring A to surrender P should A obtain that profit. As Lionel Smith rightly points out, this makes no sense: 'taking away the profit that a person makes from a transaction is not a logical way to deter them from making such profitable transactions. A properly designed deterrent has to go beyond that. You would not try to deter fraud by a rule that said that all fraudsters must surrender the profits of their frauds, but no more than that.'[9]

Irit Samet gets much closer to the truth about what the law is doing in the area of fiduciary duties.[10] The danger in (ii) is that in a situation where there is a possibility that A's doing *x* will cause her to breach a non-fiduciary duty, A will *fool herself* into thinking that there is nothing wrong with

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[1] [2013] 2 AC 108.
[2] Ibid, at [73] (per Lord Walker).
[3] [1998] Ch 1.
[4] Ibid, 16.
[5] Smith, 'Fiduciary relationships: ensuring the loyal exercise of judgment on behalf of another' (2014) 130 LQR 608.
[6] What accounts for this narrowness in Smith's account of the FID-duty is his desire to link the FID-duty with the law's protecting people's *autonomy*: that is, their 'ability to control what happens in [their] life' (ibid, 614). Smith argues that the law on fiduciaries has its roots in the fact that the 'law will not allow a person who is empowered to run another person's life to do so, except in what they perceive to be that other person's interest' (ibid, 615). As such, Smith's theory is very congenial to the Kantian theories of private law – but not so congenial to our established understanding as to who is a fiduciary and who is not.
[7] The same objection can be made to Paul Miller's definition that 'A fiduciary relationship is one in which one party (the fiduciary) exercises discretionary power over the significant practical interests of another (the beneficiary)': Miller, 'A theory of fiduciary liability' (2011) 56 McGill LJ 235, 262.
[8] Conaglen, 'The nature and function of fiduciary loyalty' (2005) 121 LQR 452; Conaglen, *Fiduciary Loyalty: Protecting the Due Performance of Non-Fiduciary Duties* (Hart Publishing, 2010).
[9] Smith, 'Fiduciary relationships' (above, n 5), 627. See also McBride, 'Restitution for wrongs' in Mitchell and Swadling (eds), *The Restatement Third: Restitution and Unjust Enrichment* (Hart Publishing, 2013), 263-66.
[10] Samet, 'Guarding the fiduciary's conscience: a justification of a stringent profit-stripping rule' (2008) 28 OJLS 763.

her doing *x* because of the profit she stands to make as a result of doing *x*.[11] So when the law does (iii), it does so not to deter duty-holders from doing the wrong thing, but to assist duty-holders to do the right thing: it clears their minds of the cognitive bias in favour of thinking that *x* is the right thing to do when *x* just happens also to be in the duty-holder's interests, and thereby helps them make an objective assessment as to whether or not *x* is the right thing to do.[12]

However, the law does not always do (iii), when (i) and (ii) are true: not every duty-holder is a fiduciary. Contrast a building contractor with a trustee. Both will have a duty to take care in performing their functions, either as a contractor or a trustee.[13] Each may be presented with the opportunity to act in a way that will make a profit for themselves, but might also result in their breaching their duty of care as a contractor or a trustee. For example, the contractor may have to decide whether to allot a lucrative subcontract to a building company in which he is an investor; while the trustee may have to decide whether to invest trust funds in a company in which she is an investor. But only the trustee is told that if she makes a gain from the decision she makes, she is duty-bound to give it up. The contractor is not a fiduciary, while the trustee is.

Why does the law seek to safeguard the trustee against breaching the duty of care she is subject to by making her a fiduciary, when it does not do the same in relation to the building contractor? The answer, I suggest, is that someone who is proposing to create a trust needs a lot more reassurance that the trustee of the trust will perform properly than someone who enters into a contract with someone else. The information and power imbalances that exist in the context of a trust make it very easy either for a trustee to get away with committing a breach of trust, or mean that there will be no effective remedy against a trustee whose breach of trust has finally been detected. Such information and power imbalances are not unknown in the contractual context, but they are a lot more unusual. They certainly do not exist in the case where a client appoints a contractor to do building work for him and can safeguard himself against poor performance by the contractor by having independent parties (such as an architect or quantity surveyor) supervise the contractor's performance, and will usually be of sufficient means to be able to afford to bring the contractor to account should the contractor perform badly. It follows that creators of trusts (settlors) have much more reason to be wary of misperformance by their trustees than contractors have reason to be wary of misperformance by their contractual counterparts. Recognising that a trustee is a fiduciary is one way the law tries to

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[11] This process is perfectly illustrated by the film *Inside Job* (Sony Pictures Classics, 2010), which shows how completely honest academic economists were led – completely unconsciously – by the prospect of being rewarded by financial companies to write approving reports on transactions set up by those companies which led to the almost complete collapse of the world financial system in 2008. Cf. James LJ's warning in *Parker* v *McKenna* (1874-75) LR 10 Ch App 96, 125 that the 'safety of mankind' depends on the law requiring fiduciaries to give up gains they made from making decisions that gave rise to, or arose out, of a situation where there was a potential conflict between the fiduciary's (non-fiduciary) duty and the fiduciary's interest in making a gain for himself.

[12] Some theorists find it difficult to see how these ideas explain the very strict liability imposed on the fiduciaries in *Keech* v *Sandford* (1726) Sel Cas Ch 61 and *Boardman* v *Phipps* [1967] 2 AC 46. There is no difficulty. In *Keech* v *Sandford*, the trustee of a lease, having been told that the landlord would not renew the lease if it was to be held on trust for the infant had a (non-fiduciary) duty to try to change the landlord's mind *if* there was a reasonable prospect that with reasonable effort he could turn the landlord's 'No' into a 'Yes'. In order to ensure that the trustee assessed whether he was duty-bound to try to change the landlord's mind with a clear head, the law made it clear to the trustee that if he didn't change the landlord's mind and instead took a lease of the land for his own benefit, he would have to give that lease up. In *Boardman* v *Phipps*, Boardman – having learned of an underperforming company, Lester & Harris, in which the trust fund for which he was a solicitor was invested – owed the trust fund a duty not to take over Lester & Harris himself if doing so was likely to make the company's finances worse not better. In order to allow Boardman to assess as objectively as possible whether this was the case, the law made it clear to him that should he take over Lester & Harris himself, he would not be allowed to retain profits from doing so. In so doing, the law *also* prevented Boardman getting into a further situation where his interest and duty conflicted: as a beneficial shareholder in Lester & Harris, Boardman would have been incapable of ensuring that any advice he gave the trust fund about *its* shareholding in Lester & Harris was completely objective and unbiased.

[13] The contractor under s 13 of the Supply of Goods and Services Act 1982; the trustee under ss 1-2 and Schedule 1 of the Trustee Act 2000.

provide settlors with the reassurance they need that their trustees will not misperform.[14] As such reassurance is not normally needed in the case of contracting parties, the law does not normally impose fiduciary status on a contractor. However, the law will if the relationship between two contracting parties approximates the power and information imbalances that lead it to impose fiduciary status on trustees. And this will be the case where, say, A contracts with B for B to work for her as her solicitor; or where A contracts with B for B to work for her as her agent. In both cases, A's contracting with B to work for her involves a hard to guard against risk of B's misperforming – and in order to reassure A on this count, and to encourage A to enter into a contractual relationship with B that could be very beneficial for A, the law imposes fiduciary status on B.

[14] Cf. Langbein, 'The contractarian basis of the law of trusts' (1995) 105 Yale LJ 625, 640-42 (explaining fiduciary law as arising as a necessary safeguard for beneficiaries' interests once trustees were given greater discretion as to how to deal with the trust property). A case could be made for saying that when the conditions under which a trust is created approximate those in which a client enters into a contract with a building contractor (for example, where a very wealthy settlor settles funds to be held on an investment trust for itself) there is no basis for finding that the trustee in that kind of case is a fiduciary and should only be held liable if he actually has breached one of the non-fiduciary duties that he owes as a trustee. In the article just cited, Langbein goes the other way, arguing that 'The prophylactic duty of loyalty presses too harshly on trustees and comparable fiduciaries...in *family* trusteeships' (at 667, emphasis added). No: it is in family trusteeships that the FID-duty is *most* needed. Ten years later, Langbein came out as against applying the FID-duty in an unqualified way to *any* trusts: Langbein, 'Questioning the trust-law duty of loyalty: sole interest or best interest?' (2005) 114 Yale LJ 929.