

**Understanding Fiduciary Duties:
Conflict of Interest and Proper Exercise of Judgment
in Private Law**

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SUMMARY

This dissertation analyses the content and justification of the notion of fiduciary duties in private law relations. The thesis promotes the following understanding of fiduciary duties: in a legal relation where one party undertakes to act in the interests of another, and acquires decision-making authority over the other's interests, such party undertakes a core duty to exercise his best judgment in the other's interests. The core judgment duty requires a fiduciary to exercise judgment based on relevant considerations. While what constitutes a relevant consideration can be determined objectively, the weight to be ascribed to each relevant factor is left at the fiduciary's subjective appreciation.

Due to the existence of this core duty, the law imposes a set of proscriptive duties. The proscriptive duties require a fiduciary to manage situations of conflict of interest. Their purpose is prophylactic: they aim to prevent self-interest (or another duty to exercise proper judgment) from affecting the reliability of fiduciary's judgment in a conscious or subconscious way. The proscriptive duties protect the core duty to exercise judgment and, as a result, the beneficiary's right to a proper exercise of judgment by the fiduciary.

RÉSUMÉ

Cette thèse examine le contenu et la raison d'être des devoirs fiduciaires dans les relations de droit privé. La permise de l'existence des devoirs fiduciaires en droit privé est la suivante : dans une relation juridique où une partie s'engage à agir dans les intérêts d'autrui, et acquiert un pouvoir de décision sur les intérêts de celui-ci, cette partie assume un devoir principal d'employer son meilleur jugement dans les intérêts d'autrui. Le devoir principal exige de la part du fiduciaire d'adopter des décisions basées sur des considérations pertinentes. Alors que ce qui constitue une considération pertinente peut être déterminé de manière objective, la relevance de chaque considération pertinente est laissé à l'appréciation subjective du fiduciaire.

En raison de l'existence de ce devoir principal, la personne devient également assujettie à un ensemble de devoirs restrictifs. Les devoirs restrictifs sont imposés par la loi. Ils exigent de la part du fiduciaire de gérer les situations de conflit d'intérêt. Leur but est prophylactique: ils visent à empêcher l'intérêt propre du fiduciaire (ou un autre devoir principal) d'affecter la fiabilité du jugement du fiduciaire d'une manière consciente ou sous consciente. Les devoirs restrictifs protègent le devoir principal, et, par conséquent, le droit du bénéficiaire au meilleur jugement du fiduciaire.

CHAPTER I: INTRODUCTION

“Almost everybody would say that [a fiduciary] is a person in whom trust and confidence is placed by another on whose behalf the fiduciary is to act.”
(Donovan W. Waters, 2000)

1.1 ‘Pour encourager les autres’

John Byng (1704-1757) was a well-reputed English Royal Navy admiral. In 1756 he was defeated by the French naval fleet in the battle for the Mediterranean island of Minorca. Although Admiral Byng had brought to the attention of his superiors the multiple causes of his failure, which included insufficient military personnel, damaged ships and failed communications, the public outrage demanded that Byng bear the blame. The following year, Byng was court-martialled, accused of “not doing his utmost” to prevent Minorca from falling to the French navy, and executed by firing-squad.¹ Byng’s scapegoat execution led Voltaire to remark sarcastically: “[D]ans ce pays-ci [Angleterre], il est bon de tuer de temps en temps un amiral pour encourager les autres.”²

Surprisingly, the practice that triggered Voltaire’s ridicule more than two centuries ago is nowadays invoked by courts and established fiduciary law scholars as the main justification for the onerous proscriptive duties that bind persons occupying a fiduciary position. In a recent decision of the England and Wales Court of Appeal (Civil Division), for example, Lady Justice Arden explained the severity of the proscriptive fiduciary duties by invoking the need to discipline fiduciaries, Admiral-Byng-style:

¹ See Peter Burke, *Celebrated Naval and Military Trials* (London: W.H. Allen, 1866) 72–81. For a thorough account of John Byng’s story see Julian Stafford Corbett, *England in the Seven Years’ War: A Study in Combined Strategy* (New York: Cambridge University Press, 2010) 69-139.

² “In this country [England], it is advisable to kill an admiral from time to time to set an example for others.” (Voltaire, “Candide, ou L’optimisme” in Voltaire, *Romans* (Paris: Librairie Firmin Didot Frères, 1851) 113 at 172, my translation).

It may be asked why equity imposes stringent liability... [E]quity imposes stringent liability on a fiduciary as a deterrent – *pour encourager les autres*... [I]n the interests of efficiency and to provide an incentive to fiduciaries to resist the temptation to misconduct themselves, the law imposes exacting standards on fiduciaries and an extensive liability to account.³

The view that very strict duties are necessary in order to deter and discipline all fiduciaries is very common in fiduciary law literature. Robert Flannigan, one of the most prolific Canadian fiduciary law scholars, contended that only an indiscriminate punishment of actual and potential situations of conflict of interest can annihilate fiduciaries' incentives to take their chances and pursue unauthorized benefits. In the learned commentator's view, only a 'sledgehammer' approach to fiduciary liability can 'motivate the others' and establish an optimal level of discipline among fiduciaries.⁴ Gareth Jones, another outstanding Equity scholar, shares this view. He contended that, in order to set an example, courts should be able to compel fiduciaries to disgorge unauthorized gains, although they acted honestly in what they believed to be the best interests of their beneficiaries, and did not cause a loss to the beneficiaries. An honest fiduciary, he asserted,

should be compelled to disgorge only if the court feels that it [is] absolutely necessary, *pour encourager les autres*, to punish him. There are cases where the innocent fiduciary must suffer, like Admiral Byng. Policy may demand a public sacrifice of the fiduciary's profit.⁵

The line of argument promoted by these scholars holds that the law must impose onerous proscriptive duties on all fiduciaries to deter them from succumbing to the temptation of easy gains. This temptation of profits has even been compared to a condition that affects fiduciaries, a disease against

³ *Murad v. Al-Saraj* [2005] EWCA Civ 959 at para. 74.

⁴ Robert Flannigan, "The Strict Character of Fiduciary Liability" [2006] New Zealand Law Review 209 at 217: "[The courts] intended an unyielding and unequivocal liability, a sledgehammer if you will, in order to eliminate any incentive for opportunistic manipulation... Our sledgehammer is designed to '*encourager les autres*' generally (rather than selectively or sporadically) to give up any thought of unauthorized gain from manipulating the appearance of transactions or relations."

⁵ Gareth Jones, "Unjust Enrichment and the Fiduciary's Duty of Loyalty" (1968) 84 Law Quarterly Review 477 at 487.

which they must be protected. The strict fiduciary duties fulfil a prophylactic rather than restitutionary role: they aim to prevent or protect against the disease of temptation.⁶

The idea that fiduciary law aims to discipline legal actors by deterring temptation should be puzzling for any private law theorist. The hallmark of private law is that it connects two particular legal subjects through the bias of liability. Private law focuses primarily on the bipolar relation between two legal subjects and not on the interests of the community as a whole. Sound private law doctrine must approach this field from the inside, using a set of coherent fundamental legal concepts and a mode of reasoning typical to private law, and not in a functionalist manner, based on a set of extrinsic purposes. The promotion of desired social goals is not an intrinsic aim of private law, but a task attained by other social sciences or branches of law.⁷

But how can the strict fiduciary duties be understood based on fundamental private law concepts? If policy arguments are set aside, how can the strict rules against conflict of interest be justified? This dissertation aims to propose a new understanding of ‘fiduciary duties’ that is compliant with private law reasoning. The first step in achieving this goal is to identify the proper understanding of ‘conflict of interest’.

The main source of the ongoing confusion regarding the content and purpose of fiduciary duties is the misunderstanding of the notion of ‘conflict of interest’. The starting point of many theories of fiduciary relations is that, because the fiduciary has scope for exercise of power or discretion, and is tempted to act self-interestedly, his self-regarding interests come into conflict with beneficiary’s interests. Equating ‘conflict of interest’ with ‘conflicting interests’ is a major error, which has obstructed the efforts to identify the proper role of the proscriptive duties and the underlying core features of all fiduciary relations.

⁶ See *Harris v Digital Pulse Pty Ltd* [2003] NSWCA 10 at paras. 413–414: “[Fiduciary duties] are prophylactic in the sense that they tend to prevent the disease of temptation in the fiduciary - they preserve or protect the fiduciary from that disease... The prevention of or protection from the relevant disease is assisted by the strictness of the standard imposed and the absence of defences justifying departures from it.”

⁷ For a detailed analysis of the goals of private law see Ernest Weinrib, *The Idea of Private Law* (Harvard: Harvard University Press, 1995).

Several scholars have departed from this mistaken understanding of conflict of interest, by showing that this notion refers to a conflict between interest and *duty* (or duty and duty).⁸ Both civil law and common law scholars have pointed out that the persons who are bound by the rules against conflicts of interest have a core duty to act in the interests of the other party (sometimes referred to as the duty of loyalty). The core duty has been defined in a positive manner, as a duty to advance the beneficiary's interests or as a duty to act with the proper motive, or in a negative manner, as a duty to abstain from acting self-interestedly. Despite the numerous attempts to identify the content of the core fiduciary duty, no fiduciary law theory has demonstrated convincingly how the proscriptive duties relate to the core duty. In other words, the doctrine has yet to explain why the strict proscriptive duties are imposed on the persons who owe the core duty.

Due to the absence of a convincing correlation between the proscriptive duties and the core fiduciary duty, courts and commentators continue to justify the onerous proscriptive duties based on policy arguments, such as the need to prevent temptations of breaching duties, the need to protect vulnerable persons, or the special utility of relations based on trust and confidence.

The theoretical model of fiduciary duties developed by this dissertation supplies the missing link between the proscriptive duties and the core fiduciary duty. Building on the latest research in fiduciary law and incorporating philosophical theories of conflict of interest, the research will make the case that the law of fiduciary duties aims to regulate the manner in which one person exercises judgment or discretion over another's interests. The core fiduciary duty, which helps distinguish fiduciary relations from other private law relations, is a 'proper judgment' duty. It requires the person subject to it to exercise judgment based on relevant considerations. The proscriptive duties protect the beneficiary's right to the fiduciary's best judgment by preventing self-interest or other-regarding interests from interfering with the proper exercise of judgment. The core fiduciary duty substantiates further the beneficiary's right. Besides freedom from self- or

⁸ These views are examined in more detail in Chapter 2.

other-regarding interests, the fiduciary must exercise judgment based on relevant considerations.

Before outlining the state of the doctrine and caselaw on fiduciary duties, as the background against which the new theory will be developed, several introductory clarifications are required. The remaining part of this section comprises introductory remarks concerning the utility of the established fiduciary vocabulary and the context in which fiduciary duties arise. The final part of the section will summarize the research question, the proposed approach and the relevance of the research.

1.2 The fiduciary vocabulary

Courts and commentators have repeatedly attempted to construct and justify rules of fiduciary law starting from the literal meaning of the words that have been used traditionally to describe the relations and the duties collectively referred to as ‘fiduciary’.⁹ Fiduciary relations are invariably described as involving trust and confidence, and fiduciary duties as the law’s tool to protect these elements. The core duty binding on the recipient of another’s trust and confidence is described as a duty of loyalty, imposing a high standard of unselfishness and fidelity. The terms ‘trust and confidence’ and ‘loyalty’ are often used in an axiomatic sense: they are supposed to be self-explanatory, conveying the same meaning to everyone. Unfortunately, these terms have proven time and time again incapable of conveying a generally accepted private law meaning. To avoid perpetuating the confusion, in this dissertation the duties that can be generically labelled ‘fiduciary’ will be referred to by their content, rather than their usual label. The duties deriving from the rules against conflict of interest will be referred to as ‘the proscriptive duties’. The core duty that a fiduciary owes will be referred to as ‘the duty to exercise proper judgment’.¹⁰ Collectively, the proscriptive duties

⁹ In *R. v. Neil*, for instance, Binnie J., writing for the Court tried to identify the content of a lawyer’s duty of loyalty using a terminological analysis of ‘fiduciary’: “The duty of loyalty is intertwined with the fiduciary nature of the lawyer-client relationship. One of the roots of the word fiduciary is *fides*, or loyalty, and loyalty is often cited as one of the defining characteristics of a fiduciary.” (*R. v. Neil* [2002] 3 S.C.R. 631 at 643).

¹⁰ The normative meaning of these duties will be explained in the following chapters.

and the duty to exercise proper judgment will be referred to as ‘fiduciary duties’.

Why is the fiduciary law afflicted by terminological imprecision? A brief look at the development of this area of law is sufficient to grasp some of the causes of this uncertainty.

The law of fiduciary relationships originated in the jurisprudence of the Court of Chancery. Up to the early nineteenth century, ‘fiduciary’ was an uncommon legal term.¹¹ The relations that are nowadays called fiduciary were typically referred to as relations of ‘trust’ or ‘confidence.’ Breach of trust or confidence was one of the traditional heads of jurisdiction in Chancery. The concepts of trust and confidence were initially used in a broad, generic sense. Matters involving confidence and discretion were called ‘trusts,’ whether there was any strict trust of property or not. As the law developed, ‘trust’ came to be recognized as a formal term, with its modern technical meaning. At the same time, the relations of confidence which were not technical trusts were qualified ‘quasi-trusts’ or trusteeships ‘in some respects’. In the second half of the nineteenth century, the word ‘fiduciary’ became the standard term to describe the relationships of confidence that fell short of the strictly-defined trust.¹²

‘Fiduciary’ is an obscure word. Uncommon in ordinary speech, this concept has never been successfully defined or analyzed in law.¹³ On the contrary, it has been described as one of the most ill-defined, if not altogether

¹¹ See Len S. Sealy, “Fiduciary Relationships” (1962) Cambridge Law Journal 69 at 72, footnote 11; Paul D. Finn, *Fiduciary Obligations* (Sydney: Law Book Co., 1977) 1.

¹² See generally Len S. Sealy, *supra* note 11 at 70-75. Jeremy Bentham was among the first scholars to use the term ‘fiduciary’ consistently. He attached this label to a right or a power to signal that such prerogatives must be used by their holder for the benefit of another. See Jeremy Bentham, *An Introduction to the Principles of Morals and Legislation*, vol. 2 (London: W. Pickering, 1823) 152: “[W]herever any such power is conferred, the end or purpose for which it was conferred... must have been the producing of a benefit to somebody... If it be for the sake of the inferior [party] that the power is established... the power, being thereby coupled with a trust, may be termed a fiduciary one.”; Jeremy Bentham, *A General View of a Complete Code of Laws*, in Sir John Bowring, ed., *The Works of Jeremy Bentham*, vol. 3 (Edinburgh: William Tait, 1843) 155 at 181, emphasis added: “Fifth division [of rights is] drawn from the persons in favour of whom the right is established: 1. *Personal* rights - those which are exercised for the benefit of him who possesses them; 2. *Fiduciary* rights - those which are possessed to be exercised for the advantage of another only, such as those of factor, attorney, guardian, father, or husband in quality of guardian... Fiduciary rights are the same in nature as personal rights, combined with certain obligations.”

¹³ Jay C. Shepherd, *The Law of Fiduciaries* (Toronto: Carswell, 1981) 4.

misleading terms of common law.¹⁴ Despite its vagueness, the label ‘fiduciary’ has been used frequently by lawyers over the past decades.¹⁵ As Southin J. famously observed, “[t]he word ‘fiduciary’ is flung around now as if it applied to all breaches of duty by solicitors, directors of companies and so forth...”¹⁶

As noun, ‘fiduciary’ has been used to refer to a trustee or someone in a trust-like position. As adjective, the term ‘fiduciary’ has been used a multitude of contexts. It has been used to refer to a certain duty, or group of duties, that form a discrete category of obligations (the fiduciary duty/duties); to identify the jural relations where fiduciary duties exist; to emphasize that a jural relation is akin to the relation between trustee and beneficiary; or in an instrumental manner, to justify the imposition of remedies that are available only if the parties are characterized as being in a fiduciary relationship.¹⁷

Unfortunately, this “unthinking resort to verbal formulae”¹⁸ has created confusion with regard to the normative content of fiduciary law concepts. On the one hand, scholars agree that the fiduciary label should be “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.”¹⁹ On the other hand, they disagree when it comes to defining these core duties.

‘Trust’, ‘confidence’ and ‘loyalty’ are the most common words that are used to define or describe fiduciary relations and the duties that are

¹⁴ Paul D. Finn, *Fiduciary Obligations*, *supra* note 11 at 1.

¹⁵ See e.g. Donovan W.M Waters, *The Constructive Trust: The Case for a New Approach in English Law* (London: Athlone Press, 1964) 4: “Fiduciary is a vague term, and it has been pressed into service for a number of ends... My view is that the term ‘fiduciary’ is so vague that plaintiffs have been able to claim that fiduciary obligations have been breached when in fact the particular defendant was not a fiduciary *stricto sensu* but simply had withheld property from the plaintiff in an unconscionable manner.”

¹⁶ *Girardet v. Crease & Co.* (1987) 11 B.C.L.R. (2d) 361 at 362. See also *Lac Minerals Ltd. v. International Corona Resources Ltd.* [1989] 61 D.L.R. (4th) 14 at 26, per Justice LaForest: “There are few legal concepts more frequently invoked but less conceptually certain than that of the fiduciary relationship.” John Glover, “The Identification of Fiduciaries”, in Peter Birks, ed., *Privacy and Loyalty* (Oxford: Oxford University Press, 1997) 269 at 269: “It is not easy to predict where and when the next fiduciary relationship will be found. Across the common law world, there is an absence of agreed criteria for how the ‘fiduciary’ word should be used.”

¹⁷ John McGhee, ed., *Snell’s Equity*, 31st ed. (London: Thomson/Sweet & Maxwell, 2005) 145-146.

¹⁸ *Bristol and West Building Society v Mothew* [1998] Ch 1 at 16.

¹⁹ *Ibid.*

specific to fiduciaries. Compare the following statements. In *Canson Enterprises Ltd. v. Boughton & Co.*, Justice McLachlin (as she then was) observed that “[t]he fiduciary relationship has trust, not self-interest, at its core...”²⁰ In *Hodgkinson v. Simms* La Forest J., writing the majority opinion, asserted that the distinguishing feature of fiduciary relations is “the presence of loyalty, trust, and confidence.”²¹ According to Lord Millet, confidence is the hallmark of fiduciary relations: “confidence is the very essence of the [fiduciary] relationship. Unless a relationship is one of trust and confidence, it is not fiduciary.”²² The trust and confidence reposed generate a duty of loyalty: “[t]he distinguishing obligation of a fiduciary is the obligation of loyalty.”²³

The prevalence of these terms in fiduciary law creates an appearance of consistency and harmony. When probing beyond these labels, however, a significant divergence of views appears.²⁴ The opinions expressed by courts and commentators as concerns the actual meaning or relevance of ‘trust’, ‘confidence’ or ‘loyalty’ demonstrate that these words have no technical meaning in fiduciary law. Moreover, ‘trust’ and ‘confidence’ are not concepts used exclusively in relation to fiduciary duties. They have been used in other legal contexts, such as mortgage or insurance contracts, family relations, public services or liberal professions in general.²⁵

The observation that fiduciary relations are based on trust and confidence, while etymologically correct, does not have any significant analytical relevance. Beneficiary’s trust and confidence in the fiduciary, while often present, are not essential elements of a fiduciary relation. The fact that in an established fiduciary relation (such as trustee-beneficiary or parent-

²⁰ *Canson Enterprises Ltd. v. Boughton & Co.* (1991), 85 D.L.R. (4th) 129 at 154.

²¹ *Hodgkinson v. Simms* (1995) 117 DLR (4th) 161 at 173.

²² *R. v. Chester and North Wales Legal Aid Area Office (No.12), Ex parte Floods of Queensferry Ltd.* [1998] 1 W.L.R. 1496 at 1500.

²³ *Bristol and West Building Society v Mothew* [1998] Ch 1 at 18, per Millet L.J.

²⁴ See Paul D. Finn, “The Fiduciary Principle”, in T. G. Youdan, ed., *Equity, Fiduciaries and Trusts* (Toronto: Carswell, 1981) 1 at 26: “Our present uncertainty is thought to be exacerbated by the lack of a workable and unexceptionable definition of a fiduciary. We have no shortage of rival approaches, but none has carried the day.”

²⁵ See e.g. Sir Thomas Wardlaw Taylor and Joseph Story, *Commentaries on Equity Jurisprudence: Founded on Story* (Toronto: Willing and Williamson, 1875) at 59-63; Carole Smith, “Understanding Trust and Confidence: Two Paradigms and their Significance for Health and Social Care” (2005) 22 *Journal of Applied Philosophy* 299.

child) the beneficiary has subjectively no trust at all in the fiduciary does not in any way relieve the latter from his duties as a fiduciary.²⁶

Consequently, strictly from a terminological point of view, ‘trust’, ‘confidence’ or ‘loyalty’ should not be drivers of fiduciary law analysis. Identifying the substance of fiduciary duties is not a question of semantics.²⁷ Fiduciary law theory needs to break loose from the constraints of the traditional terminology, and concentrate on the substantial features of a fiduciary role.

1.3 Who is a ‘fiduciary’?

In addition to the problem of identifying the content of fiduciary duties, a central question that has preoccupied fiduciary law scholars for the longest time is: how do fiduciary duties arise? In other words, when is a person bound by fiduciary duties? Who is a fiduciary?

The traditional view of fiduciary relations is based on the idea that one person holds or controls property that in Equity belongs to another.²⁸ The traditional position of the Court of Chancery to fiduciary relations was narrow: only a limited number of relations were recognized as fiduciary. Established fiduciary positions included trustees, guardians, executors, receivers, agents, attorneys, corporate directors or officers, partners, and joint adventurers.²⁹

²⁶ See Ernest Weinrib “The Fiduciary Obligation” (1975) 25 University of Toronto Law Journal 1 at 5.

²⁷ As Robert Flannigan aptly observed, “semantics are a main source of confusion in the fiduciary jurisprudence.” Robert Flannigan, “The Boundaries of Fiduciary Accountability” (2004) 83 Canadian Bar Review 35 at 86.

²⁸ See generally Andrew Hicks, “The Remedial Principle of *Keech v Sandford* Reconsidered” (2010) 69 Cambridge Law Journal 287.

²⁹ See e.g. Austin W. Scott, “The Trustee’s Duty of Loyalty” (1936) 49 Harvard Law Review 521 at 521. The Indian Trusts Act of 1882 offers a statutory enumerations of such positions and of the duties attached to them: “Where a trustee, executor, partner, agent, director of a company, legal adviser, or other person bound in a fiduciary character to protect the interests of another person, by availing himself of his character, gains for himself any pecuniary advantage, or where any person so bound enters into any dealings under circumstances in which his own interests are, or may be, adverse to those of such other person and thereby gains for himself a pecuniary advantage, he must hold for the benefit of such other person the advantage so gained.” (*Indian Trusts Act of 1882*, S.88, in William Fischer Agnew, *The Law of Trusts in British India* (Calcutta: Thacker, Spink and Co., 1882) 493).

The traditional narrow approach, however, has been incrementally loosened by adding other persons “clothed with a fiduciary character”,³⁰ without a firm understanding of the main elements of a fiduciary relation. This has led to an unprincipled and often inconsistent body of court decisions with regard to the identification of fiduciaries. At the end of the nineteenth century, commentators began to express their doubts that a unifying theme could be identified:

The fiduciary relation, as it is called, does not depend upon any particular circumstances. It exists in almost every shape. It exists, of course, notoriously in the case of trustee and *cestui que trust*; it exists in the case of guardian and ward, of parent and child, of solicitor and client. Indeed, [a] recent decision... has gone so far as to say that it also may be created voluntarily, as it were, by a person voluntarily coming into a state of confidential relation with another...³¹

The family of fiduciary relations grew throughout the twentieth century in an unprincipled way. The label ‘fiduciary relationship’ started to be applied loosely to relationships marked by ‘trust and confidence.’ In a famous comment, Fletcher Moulton L.J. observed that

Fiduciary relations are of many different types; they extend from the relation of myself to an errand boy who is bound to bring me back my change up to the most intimate and confidential relations which can possibly exist between one party and another where the one is wholly in the hands of the other *because of his infinite trust in him*.³²

The remedies-driven approach was another way in which the fiduciary relations were expanded haphazardly. In *Reading v R*, for example, Asquith L.J. stretched the ambit of fiduciary relation and argued that a person wearing the Crown’s uniform stood in a fiduciary relation to the Crown with respect to the use of the uniform.³³ Asquith L.J. argued that, for the purpose of the fiduciary relation, ‘property’ should be interpreted extensively:

³⁰ Charles Forsyth, *The Principles and Practice of the Law of Trusts and Trustees in Scotland* (Edinburgh: W. Blackwood and Sons, 1844) 113.

³¹ *Plowright v. Lambert* (1885) 52 L.T. 646 at 652, per Field J.

³² *Re Coomber* [1911] 1 Ch 723 at 728, emphasis added.

³³ *Reading v R* [1949] 2 KB 232.

[T]he term ‘fiduciary relation’... is used in a very loose, or at all events a very comprehensive, sense. A consideration of the authorities suggests that for the present purpose a ‘fiduciary relation’ exists (a) whenever the plaintiff entrusts to the defendant property, including intangible property as, for instance, confidential information, and relies on the defendant to deal with such property for the benefit of the plaintiff or for purposes authorized by him, and not otherwise ... and (b) whenever the plaintiff entrusts to the defendant a job to be performed, for instance, the negotiation of a contract on his behalf or for his benefit, and relies on the defendant to procure for the plaintiff the best terms available...³⁴

The next step in expanding the application of fiduciary duties was the assertion that the list of fiduciary relations is not closed. Canadian courts and commentators have been the champions of the open-ended nature of fiduciary relations. In *Guerin v. The Queen* Dickson J. of the Supreme Court of Canada, writing for the majority, famously affirmed:

It is sometimes said that the nature of fiduciary relationships is both established and exhausted by the standard categories of agent, trustee, partner, director, and the like. I do not agree. It is the nature of the relationship, not the specific category of actor involved that gives rise to the fiduciary duty. The categories of fiduciary, like those of negligence, should not be considered closed.³⁵

The recognition of the open-ended nature of the family of fiduciary relations has created the need to identify the core elements that trigger the application of fiduciary duties in new relations. In her minority opinion in *Frame v. Smith*, Justice Wilson laid down a ‘rough and ready guide’ that could help judges investigate whether or not the imposition of a fiduciary obligation

³⁴ *Ibid.* at 236. On appeal Lord Porter expressed his agreement with Asquith LJ: “In any case, I agree with Asquith LJ in thinking that the words ‘fiduciary relationship’ in this setting are used in a wide and loose sense.” (*Reading v A-G* [1951] AC 507 at 516). This decision has been criticised by many commentators. Paul Finn has criticised the finding of a fiduciary relationship in *Reading* on the ground that the duties of someone holding such a public office would be better regulated by public law (Paul D. Finn, *supra* note 11 at 215). Gareth Jones argued that it was unnecessary to impose the fiction of a fiduciary relationship in *Reading* in order to obtain an account for the profits; the case is best understood as one of unjust enrichment (Gareth Jones, “Unjust Enrichment and the Fiduciary’s Duty of Loyalty” (1968) 84 Law Quarterly Review 472).

³⁵ *Guerin v. The Queen*, [1984] 2 S.C.R. 335 at 384. See also *Laskin v Bache & Co Inc* (1971) 23 D.L.R. (3d) 385 at 392, per Arnup J.: “In my opinion, the category of cases in which fiduciary duties and obligations arise from the circumstances of the case and the relationship of the parties is no more ‘closed’ than the categories of negligence at common law.”

on a new relationship would be appropriate.³⁶ Although it has been subsequently endorsed by the Supreme Court of Canada, Wilson J.'s guide has failed to provide a cogent foundation for the expansion of the fiduciary family.

The problem of identifying the core elements of a fiduciary relation has been amply debated and, until recently, there was no sign of progress in sight.³⁷ At a very general level, scholars agree to classify fiduciary relations in two groups. First, there are the recognized, or *per se* categories (such as trustee-beneficiary, agent-principal, director-corporation, or solicitor-client) in which, do to their inherent purpose or their presumed factual or legal incidents, fiduciary obligations are presumed to exist. Second, there are legal relations that do not belong to an established category, but where fiduciary obligations may arise *ad hoc*, based on the concrete factual circumstances. In these relations, the existence of fiduciary duties must be proved, based on relevant indicia. The main significance of the distinction between established and *ad hoc* fiduciary relations concerns the proof of the existence of fiduciary duties. The established fiduciary relations create a strong, yet rebuttable, presumption that fiduciary duties have been assumed, while in the *ad hoc* cases the existence of the relevant indicia must be proved in order to establish the incidence of fiduciary duties.³⁸

³⁶ *Frame v. Smith* [1989] 2 S.C.R. 99 at [60]

³⁷ Lord Millett, writing extra-judicially, observed that "as usual, we have tried to muddle through without attempting a definition, believing that anyone can recognize a fiduciary when he sees one. Recent experience shows this to be optimistic." (Peter Millett, "Equity's Place in the Law of Commerce" (1998) 114 Law Quarterly Review 214 at 218); see also Peter D. Maddaugh, "Definition of Fiduciary Duty", in *Special Lectures of the Law Society of Upper Canada, 1990, Fiduciary Duties* (Scarborough: The Law Society of Upper Canada, 1991) 15 at a 16: "Who is a fiduciary? The answer to this question, despite hundreds of years of litigation on the subject, is not at all clear."

³⁸ See *Lac Minerals Ltd v International Corona Resources Ltd* (1989) 61 D.L.R. (4th.) 14 at 28. To these two categories another category may be added: the instrumental use of 'fiduciary relation'. In some cases the courts have found a breach of fiduciary duties motivated by the desire to apply certain equitable remedies that they considered applicable only for breach of fiduciary duty. In *Re West of England and South Wales District Bank, Ex parte Dale and Co*, for instance, Fry J. defined a fiduciary relation as 'one in respect of which if a wrong arise the same remedy exists against the wrongdoer on behalf of the principal as would exist against a trustee on behalf of the cestui que trust.' (*Re West of England and South Wales District Bank, Ex parte Dale and Co* (1879) 11 Ch.D. 772 at 778). See also *Chase Manhattan Bank N.A. v. Israel-British Bank (London) Ltd.*, [1981] Ch. 105, where a fiduciary duty was artificially found in order to entitle the plaintiff to trace a mistaken payment; *Goodbody v. Bank of Montreal* (1974), 47 D.L.R. (3d) 335 at 339, where a thief was considered to be a fiduciary so as to ground an equitable tracing order. This approach has been

Beyond this broad consensus concerning the two types of scenarios where fiduciary duties may arise, courts and theorists have expressed many different views with respect to the necessary and sufficient core elements that attract fiduciary duties. These views have resulted in an abundance of theories, which have rendered almost hopeless the quest for unifying principles.³⁹ Recent jurisprudential developments, however, have focused the analysis of the core elements of fiduciary relations on two elements: undertaking to act in another's interests and power or discretion to affect another's interests.

In contrast with the views on the content of fiduciary duties, which continue to be divided, a consensus seems to emerge with respect to the

widely criticized. Peter Birks described this approach as shifting "the characterization of a relationship as fiduciary from the reasoning which justifies a conclusion to the conclusion itself: a relationship becomes fiduciary because a legal consequence traditionally associated with that label is generated by the facts in question." (Peter Birks, "Restitutionary Damages for Breach of Contract: Sneppe and the Fusion of Law and Equity" [1987] *Lloyd's Maritime and Commercial Law Quarterly* 421, at 436). Similarly, Ernest Weinrib argued that "[t]his definition in terms of the effect produced by the finding of a fiduciary relation begs the question in an obvious way: one cannot both define the relation by the remedy and use the relation as a triggering device for remedy." (Ernest Weinrib "The Fiduciary Obligation", *supra* note 26 at 5).

³⁹ This dissertation will not attempt to review the main theories concerning the core elements of a fiduciary relation. In the light of the recent developments, such an exercise would be largely useless. Besides, several excellent reviews of the main theories have already been written. See Leonard Rotman, *Fiduciary Law* (Toronto: Thomson Canada, 2005); Matthew Conaglen, *Fiduciary Loyalty: Protecting the Due Performance of Non-Fiduciary Duties* (Oxford: Hart Publishing, 2010). Shepherd's classification of such theories, drawn up thirty years ago, is illustrative of the multitude of diverging views. Shepherd identified eight currents of thought on the nature of the fiduciary relationship: (1) the *property theory*, claiming that the fiduciary relationship exists when one person has legal title over the property of another, the later being the beneficial owner; (2) the *reliance theory*, arguing that a fiduciary relationship exists where one person reasonably relies on another to act in the former's best interests; (3) the *unequal relationship theory*, according to which a fiduciary relationship is created whenever there is a *de jure* or *de facto* inequality of footing between parties; (4) the *contractual theory*, claiming that a fiduciary relationship occurs whenever a person binds himself in some way to protect and/or to advance the interests of another; (5) the *unjust enrichment theory*, claiming that a fiduciary relationship is created when one person obtains property or other advantages which should belong to another; (6) the *commercial utility theory*, claiming that a fiduciary relationship will be found whenever the court feels it necessary to hold a person or a certain class of persons to a higher than average standard of ethics or good faith, with a view to protecting the integrity of commercial relations; (7) the *power and discretion theory*, arguing that the fiduciary relationship is a relation in which the principal's interest can be affected by the manner in which the fiduciary uses the discretion which has been delegated to him; and (8) *rule or dualistic theories*, which represent combinations or refinements of the previous theories. Jay C. Shepherd, *The Law of Fiduciaries* (Toronto: Carswell, 1981) 51-92. In addition to these theories, Shepherd proposed his own view, "the transfer of encumbered power," according to which a fiduciary relationship exists "whenever any person acquires a power of any type, on condition that he also receive with it a duty to utilize that power in the best interests of another, and the recipient of that power uses that power." (*Ibid.* at 93-125).

question of determining how these duties arise. In the recent unanimous decision in *Galambos v. Perez*,⁴⁰ the Supreme Court of Canada has made significant progress towards reconciling the multitude or divergent theoretical approaches to this difficult question. The Court has unanimously identified *undertaking* to act for another and *power* over another's interests as the two core elements that make a person a fiduciary. Due to the leading role that the Canadian Supreme Court has played in developing the law of fiduciary duties, it can be expected that *Galambos* will put to rest the controversies concerning the source of fiduciary duties. Consequently, this dissertation will not focus on the question of the core elements of a fiduciary relation. The analysis of fiduciary duties will be based on the premise that the core fiduciary duty is undertaken voluntarily and require power or discretion over another's interests. Elements such as trust and confidence (in the lay meaning of these words), vulnerability, reliance or reasonable expectations may be present in a fiduciary relation, but are not essential for its existence. Since *Galambos* is especially relevant for the context of this research, a succinct presentation of this decision is opportune at this stage.

The main issue in *Galambos* was whether a law firm and a senior lawyer owed a fiduciary duty to the firm's bookkeeper with regard the unsolicited cash advances made by the latter.⁴¹ The Supreme Court held in unanimity that no fiduciary duty existed between the defendants and the plaintiff, since the essential requirements of power and undertaking of loyalty were absent.

⁴⁰ *Galambos v. Perez* [2009] 3 S.C.R. 247.

⁴¹ Estela Perez was bookkeeper with the law firm founded by Michael Galambos. In time, Perez effectively became the office manager, overseeing the firm's income, expenses and accounting and had unlimited signing authority on the firm's non-trust bank accounts. Wishing to help alleviate the cash flow problems of her employer, Perez made sizeable unsolicited cash advances to the firm from her own funds. The firm, during the time Perez worked for it, took charge of the preparation and execution of wills for her and her husband, as well as two mortgage transactions. The firm did not expect to be and was not paid for these services. When the firm was placed in receivership and Galambos went bankrupt, Perez found herself an unsecured creditor. Perez sued Galambos and the firm for negligence, breach of contract and breach of fiduciary duty. The trial judge dismissed Perez's claims, finding that her rights were only those of an unsecured creditor. The Court of Appeal of British Columbia set aside the trial decision and held that Galambos and his law firm owed Perez *ad hoc* fiduciary duties in relation to the cash advances, which they had breached. The Supreme Court of Canada allowed the lawyers' appeal and restored the trial court judgment.

Cromwell J., writing the unanimous decision, started the analysis of the fiduciary duty by endorsing the established distinction between recognized, or *per se* fiduciary relations, where fiduciary obligations are presumed to exist, and specific circumstances where fiduciary obligations exist *ad hoc*.⁴² Concerning the latter scenario, Cromwell J. clarified several key points in determining when fiduciary obligations arise. First, Cromwell J. discarded the normative relevance of vulnerability. He emphasized that vulnerability may be relevant insofar as it *results* from the relationship which creates the fiduciary duty, but a pre-existing situation of vulnerability is not an essential element for identifying the existence of a fiduciary duty.⁴³ Second, Cromwell J. contested the analytical relevance of the power-dependency concept. Since not all power-dependency relations are fiduciary in nature, labelling a relation as power-dependency is not, on its own, relevant in deciding whether the relationship is fiduciary or not.⁴⁴

In the remaining part of the decision, Cromwell J. analyzed the two elements that are indispensable for the existence of a fiduciary relation: undertaking to act in another's interests and power (or discretion) to affect the other's interests.

The requirement of undertaking to act for another signifies that fiduciary duties are triggered voluntarily. They are enforceable only against those persons who undertook them, either expressly or implicitly: "... the law is, in my view, clear that fiduciary duties will only be imposed on those who have expressly or impliedly undertaken them."⁴⁵ Although one party's voluntary manifestation of will to act in the interests of the other party is essential, the other party's consent is not required. The undertaking may be the result of "exercise of statutory powers, the express or implied terms of an agreement or, perhaps, simply an undertaking to act in this way."⁴⁶ In the case of *per se* fiduciary relations, this undertaking is found in the nature of

⁴² *Supra* note 40 at [49].

⁴³ *Ibid.* at [68].

⁴⁴ *Ibid.* at [74].

⁴⁵ *Ibid.* at [71]. See also Lionel Smith, "Fiduciary Relationships Arising in Commercial Contexts; Investment Advisors: *Hodgkinson v Simms*" (1995) 74 Canadian Bar Review 714 at 717: "The fiduciary must *relinquish* self-interest" for a fiduciary relationship to be established."

⁴⁶ *Ibid.* at [77].

the category of relation. In the *ad hoc* circumstances, there must be an express or implied undertaking to exercise a discretionary power in the interests of the other party.⁴⁷

Concerning the requirement of power, Cromwell J. observed that the Supreme Court has consistently held that the existence of a discretionary power to affect the legal or practical interests of another is a fundamental characteristic of fiduciary relations.⁴⁸ Although power in itself is not sufficient to create fiduciary duties, its absence negates the existence of such duties.⁴⁹ Unfortunately, Cromwell J. described the power only in broad terms, as the ability to affect the other party's legal or practical interests.⁵⁰ Such a broad definition, however, is unhelpful for determining when fiduciary duties arise. Something more is needed.

The feature that qualifies the 'power' requirement of a fiduciary relation is discretion.⁵¹ A fiduciary has discretionary power in the sense that he has authority to decide how to promote the best interests of the beneficiary (and not simply authority to decide whether to act or not in a pre-defined manner). In other words, the requirement of power is best understood as decision-making authority. In a very recent article on fiduciary duties, Paul Miller compared and contrasted various meanings of power and concluded

⁴⁷ *Ibid.* at [66]-[77]: "[I]t is clearly settled that the undertaking itself is fundamental to the existence of an *ad hoc* fiduciary relationship... [A] critical aspect of a fiduciary relationship is an undertaking of loyalty: the fiduciary undertakes to act in the interests of the other party... Thus, what is required in all cases of *ad hoc* fiduciary obligations is that there be an undertaking on the part of the fiduciary to exercise a discretionary power in the interests of that other party... In cases of *per se* fiduciary relationships, this undertaking will be found in the nature of the category of relationship in issue. The critical point is that in both *per se* and *ad hoc* fiduciary relationships, there will be some undertaking on the part of the fiduciary to act with loyalty."

⁴⁸ For other Supreme Court cases underlining the importance of power or discretion see *infra* note 53.

⁴⁹ *Supra* note 40 at [84]: "The presence of this sort of power will not necessarily on its own support the existence of an *ad hoc* fiduciary duty; its absence, however, negates the existence of such a duty."

⁵⁰ *Ibid.*: "The nature of this discretionary power to affect the beneficiary's legal or practical interests may, depending on the circumstances, be quite broadly defined. It may arise from power conferred by statute, agreement, perhaps from a unilateral undertaking..." Cromwell J's definition resembles Hohfeld's understanding of power. Hohfeld defined power as the legal ability to perform a juridical act that changes legal relations or legal positions (see Wesley N. Hohfeld, *Fundamental Legal Conceptions* (New Haven: Yale University Press, 1923) 50. This understanding of power is too broad for the purpose of defining fiduciary relations.

⁵¹ For more details concerning the relevance of discretion see Section 4.4 below.

that the best way to understand this concept in fiduciary law is as discretionary authority:

To have fiduciary power is to enjoy authority over the practical interests of another... The discretionary character of authority means that the fiduciary has scope for judgment in determining how to act under authority... [T]he scope of authority, and thus the ambit of rightful conduct, is broader than would be the case if authority were fixed.⁵²

The argument of this dissertation is built on this understanding of power. In order for fiduciary duties to exist, the fiduciary must have authority to decide how to promote the interests of the beneficiary within a specific relation.

The unanimous decision of the Supreme Court of Canada in *Galambos* represents an important step forward in the efforts to articulate cogent legal principles governing fiduciary duties. *Galambos* advances the fiduciary law theory by systematizing the existing knowledge, rather than revolutionizing the law. The Supreme Court's focus on undertaking and power endorses a pre-existing current of opinion, rather than introducing completely new elements. The importance of these elements had been underlined before by many other courts and commentators.⁵³ The unanimous

⁵² Paul B. Miller, "A Theory of Fiduciary Liability" (2011) 56 McGill Law Journal 235 at 272-275. Evan Fox-Decent expressed the same idea using the concept of administration. See Evan Fox-Decent, "The Fiduciary Nature of State Legal Authority" (2005) 31 Queen's Law Journal 259 at 301: "[T]he kind of power a fiduciary exercises is more than a simple possessory or dispositive control over another party's interests. It is a complex of powers the incidents of which are best captured and thematically unified by the idea of administration. Administration implies a capacity to exercise discretion on behalf of a principal in respect of certain interests, and vis-à-vis third parties."

⁵³ In 1987, referring to the constitutive elements of her 'rough and ready' guide, Wilson J. asserted that unilateral power or discretion over another's interests is the central factor that signals the existence of a fiduciary duty in a given relation. No fiduciary duty can exist in the absence of power: "[U]nless such a discretion or power is present there is no need for a superadded obligation to restrict the damaging use of the discretion or power." (*Frame v Smith* (1987) 42 DLR (4th) 81 at 99). See also: *Haida Nation v. British Columbia (Minister of Forests)*, [2004] 3 SCR 511 at [18], per McLachlin CJ: "[W]here the Crown has assumed discretionary control over specific Aboriginal interests... the honour of the Crown gives rise to a fiduciary duty."; *Wewaykum Indian Band v Canada*, [2002] 4 SCR 245 at [79], per Binnie J: The Crown owes fiduciary duties to the aboriginal nations in order to "facilitate supervision of the high degree of discretionary control gradually assumed by the Crown over the lives of aboriginal peoples." *Hodgkinson v Simms*, [1994] 3 SCR 377 at 466, per Sopinka and McLachlin JJ: "The distinguishing characteristic [of a fiduciary relation] is the ceding by one party of effective power to the other."; *Norberg v Wynrib*, [1992] 2 S.C.R. 226 at 230, per McLachlin J: "The essence of a fiduciary relationship... is that one party exercises power on behalf of another and pledges himself or herself to act in the best interests of the other."

recognition of the centrality of these elements, however, coupled with the abandonment of several false indicia (vulnerability and power-dependency) have created the premise for a sound understanding of when fiduciary duties arise and what they entail.

The importance of undertaking and discretion has been restated recently in another unanimous decision of the Supreme Court of Canada. In *Alberta v. Elder Advocates of Alberta Society*, McLachlin C.J., writing for the Court, stated that, in order for ad hoc fiduciary duties to be imposed, the following elements must be present:

- (1) an undertaking by the alleged fiduciary to act in the best interests of the alleged beneficiary or beneficiaries;
- (2) a defined person or class of persons vulnerable to a fiduciary's control (the beneficiary or beneficiaries); and
- (3) a legal or substantial practical interest of the beneficiary or beneficiaries that stands to be adversely affected by the alleged fiduciary's exercise of discretion or control.⁵⁴

The ambiguous presence of vulnerability in this decision is a remnant of *Galambos*. Nevertheless, similarly to Cromwell J, McLachlin CJ explained that vulnerability alone is insufficient to support a claim for recognition of fiduciary duties.⁵⁵ Vulnerability is relevant only insofar as it represents the correlative of discretionary power. Thus, fiduciary duties are owed “to a defined person or class of persons who must be vulnerable to the fiduciary *in*

Guerin v. The Queen, [1984] 2 S.C.R. 335 at 384: “[W]here by statute, agreement, or perhaps by unilateral undertaking, one party has an obligation to act for the benefit of another, and that obligation carries with it a discretionary power, the party thus empowered becomes a fiduciary. Equity will then supervise the relationship by holding him to the fiduciary’s strict standard of conduct.” Ernest Weinrib identified discretion to affect another’s interests as the key element of a fiduciary relation: “First, the fiduciary must have scope for the exercise of discretion, and, second, this discretion must be capable of affecting the legal position of the principal.” See Ernest Weinrib, *supra* note 26 at 4. Austin Scott expressed a similar view. See Austin W. Scott “The Fiduciary Principle” (1949) 37 California Law Review 539 at 540: “Who is a fiduciary? A fiduciary is a person who undertakes to act in the interest of another person. It is immaterial whether the undertaking is in the form of a contract. It is immaterial that the undertaking is gratuitous.” More recently, Paul Miller emphasized the centrality of discretionary power in a fiduciary relation. See Paul B. Miller, *supra* note 52 at 262: “A fiduciary relationship is one in which one party (the fiduciary) enjoys discretionary power over the significant practical interests of another (the beneficiary).”

⁵⁴ *Alberta v. Elder Advocates of Alberta Society* [2011] 2 S.C.R. 261 at [36].

⁵⁵ *Ibid.* at [28].

the sense that the fiduciary has a discretionary power over them.”⁵⁶ This explanation is both useful and confusing. It is useful in the sense that it could clarify the meaning of ‘vulnerability’ in *Galambos*. Beneficiary’s vulnerability resulting from the fiduciary relation is a consequence of the existence of discretionary power on the fiduciary’s part, rather than an independent requirement. The inclusion of vulnerability among the requirements for an ad hoc fiduciary relation is confusing because it leaves room for the continuance of the debate concerning the normative relevance of vulnerability. Interpreted systematically, however, *Galambos* and *Elder Advocates* make it clear that undertaking to act for another and acquisition of power or discretion over the other’s interests are the central elements that justify the imposition of fiduciary duties.

These developments form the basis on which this dissertation will build the new approach to the content of fiduciary duties. The requirements of undertaking and power (in the sense of decision-making authority) inform the understanding of the content and justification of fiduciary duties in two important ways. First, the element of authority to affect the beneficiary’s interests shows that the fiduciary has discretion, or scope for exercise of judgment with respect to the manner in which he will affect these interests.

Second, the element of undertaking shows that fiduciary duties are enforced because the fiduciary has agreed to do a certain task or fulfil a certain position that requires exercise of judgment for the benefit of another. In other words, the requirement of undertaking shows that there is a voluntary aspect in the creation of fiduciary duties. As it will be explained in more detail throughout the following sections, the view adopted by this dissertation is that the fiduciary duties are composed of a core duty and a set of prophylactic or proscriptive duties. The core duty is the duty to exercise judgment based on relevant factors. It aims to guide the way in which fiduciaries exercise discretion. The prophylactic duties are the duties stemming from the general prohibition of deciding in a position of conflict of interest. These duties aim to protect the core duty, by keeping aside interests that may impair the proper fulfilment of the core duty. In this context, the

⁵⁶ *Ibid.* at [33].

element of undertaking shows that the core duty always arises voluntarily: a fiduciary is required to exercise judgment based on relevant considerations because he has voluntarily undertaken a position or a task that involves exercise of discretion. The prophylactic duties, however, are imposed by law. As it will be discussed in more detail below, cognitive sciences have argued convincingly that the presence of self-interest with regard to the outcome of a decision-making process affects the reliability of the decision maker's judgment in ways that are difficult to measure or to prevent. Consequently, the law imposes the prophylactic duties in order to prevent the potential impairment of the fiduciary's exercise of judgment.

1.4 Dissertation objectives, structure and limitations

In a famous aphorism, Oliver Holmes stated that “the life of the law has not been logic: it has been experience.”⁵⁷ Does this aphorism indicate the best approach to fiduciary law? Is it necessary to identify the content and justification of fiduciary duties or should this concept be left vague and flexible? The constant attempts to identify workable fiduciary law rules and principles show that it is time to “reconcile the cases” in this legal field.⁵⁸

The increasing applicability of the fiduciary duties and the continuing tendency to invoke breach of these duties as an instrumental shortcut to alluring legal remedies have forced the courts to search for conceptual clarity with respect to the content and aims of fiduciary duties. In contrast to the sustained endeavours to map out the principles governing the fiduciary duty, or perhaps due to their unsatisfactory results, some commentators have expressed doubts concerning the feasibility or opportunity of systematization in this area of law. Some have taken the view that the principles governing fiduciary duties

⁵⁷ Oliver W. Holmes, *The Common Law* (Boston: Little & Brown 1881) 1.

⁵⁸ “It is the merit of the common law that it decides the case first, and determines the principle afterwards... It is only after a series of determinations on the same subject matter, that it becomes necessary to ‘reconcile the cases’, as it is called, that is, by a true induction to state the principle which has until then been obscurely felt. And this statement is often modified more than once by new decisions before the abstracted general rule takes its final shape.” (Oliver W. Holmes, “Codes and the Arrangement of the Law” (1870) in Sheldon M. Novick, *The Collected Works of Justice Holmes* (Chicago: University of Chicago Press, 1995) 212).

may be undefinable,⁵⁹ while others have doubted whether there can be any universal, all-purpose definition of fiduciary duties.⁶⁰

One of the few things on which commentators and justices seem to agree upon is that the search for conceptual precision “continues without evident sign of success.”⁶¹ The fiduciary duties remain, for the time being, “a concept in search of a principle.”⁶²

1.4.1 The research question and the proposed approach

This dissertation aims to investigate and explain the content and justification of the notion of fiduciary duties in private law relations. The thesis proposes the following understanding of fiduciary duties: in a legal relation where one party undertakes to act in the interests of another, and acquires power or discretion over the other’s interests, such party becomes subject to a core duty to exercise his best judgment in the other’s interests. Due to the existence of this core duty, the person also becomes subject to a set of proscriptive duties. The purpose of the proscriptive duties is prophylactic: they aim to prevent self-interest from affecting the person’s best judgment in a conscious or subconscious way. The proscriptive duties add extra protection to the beneficiary’s right to a proper exercise of judgment by the fiduciary.

The dissertation argues that strict private law no-conflict duties exist not to deter temptations, but to protect the beneficiary’s right to the fiduciary’s best judgment. Modern studies in business ethics, political theory and psychology have demonstrated that the decision-making process of persons who must decide over the interests of others (such as public officials or professional providers of services) can be affected if the decision-maker

⁵⁹ See Dennis Klinck, “The Rise of the ‘Remedial’ Fiduciary Relationship: A Comment on *International Corona Resources Ltd. v. Lac Minerals Ltd.*” (1988) 33 McGill Law Journal 600 at 603.

⁶⁰ See Robert P. Austin, “Commerce and Equity: Fiduciary Duty and Constructive Trust” (1986) 6 Oxford Journal of Legal Studies 444 at 445.

⁶¹ Sir Peter Millet, “Equity’s Place in the Law of Commerce” (1998) 114 Law Quarterly Review 328 at 426.

⁶² Sir Anthony Mason, “Themes and Prospects” in Paul D. Finn, ed., *Essays in Equity* (Sydney: Law Book Co, 1985) 242 at 246.

has a potential personal interest in the outcome of the decision.⁶³ The proscriptive duties are imposed to prevent self- or other-regarding interests from interfering with the decision-making process.

1.4.2 The relevance of the research

A cogent articulation of the fiduciary principle is required for two main reasons. First, within the common law jurisdictions, a uniform understanding of fiduciary duties is required in order to reconcile the contradictory jurisprudential developments and to offer a firm basis for future developments. Second, from a comparative law perspective, understanding the circumstances in which fiduciary duties arise and their content demystifies this concept as a purely common law institution that is ‘transplanted’ in civil law. The comparative research undertaken in this dissertation demonstrates that identifying a theoretical model for the law’s approach to exercising discretion over another’s interest is a problem that transcends national jurisdictions or legal traditions.

The proposed theory advances the existing scholarship concerning the fiduciary duty by offering a model that transcends the traditional conceptual framework within which debates over the nature and content of this concept have taken place. Its original insights have the potential not only to align the caselaw in a particular jurisdiction, but also to suggest the basis for the inclusion of general principles governing conflicts of interest in the various projects of European-level private law principles.

The dissertation advances the knowledge in the field of fiduciary relations due to the multiple dimensions along which the research is carried. In addition to the common law traditions, the dissertation has a comparative, a philosophical and a historical dimension.

⁶³ Consider the following example, provided by Michael Davis: “I would have a conflict of interest if I had to referee at my son’s soccer game. I would find it harder than a stranger to judge accurately when my son had committed a foul... I do not know whether I would be harder on him than an impartial referee would be, easier, or just the same... I could not be as reliable as an equally competent [referee] would be.” (Michael Davis, “Introduction” in Michael Davis and Andrew Stark, eds., *Conflict of Interest in the Professions* (Oxford: Oxford University Press, 2001) 3 at 16).

The comparative dimension is focused on the French civil law, and purports to show that the preoccupation with identifying a common set of rules for private law relations where one party must act in the interests of the other is not unique to common law.

The philosophical dimension shows that theorists from the fields of ethics or political science have developed a ‘standard view’ of what a conflict of interest is. This standard view shows that an accurate understanding of conflict of interest involves a conflict between exercise of judgment and self-interest (the same rationale applying to conflict between duties to exercise proper judgment owed to different beneficiaries). The ‘standard view’ incorporates recent research in cognitive sciences and demonstrates that the traditional ethical understanding of conflict of interest (i.e. conflict between two person’s diverging interests, to be addressed by firm resistance to temptation) is naïve. A conflict of interest situation cannot be managed by resisting temptation: the presence of self-interest affects the liability of decision-maker’s judgment in ways that cannot be measured or prevented.

The historical dimension demonstrates that the idea that self-interest affects the reliability of judgment is older than the contemporary conflict of interest philosophers may suggest. With roots going back to the beginning of the Christian era, the ideas of error of judgment caused by self-interest or biased judgment have been articulated in various forms in the legal and philosophical landscape of the middle ages.

1.4.3 The structure of the dissertation

In addition to the introduction, the dissertation comprises four main chapters and the conclusion. The second chapter is an overview of the development of the common law doctrine and caselaw concerning the meaning and the purpose of fiduciary duties. The research shows that the predominance of the idea of ‘conflicting interests’ between the fiduciary and the beneficiary, as opposed to the conflict between interest and core duty is the main source of misunderstanding of the content and role of ‘fiduciary duties’.

The third chapter is a foray into French civil law. The analysis of several recent theories shows that, similar to their common law colleagues, French scholars are concerned with identifying a set of rules and principles that regulate conflicts of interest and exercise of discretion in private law relations.

The fourth chapter presents recent research in ethics and philosophy that demonstrates that a cogent understanding of ‘conflict of interest’ opposes self-interest (or other extraneous interests) and the duty to exercise proper judgment. The same understanding is conveyed by the rules against bias developed in administrative law.

The fifth chapter is a historical essay. Without attempting to demonstrate that the proposed understanding of fiduciary duties is supported by historical arguments, this chapter shows that legal scholars and philosophers have been aware for many centuries that self-interest affects the reliability of one’s judgment.

The final chapter summarizes the findings of the research and places them in the broader framework of the comparative law efforts to explain the private law in system-neutral concepts.

1.4.4 The limitations of the research

As mentioned before, the dissertation does not engage with the problem of identifying the core elements that are required for fiduciary duties to exist. The recent jurisprudential developments in this field, underlining the importance of ‘undertaking’ and ‘power’, are taken as a premise for understanding the content of fiduciary duties. Furthermore, the dissertation does not analyze the remedies specific to breach of fiduciary duties.

The study is focused on the most relevant cases and theories in Canadian and English common law. References will be made to landmark Australian, American and Scottish cases and theories. Concerning civil law, the research engages exclusively with the French civil law.

The historical part of the dissertation does not aim to trace the historical development of the proposed approach to fiduciary duties. Its aim

is simply to suggest that the idea behind the contemporary understanding of ‘conflict of interest’ may have been known to legal scholars and philosophers many centuries ago, and therefore it is not a complete innovation.

CHAPTER II: FIDUCIARY DUTIES IN COMMON LAW

*“‘A fiduciary is not allowed to put himself in a position where his interest and duty conflict.’
‘A fiduciary is disentitled from making a profit out of his position.’
These two principles have danced a dizzying waltz
through the history of the law of fiduciaries.
And, as long as they have been dancing, academics have been whispering in the corners,
trying to fathom their relationship.” (Jay Shepherd, 1981)*

2.1 Introduction

Fiduciary duties wield on common law scholars “something of the fascination... that the search for the Holy Grail had for the knights of Antiquity.”⁶⁴ Like the quest for the Holy Grail, the search for the nature and content of fiduciary duties is complicated by the fact that scholars disagree as to what precisely the expression ‘fiduciary duty’ means. The controversy surrounds not only the group of duties that should be labelled as ‘fiduciary’, but also the normative content of the fiduciary duties. Robert Austin articulated these uncertainties in a very concise and evocative manner:

Is the hallmark of a fiduciary relationship simply that one party owes a duty of loyalty to another, or are there separate fiduciary duties of care, disclosure, and (where relevant) strict adherence to the charter (such as an instrument or memorandum or articles of association) which constitutes the relationship? What precisely do we mean by ‘loyalty’? Does it extend beyond the narrowly defined conflict and profit rules to encompass positive duties to act in the interest of the principal and in good faith?⁶⁵

This chapter is a survey of the main theories concerning the content of ‘fiduciary duties’ and the principal justifications for their existence, expressed across the most important common law jurisdictions. The dominant theory that emerges from this analysis is that ‘fiduciary duties’ are a set of proscriptive duties (encompassed by the general no-conflict rule) that

⁶⁴ Donovan Waters “Banks, Fiduciary Obligations and Unconscionable Transactions” (1986) 65 Canadian Bar Review 37 at 56.

⁶⁵ Robert P. Austin, “Moulding the Content of Fiduciary Duties” in A.J. Oakley, *ed.*, *Trends in Contemporary Trust Law* (Oxford: Oxford University Press, 1996) 153 at 153.

aim to prevent the temptation of self-interested acts to which certain private law actors are exposed. As will be shown throughout the following analysis, this entrenched view of the content and purpose of fiduciary duties is a major obstacle to creating a sound principled foundation for the law of fiduciary duties. The shortcoming of the dominant theory is that it fails to take into account what in this dissertation is considered to be the core feature of a fiduciary position: the exercise of judgment (or discretion) in another's benefit. As the following chapters will show, once the central duty to exercise judgment appropriately is understood properly, it becomes possible to offer a cogent explanation of the content and purpose of the 'fiduciary duties' (understood as the sum of the established proscriptive duties and the central duty to exercise judgment appropriately). This dissertation aims to present exactly such an explanation, and to argue that it provides a better account of fiduciary obligations than the dominant theory does.

2.2 The meaning of 'fiduciary duties'

Three main views on the meaning of fiduciary duties can be identified. In a narrow approach, the fiduciary duties are equated with the specific proscriptive duties imposed on fiduciaries. In a broader view, the fiduciary duties comprise the proscriptive duties and a set of prescriptive duties. In a third view, the fiduciary duties group is formed of the proscriptive duties and a core duty. As this section will demonstrate, only the third approach has the potential to provide a satisfactory explanation of the core feature of a fiduciary position and of the role of the proscriptive duties. The narrow view is unsatisfactory because it explains the strictness of the proscriptive duties using policy justifications that do not sit well with the private law theory (such as the need to remove temptation and discipline fiduciaries). The broader view is imprecise because it includes duties that are not restricted to fiduciaries (such as the duty of good faith or the duty of confidentiality). As concerns the third view, the theories proposed so far, which explain the content and role of fiduciary duties by reference to a core duty specific to a fiduciary position, have not demonstrated convincingly

why the core duty needs the protection of the proscriptive duties. The approach adopted by this dissertation falls in the third category. As the next chapters will show, the proscriptive duties protect the duty to exercise proper judgment by eliminating interests that could affect fiduciary's judgment independently of his good faith.

2.2.1 'Fiduciary duties' as a group of proscriptive duties

In a narrow view, 'fiduciary duty' (or 'duties') is used to refer to the established prohibitions encapsulated by the rule against conflicts of interest (the 'proscriptive duties'). This narrow view is generally formulated as follows: fiduciary duties are proscriptive; they do not tell fiduciaries what to do, only what not to do, in discharging their other duties.⁶⁶ Sometimes, however, authors express the idea that fiduciary duties are purely negative in a manner that creates confusion with respect to their actual message. These authors use a positive formulation (such as the duty 'to act altruistically' or 'selflessly' or 'solely in the best interests of the beneficiary') to express the idea that a fiduciary must not act selfishly. Therefore, when they say 'a fiduciary must act solely in the best interests of the beneficiary' they actually mean 'the fiduciary must not be in a situation of conflict of interest and must not obtain an unauthorized advantage'.⁶⁷

⁶⁶See e.g. *Breen v. Williams* (1996) 186 CLR 71 at 113, per Gaudron and McHugh JJ: "[E]quity imposes on the fiduciary proscriptive obligations - not to obtain any unauthorised benefit from the relationship and not to be in a position of conflict... [T]he law... does not otherwise impose positive legal duties on the fiduciary to act in the interests of a person to whom the duty is owed."; Deborah A. DeMott, "Breach of Fiduciary Duty: On Justifiable Expectations of Loyalty and Their Consequences" (2006) 48 Arizona Law Review 925 at 926: "[W]ithin the scope of their relationship, the fiduciary duty of loyalty proscribes self-dealing by the actor and other forms of self-advantaging conduct without the beneficiary's consent." Robert P. Austin, "Moulding the Content of Fiduciary Duties", *supra* note 65 at 156: "The fiduciary duties relate to improper profits and the avoidance of conflicts of interest, and we should no longer use fiduciary terminology to describe other duties to which fiduciaries and other may be subject."; A.J. McClean, "The Theoretical Basis of the Trustee's Duty of Loyalty" (1969) 7 Alberta Law Review 218 at 236: "In both England and Canada... two separate rules respecting a trustee's duty of loyalty have developed, the first that he may not retain a profit made out of his position and the second that he may not retain a profit made in circumstances where there is a conflict of his interest and duty."

⁶⁷See e.g. Sarah Worthington, *Equity*, 2nd ed. (Oxford: Oxford University Press, 2006) 130-131, emphasis added: "The only real 'fiduciary' obligation is the obligation of loyalty... [T]he fiduciary duty of loyalty requires fiduciaries to put their principals' interests ahead of their own: it requires fiduciaries to act altruistically. In particular, a fiduciary cannot enter

The proscriptive duties are commonly divided into four fiduciary rules: the ‘no-profit rule’, the ‘no-conflict rule’, the ‘self-dealing rule’ and the ‘fair dealing rule’.

The ‘no-profit rule’ forbids a fiduciary from retaining an unauthorized benefit acquired by virtue of his fiduciary position.⁶⁸ The ‘no-conflict rule’ states that a fiduciary is not allowed to place himself in a position where his personal interest, or interest in another fiduciary capacity, conflicts or possibly may conflict with his ‘duty’. The ‘self-dealing rule’ renders voidable, at the beneficiary’s will, purchases by a fiduciary, in his personal capacity, of property under his administration, irrespective of the honesty of the transaction. The ‘fair dealing rule’ renders voidable the purchase by a fiduciary of the beneficiary’s interest, unless the fiduciary demonstrates that the transaction is entirely fair and honest and that the beneficiary gave his informed consent.⁶⁹

into any transaction that involves a conflict between his personal interests and his management duties... [I]n fact, he cannot profit in any secret way from his position”; Paul D. Finn, “The Fiduciary Principle”, *supra* note 24 at 4: “The ‘fiduciary’ standard for its part enjoins one party to act in the interests of another – to act selflessly and with undivided loyalty.” Later in his article, Finn contended that the fiduciary principle is limited to the proscriptive rules (see *supra* note 24). Karen E. Boxx, “Of Punctilios and Paybacks: The Duty of Loyalty under the Uniform Trust Code” (2002) 67 *Missouri Law Review* 279 at 281, footnotes omitted: “The duty of loyalty requires the trustee to administer the trust solely in the interests of the beneficiaries. In general, this duty prohibits the trustee from transacting in her individual capacity with the trust and from entering into transactions where the trustee is not directly dealing with the trust but, nevertheless, has a conflict of interest.” Richard Nolan adopts a middle path between the negative and the positive formulation of the proscriptive duties. In his view, the aim of fiduciary obligations (equated with the proscriptive duties) is to encourage loyalty. Loyalty, however, is not a positive obligation the breach of which can be enforced by an equitable remedy. It is merely a “goal” to which fiduciaries are encouraged to aspire: “Fiduciary obligations promote loyalty by prohibiting disloyalty, and activity which might lead to disloyalty: fiduciary obligations are proscriptive in nature, and do not encompass the positive duties laid on those described as fiduciaries... [F]iduciary obligations are directed towards the maintenance of loyalty from those who are subject to such obligations... Loyalty is the goal.” (Richard Nolan, “Conflicts of Interest, Unjust Enrichment, Wrongdoing” in W.R. Cornish *et al.*, *Restitution Past, Present and Future: Essays in Honour of Gareth Jones* (Oxford: Hart Publishing, 1998) 87 at 88-89.

⁶⁸ The profit rule applies only when a fiduciary obtains an unauthorized benefit by use of, or by reason of, his fiduciary position (see e.g. *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 at 144-153).

⁶⁹ See John Mowbray *et al.*, eds., *Lewin on Trusts*, 18th ed. (London: Sweet & Maxwell, 2008) at para. 20-01; Lionel Smith, “The Motive Not the Deed” in *Rationalizing Property, Equity, and Trusts: Essays in Honour of Edward Burn* (London: LexisNexis UK, 2003) 53 at 55-56, note 12; Frederic W. Maitland, *Equity: Also the Forms of Action at Common Law: Two Courses of Lectures* (Cambridge: Cambridge University Press, 1909) 96-97; Matthew

Fiduciary law scholars have engaged in long debates over the autonomy of the no-profit, self-dealing and fair dealing rules with respect to the no-conflict rule. Concerning the no-conflict and the no-profit rules, a position that has strong doctrinal support is that the no-conflict rule encompasses the no-profit rule. In the landmark case *Boardman v. Phipps*, for instance, Lord Upjohn remarked that the profit rule is an illustration of the wider conflict rule:

[A] fundamental rule of equity [is] that a person in a fiduciary capacity must not make a profit out of his trust which is part of the wider rule that a trustee may not place himself in a position where his duty and his interest may conflict.⁷⁰

The opposing view holds that the two rules, while overlapping, are distinct. In *Chan v. Zacharia*, for example, Deane J of the High Court of Australia observed that the no-conflict and the no-profit rules form two distinct themes, each having its own rationale:

The first [rule] is that, which appropriates for the benefit of the person to whom the fiduciary duty is owed any benefit or gain obtained or received by the fiduciary in circumstances where there existed a conflict of personal interest and fiduciary duty or a significant possibility of such conflict: the objective is to preclude the fiduciary

Conaglen, *Fiduciary Loyalty: Protecting the Due Performance of Non-Fiduciary Duties* (Oxford: Hart Publishing, 2010) at 113-139.

⁷⁰ *Boardman v. Phipps* [1967] 2 A.C. 46 at 123. See also *Huntington Copper and Sulphur Co Ltd v Henderson* (1877) 4 R 294 at 299, per Lord Young: “[The] rule of trust law that a trustee... shall not without the knowledge and consent of his constituent make profit of his office, or take any personal benefit from his execution of it... is not a different rule, but merely a development and instance of the same rule, that a trustee shall not be permitted to do anything which involves or may involve a conflict between his personal interest and his trust duty. The rule is not confined to particular cases which are capable of being enumerated, but is commensurate with a large and important principle on which it rests. That principle is that a person who is charged with the duty of attending to the interest of another shall not bring his own interest into competition with his duty.”; *Attorney-General v Blake* [2001] 1 AC 268 at 280, per Lord Nicholls: “[T]rustees and fiduciaries... may not put themselves in a position where their duty and interest conflict. To this end they must not make any unauthorized profit.”; *New Zealand Netherlands Society ‘Oranje’ Inc v Kuys* [1973] 1 WLR 1126 at 1129: “The obligation not to profit from a position of trust, or, as it sometimes relevant to put it, not to allow a conflict to arise between duty and interest, is one of strictness.”; Matthew Conaglen, *Fiduciary Loyalty: Protecting the Due Performance of Non-Fiduciary Duties*, *supra* note 69 at 120 (stating that the best way to understand the profit principle is as an outgrowth from the conflict principle); John McGhee, ed., *Snell’s Equity* 13th ed. (London: Sweet & Maxwell, 2000) 278; Albert H. Oosterhoff *et al.*, *Oosterhoff on Trusts: Text, Commentary and Materials*, 7th ed. (Toronto: Carswell, 2009) 917, note 263.

from being swayed by considerations of personal interest. The second [rule] is that which requires the fiduciary to account for any benefit or gain obtained or received by reason of or by use of his fiduciary position or of opportunity or knowledge resulting from it: the objective is to preclude the fiduciary from actually misusing his position for his personal advantage.⁷¹

The understanding of the proscriptive duties is further complicated by the debate surrounding the conceptual independence of the ‘self-dealing’ and ‘fair dealing’ rules. In one view, the two ‘dealing’ rules are independent. Megarry V.-C., deciding *Tito v. Waddell (No. 2)* took the view that the self-dealing and the fair-dealing rules, while having a common origin, are independent:

Mr. Mowbray strenuously contended that there was only one rule, though with two limbs... I can well see that both rules, or both limbs, have a common origin in that equity is astute to prevent a trustee from abusing his position or profiting from his trust... But subject to that, it seems to me that for all practical purposes there are two rules: the consequences are different, and the property and the transactions which invoke the rules are different...⁷²

In another view, the two rules are most appropriately understood as applications of the same rule general no-conflict principle. In *Re Thompson’s Settlement*, Vinelott J observed: “It is clear that the self-dealing rule is an application of the wider principle that a man must not put himself in a position where duty and interest conflict *or* where his duty to one conflicts with his duty to another.”⁷³

⁷¹ *Chan v. Zacharia* (1984) 154 CLR 178 at 198-199. See also Charles Harpum “Fiduciary Obligations and Fiduciary Powers” in Peter Birks, ed., *Privacy and Loyalty* (Oxford: Oxford University Press, 1997) 145 at 147; A.J. McClean, “The Theoretical Basis of the Trustee’s Duty of Loyalty” (1969) 7 Alberta Law Review 218 at 236.

⁷² *Tito v. Waddell (No. 2)* [1977] Ch. 106 at 241. See also Rick Bigwood, *Exploitative Contracts* (Oxford: Oxford University Press, 2003) at 394-395, note 113.

⁷³ *Re Thompson’s Settlement* [1986] 1 Ch 99 at 115; Matthew Conaglen, *Fiduciary Loyalty: Protecting the Due Performance of Non-Fiduciary Duties*, *supra* note 69 at 129 (observing that the difference between the self-dealing rule and the fair dealing rule concerning the relevance of the substantive fairness of the impugned transaction is more apparent than real; both rules are ultimately concerned with the conflict between duty and interest that a fiduciary faces when entering such transactions); Paul D. Finn, *Fiduciary Obligations* (Sydney: Law Book Co, 1977) 184-185 (maintaining that there is only one ‘dealing’ rule, rather than separate self-dealing and fair-dealing rules).

Regardless of the way in which they are grouped (from a single rule to four separate rules) it is uncontested that a breach of any of these four rules is a breach of fiduciary duty. The theoretical debates concerning the relative autonomy or dependency of these four proscriptive rules have engaged legal scholars for many decades, without a conclusive result. This debate is meaningful only in the broader context of analyzing what these rules aim to protect. As the following chapter will show, the view adopted in this dissertation is that the underlying common purpose of these rules is to protect the fiduciary's exercise of judgment from being influenced by self-interest. Consequently, the self-dealing and fair dealing rules, as well as the other proscriptive rules can be regarded as manifestations of a broad no-conflict rule, which plays a prophylactic role with regard to the core duty of exercising judgment appropriately.

Irrespective of their approach to the question of the independence of the four proscriptive rules, the vast majority of scholars agree that these rules are very strict. The peculiar strictness of the proscriptive duties has been the leitmotif of fiduciary law since the earliest reported cases. In the first landmark case, *Keech v. Sandford*, the strictness of the no-profit rule appears to be already well-established. Lord Keeper King famously argued for the preservation of the severity of this rule: "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 rule *should be strictly pursued, and not in the least relaxed...*"⁷⁴ Half a century later, in 1788, in Lord Thurlow affirmed that the no-profit rule binding on trustees is the most "sacred rule" of the Court of Chancery.⁷⁵

⁷⁴ *Keech v. Sandford* (1726) Sel Cas Ch 61 at 63, emphasis added. For a historical analysis of this case see Joshua Getzler, "Rumford Market and the Genesis of Fiduciary Obligations" in A Burrows and Lord Rodger of Earlsferry, eds, *Mapping the Law: Essays in Honour of Peter Birks* (Oxford Oxford University Press, 2006) at 581.

⁷⁵ *Forbes v. Ross* (1788) 2 Cox 112 at 116, emphasis added: "Now there is *no one more sacred rule of a Court of Equity* than that a trustee cannot so execute a trust as to have the least benefit from it himself." See also *Parker v. McKenna* (1874) LR 10 Ch App 96 at 124-125 per Lord James, emphasis added: "[W]e should concur in laying down again and again the general principle that in this Court no agent in the course of his agency... can be allowed to make any profit without the knowledge and consent of his principal; that *that rule is an inflexible rule, and must be applied inexorably by this Court...*" *Bray v. Ford*, [1896] A.C. 44 at 51, emphasis added: "It is an *inflexible rule of a Court of Equity* that 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." *Meinhard v. Salomon*, 294 N.Y. 458 at 464 (1928) per Cardozo J., emphasis added: "Not honesty alone,

Throughout the centuries, the courts have developed several facets to this specific severity of the proscriptive duties. One facet is the reprehensibility of the *possibility* of self-interested conduct. Fiduciaries have been held liable for breach of the no-conflict rule not only in case of an *actual* conflict between interest and duty, but also when there is a reasonable possibility of such a conflict.⁷⁶ In *Aberdeen Railway Co v. Blaikie Brothers*, for instance, Lord Cranwoth LC stated that the prohibition of potential conflicts of interest is a rule that applies universally to all fiduciaries:

[I]t is a rule of universal application, that no one, having [fiduciary] duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, *or which possibly may conflict*, with the interests of those whom he is bound to protect.⁷⁷

Although the established view is that the appearance of conflict of interest is sufficient to breach the proscriptive duties, there is uncertainty as regards the *degree of likelihood* that an actual conflict of interest will occur, which is necessary to make the appearance reprehensible. In some cases, it has been argued that even the remote possibility of conflict is sufficient to find a breach. In *Boardman v. Phipps*, for instance, the majority decision imposed a very strict standard for determining the existence of a reprehensible conflict. Lord Hodson asserted that a fiduciary is liable to disgorge the profits whenever there was a mere possibility, even remote, that the fiduciary's self-interest might conflict with his duty of loyalty:

No doubt it was but a *remote possibility* that Mr. Boardman would ever be asked by the trustees to advise on the desirability of an application to the court in order that the trustees might avail themselves of the information obtained. Nevertheless, even if the

but the punctilio of an honor the most sensitive, is then the standard of behavior. And to this there has developed a tradition that is *unbending and inveterate*. *Uncompromising rigidity* has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions."

⁷⁶ For more recent cases endorsing the 'real sensible possibility of conflict' see *Bhullar v. Bhullar* [2003] EWCA Civ 424, per Parker LJ; *Item Software (UK) Ltd. v. Fassihi* [2004] EWCA Civ 1244, per Arden LJ.

⁷⁷ *Aberdeen Railway Co v. Blaikie Brothers* (1854) 1 Macq 461 at 471-472, emphasis added.

possibility of conflict is present between personal interest and the fiduciary position the rule of equity must be applied.⁷⁸

In contrast, Lord Upjohn, dissenting, took the view that a fiduciary should be compelled to disgorge the profits only where there has been a “real sensible possibility” of conflict of interest. In the circumstances, he considered that a possibility of conflict was too remote to render Boardman liable:

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.⁷⁹

Lord Upjohn’s view has prevailed. In order for a potential conflict of interest to exist, there must be a reasonable possibility of such conflict, not merely an appearance.⁸⁰ Even the less strict standard proposed by Lord Upjohn appears unusually stringent for a private law relation. Why is the law concerned with *preventing* the risk of breach of a duty by the fiduciary (or, as other theories put it, preventing a loss to the beneficiary)? The traditional explanations, based on public policy, do not offer a satisfactory response.

Liability for breach of the proscriptive rules is very strict, also in the sense that it does not depend on the fiduciary’s good faith or actual motives, on the fact that the beneficiary has suffered no loss or has obtained a benefit following the conflicted transaction, or on the fact that the opportunity that the fiduciary has taken for himself was no longer available to the

⁷⁸ *Boardman v. Phipps* [1967] 2 AC 46 at 111.

⁷⁹ *Ibid.* at 124, emphasis added.

⁸⁰ See *Marks and Spencer plc v Freshfields Bruckhaus Deringer* [2004] 3 All ER 773 at 777: “The cases establish that the potential conflict must be a reasonable apprehension of a potential conflict, not a mere theoretical possibility.” See also Donovan W.M. Waters, Mark R. Gillen and Lionel D. Smith, *Waters’ Law of Trusts in Canada*, 3rd ed. (Toronto: Thomson Canada Ltd, 2005) 918.

beneficiary.⁸¹ In *Regal (Hastings) Ltd v Gulliver* Lord Russell underlined the irrelevance of these factors for finding a breach of the proscriptive duties:

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 to 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 and well intended, cannot escape the risk of being called upon to account.*⁸²

Yet another aspect of the strictness of the proscriptive duties is the fact that the purchase by the fiduciary of property under his administration is voidable, even if the transaction appears to be entirely honest and fair. In *Robertson v Robertson* Salmond J observed:

It is well established that a trustee for sale cannot purchase the trust property for himself, and that such a purchase is voidable *ex debito justitiae* at the suit of the beneficiary even though full value was given by the trustee... The rule is not based on any technical considerations relative to any difficulty, real or supposed in the way of a person transferring property to himself. It is based on considerations of

⁸¹ Some judges have argued that the rule against profits is so strict, that there is no need to demonstrate that the profit was earned directly 'from the fiduciary office': "If there is a fiduciary duty of loyalty and if the conduct complained of falls within the scope of that fiduciary duty... then I see no justification for any further requirement that the profit shall have been obtained by the fiduciary 'by virtue of his position'. Such a condition suggests an element of causation which neither principle nor the authorities require." (*United Pan-Europe Communications NV v. Deutsche Bank AG* [2000] 2 B.C.L.C. 461 at para 47, per Morritt L.J., approved in *Button v. Phelps* [2006] EWHC 53 at para 66).

⁸² *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378; [1967] 2 AC 134 at 144, emphasis added. See also *Bray v. Ford* [1896] AC 44 at 51, per Lord Herschell, underlining the irrelevance of good faith: "[The profit and conflict rules] might be departed from in many cases, *without any breach of morality*, without any wrong being inflicted, and *without any consciousness of wrong-doing*."; *Parker v McKenna* (1874) LR 10 Ch App 96 at 124-125, per Lord James, emphasizing that the presence or absence of a loss to the beneficiary is not a relevant factor: "[W]e should concur in laying down again and again the general principle that in this Court no agent in the course of his agency, in the matter of his agency, can be allowed to make any profit without the knowledge and consent of his principal; that that rule is an inflexible rule, and must be applied inexorably by this Court, which is not entitled, in my judgment, to receive evidence, or suggestion, or argument as to whether the principal did or did not suffer any injury in fact by reason of the dealing of the agent..."

public policy, with intent to protect beneficiaries of a trust by precluding the trustee from placing himself in a position where his interests conflict with his duty.⁸³

The limitation of the ‘fiduciary duty’ or of the ‘duty of loyalty’ to strictly proscriptive duties is the most common approach to the ‘fiduciary duty’. Although it represents the dominant theory of fiduciary duties, the strictly-proscriptive view is the principal cause of the continuing uncertainty that surrounds fiduciary duties. The central flaw of this approach is that it attempts to explain the existence and the strictness of the proscriptive duties using public policy arguments such as the need to discourage fiduciaries from abusing their position or the need for enhanced protection of vulnerable beneficiaries, instead of connecting the proscriptive duties with a core feature of the fiduciary position.⁸⁴ As will be discussed in more detail throughout this section, these arguments have proven incapable of offering an understanding of fiduciary duties that is consonant with private law theory. A more profound understanding of the reasons why fiduciary law prohibits situations of conflict of interest unveils an intimate connection between the presence of an actual or potential conflict of interest and the reliability of the decision-maker’s judgment.

2.2.2 ‘Fiduciary duties’ as a group of both proscriptive and prescriptive duties

The idiom ‘fiduciary duty’ or ‘fiduciary obligation’ (in singular or plural form) is sometimes used in a broad sense, to refer to a *group of both prescriptive and proscriptive duties* that some authors believe to be specific to persons in a fiduciary position.

Paul Finn, for instance, deconstructed the general ‘fiduciary obligation’ into eight specific duties. The general fiduciary standard imposes on fiduciaries a broad duty to act “honestly in what [the fiduciary] alone

⁸³ *Robertson v Robertson* [1924] NZLR 552 at 553.

⁸⁴ As Maitland observed, “[t]he trustee is bound to use his rights in a certain way, bound to use them for the benefit of another, or for the accomplishment of a certain purpose. One is not made a trustee by being bound not to use one’s rights in some particular manner.” (Frederick W. Maitland, *supra* note 69 at 45).

considers to be the interests of his beneficiaries.”⁸⁵ The general formulation, Finn argued, is too broad to provide a useful yardstick against which the judges could measure the propriety or impropriety of fiduciary’s actions in a given case. Consequently, he identified eight specific ‘fiduciary duties’, which include proscriptive duties (such as the fiduciary’s duty not to act for his own benefit or for the benefit of a third person, or the duty not to place fetters on discretion) and prescriptive duties (such as the duty to consider whether discretion should be exercised, or the duty to treat equally beneficiaries with similar rights). In Finn’s view, these eight duties are only the most important manifestations of the fiduciary obligation, and should not be regarded as a closed list: “The writer would not for one moment suggest that these eight duties exhaust the content of the fiduciary obligation. And it is certain that no court would hold this to be so. New situations demand new responses.”⁸⁶

In addition to the core proscriptive rules or duties, the theories regarding the concept of ‘fiduciary duty’ as a generic notion include in its ambit other negative or positive duties, such as the duty of good faith, the duty of fidelity, the duty of care, the duty to treat beneficiaries fairly, the duty of candour, the duty of confidentiality, or the duty to grant the beneficiary access to information. The main flaw of this broad approach is that it fails to identify a core feature or duty that is specific only for fiduciary positions. It is generally agreed that not all duties owed by a fiduciary are ‘fiduciary duties’.⁸⁷ Duties of good faith, care, confidentiality or disclosure are often

⁸⁵ Paul D. Finn, *Fiduciary Obligations* (Sydney: Law Book Co, 1977) 15.

⁸⁶ *Ibid.* at 15-16. In a more recent study of fiduciary obligations, Finn appears to revisit his earlier view. Concerning the content of the fiduciary obligation, he claimed that the fiduciary principle is properly understood as limited to the duty of loyalty, which he equates to the strict proscriptive duties: “To maintain the integrity and the utility of those relationships in which the (or a) role of one party is perceived to be the service of the interests of the other, [the fiduciary principle] insists upon a fine loyalty in that service. The fiduciary is not to use his position or the power or opportunity it gives him to serve an interest other than the beneficiary’s, be this his own or a third party’s... Loyalty is thus exacted, often in a draconian way.” (Paul D. Finn, “The Fiduciary Principle” in T.G. Youdan, *Equity, Fiduciaries and Trust* (Toronto: Carswell, 1989) 1 at 27-28). For another example of the ‘umbrella duty’ approach to fiduciary duty see also *Simonetti v. Plenge*, 224 A.D.2d 1008 at 1010 (4th Dept. 1996): “General partners are in a fiduciary relation to all limited partners... This [fiduciary] duty... is one of candor, fairness, good faith, honesty, loyalty and unselfishness.”

⁸⁷ See e.g. *Lac Minerals Ltd v International Corona Resources Ltd*, [1989] 2 SCR 574 at 597, per Sopinka J: “not all obligations existing between the parties to a well-recognized fiduciary relationship will be fiduciary in nature.” *Wewaykum Indian Band v Canada*, [2002]

associated with a fiduciary position, but they apply to a wide spectrum of non-fiduciary legal actors as well.

A. *The duty of good faith*

The duty of good faith is habitually included in the enumeration of fiduciary duties, without any explanation concerning why this duty is specific to persons in a fiduciary position. In an often quoted passage, Millet LJ identified good faith as one of the core ‘facets’ of the fiduciary duty of loyalty:

The distinguishing obligation of a fiduciary is the obligation of loyalty... The core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict...⁸⁸

Canadian fiduciary law scholars adopted a similar view. In *Canadian Aero Service Ltd. v. O'Malley*, for example, Laskin J identified loyalty, good faith and avoidance of conflicts of interest as the hallmarks of fiduciary relations.⁸⁹

Another illustrative example can be found in the US corporate law. Starting with *Cinerama Inc. v. Technicolor, Inc.*,⁹⁰ the Delaware Supreme Court has constantly upheld the so-called ‘triad’ of directors’ fiduciary duties: good faith, loyalty and care.⁹¹ In 2006, however, the Delaware

4 SCR 245 at para. 83, per Binnie J: “not all obligations existing between the parties to a fiduciary relationship are themselves fiduciary in nature.” *Bristol and West Building Society v. Mothew* [1998] 1 Ch (CA) 16, per Millet L.J.: “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...Not every breach of duty by a fiduciary is a breach of fiduciary duty.”

⁸⁸ *Bristol and West Building Society v. Mothew*, *supra* note 87 at 18.

⁸⁹ *Canadian Aero Service Ltd. v. O'Malley* [1974] S.C.R. 592 at 606: “[A] fiduciary relationship... in its generality betokens loyalty, good faith and avoidance of a conflict of duty and self-interest;” In *Norberg v. Wynrib* [1992] 2 S.C.R. 226, McLachlin J., writing the minority opinion referred to “the classic duties associated with a fiduciary relationship - the duties of loyalty, good faith and avoidance of a conflict of duty and self-interest” (*ibid.* at 275).

⁹⁰ *Cinerama Inc. v. Technicolor, Inc.*, 663 A.2d 1156 at 1179 (Del. 1995).

⁹¹ See e.g. Hillary A. Sale, “Delaware’s Good Faith” (2004) 89 Cornell L. Rev. 456 (arguing that corporate directors breach their fiduciary duty of good faith by deliberate indifference to their tasks or intentional subversion of their duties).

Supreme Court aligned its view with that of the Delaware Court of Chancery, and clarified that there is no independent fiduciary duty of good faith:

[A]lthough good faith may be described colloquially as part of a ‘triad’ of fiduciary duties that includes the duties of care and loyalty, the obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty. Only the latter two duties, where violated, may directly result in liability, whereas a failure to act in good faith may do so, but indirectly.⁹²

The duty of good faith continues to be regarded as an independent fiduciary duty by prominent legal scholars. Richard Nolan and Mathew Conaglen argued that the fiduciary duty of good faith prohibits fiduciaries from “consciously acting in a way that is anticipated to harm the principal’s existing interests or not to further the principal’s interests in the future.”⁹³ In their view, the fiduciary duty of good faith is distinct from the good faith applied outside the context of fiduciary relationships in the sense that the latter limits a person’s breadth of legitimate decisions by imposing *only* the requirement not to harm consciously the economic interests of others (but not the requirement to promote the others’ interests).⁹⁴ Moreover, the fiduciary duty of good faith is different from the conflict rules in the sense that the former prohibits consciously anticipated harm, while the latter apply whenever there is an objectively increased risk of harm caused by the fiduciary’s temptation to breach his duties.⁹⁵ Conaglen’s approach to the fiduciary duty of good faith may require a readjustment of his previously expressed view, according to which the proscriptive duties are meant to protect the non-fiduciary duties.⁹⁶ If fiduciaries owe a specific duty of good faith that controls the fiduciary’s conscious actions or inactions, and this duty

⁹² *Stone v. Ritter*, 911 A.2d 362 (Del. 2006) at para. 16, footnotes omitted.

⁹³ Richard Nolan and Mathew Conaglen, “Good Faith: What Does It Mean for Fiduciaries?” in Elise Bant and Matthew Harding, *Exploring Private Law* (Cambridge: Cambridge University Press, 2010) 319 at 333, emphasis added.

⁹⁴ *Ibid.* at 329.

⁹⁵ “One is concerned that a bad decision has been taken; the other is concerned with a situation that risks a bad decision being made.” (*ibid.* at 333).

⁹⁶ See Matthew Conaglen, “The Nature and Function of Fiduciary Loyalty” (2005) 121 *Law Quarterly Review* 452.

is protected by the proscriptive duties, it is unclear why the non-fiduciary duties still need to be protected directly by the proscriptive duties.

The duty of good faith is present in other legal fields, and, unless qualified to have a special meaning for fiduciary relations, it cannot be considered to be a duty specific to persons in a fiduciary position. While it is correct to say that fiduciaries must act in good faith, this duty is recognized in other contexts which do not involve a fiduciary duty (such as the *uberrima fides* of insurance contracts). The duty of good faith is, therefore, not peculiar to fiduciaries and ought not to be labelled as fiduciary duty.⁹⁷

Moreover, a requirement of good faith does not serve the same purpose as the proscriptive duties or the duty to exercise proper judgment. First, a duty of good faith cannot serve the same purpose as the proscriptive duties. As Chapter 4.2 below shows, the existence of a situation of conflict of interest creates a danger for the proper exercise of judgment even if the decision-maker believes in good faith that his exercise of discretion is not affected by the conflict of interest. In other words, in a situation of conflict of interest, good faith does not help protect the core duty to exercise proper judgment, in the way in which the proscriptive duties do. The comparison with the core duty to exercise discretion based on relevant factors leads to the same conclusion. Good faith is not sufficient to show that discretion has been exercised appropriately. In order to meet this requirement, a fiduciary must base his judgment on matters that can be objectively identified as relevant for a particular exercise of discretion. It can be argued that good faith plays a role in the subjective part of the duty to exercise proper judgment. This subjective part refers to the weigh that the fiduciary gives to each relevant factor. As long as the decision is a combination of relevant factors, then the discretion is exercised appropriately. If other factors are taken into account, such as self-regarding or third party-regarding interests, than there is a breach of the core duty, and, potentially of the proscriptive duties. Consequently, there is no justification for regarding the duty of good faith as serving the same purpose as the proscriptive duties or the duty to exercise proper judgment.

⁹⁷ See *Snell's Equity*, *supra* note 70 at 152.

B. The duty of care

The predominant view across common law jurisdictions is that the duty of care is not a duty specific to fiduciaries. The Supreme Court of Canada has constantly affirmed that the duty of care that fiduciaries owe should not be labelled ‘fiduciary duty’.⁹⁸ Many English courts and scholars seem to share this view.⁹⁹ In US law, in contrast, it is customary to refer to fiduciary duties as including a duty of care.¹⁰⁰

Many authors who regard the duty of care as a fiduciary duty argue that the standard of care imposed by the fiduciary duty of care is different from that imposed by the duty of care imposed by negligence law.¹⁰¹ Although the standard of care imposed by fiduciary law may be different than

⁹⁸ See e.g. *Peoples Department Stores Inc. (Trustee of) v. Wise* [2004] 3 S.C.R. 461 at 463: “[D]irectors owe a duty of care to creditors, but that duty does not rise to a fiduciary duty.”; *Hodgkinson v. Simms* [1994] 3 S.C.R. 377 at para. 26, per La Forest J.: “[T]he fiduciary duty is different in important respects from the ordinary duty of care.” Compare this statement with La Forest’s view, expressed extra-judicially: the fiduciary duty is “a kind of superadded civil duty which will often encompass common law duties such as the duty of care, while at the same time requiring a high standard of behaviour consistent with the best interests of the beneficiary.” (Gerard V. La Forest, “Overview of Fiduciary Duties” in Alan MacInnes *et al*, eds., *Fiduciary Duties / Conflicts of Interest: The 1993 Isaac Pitblado Lectures* (Winnipeg: Law Society of Manitoba, 1993) 1 at 3).

⁹⁹ See *Girardet v Crease & Co* (1987) 11 BCLR (2d) 361 at 362, per Southin J.: “The word ‘fiduciary’ is flung around now as if it applied to all breaches of duty by solicitors, directors of companies and so forth... [T]o say that simple carelessness in giving advice is such a breach is a perversion of words.”; *Lac Minerals Ltd v International Corona Ltd* (1989) 61 DLR (4th) 14 at 28, per La Forest J.: “[N]ot every legal claim arising out of a relationship with fiduciary incidents will give rise to a claim for a breach of fiduciary duty.” *Bristol and West Building Society v Mothew* [1996] 4 All ER 698 at 710: “[I]t is obvious that not every breach of duty by a fiduciary is a breach of fiduciary duty.” *Permanent Building Society v Wheeler* (1994) 11 WAR 187 at 237-239 per Ipp J. “[A] trustee’s duty to exercise reasonable care, though equitable, is not specifically a fiduciary duty... [The duty of care] is not to be equated with or termed a ‘fiduciary’ duty”; *Henderson v Merrett Syndicates* [1995] 2 AC 145 at 155 per Lord Browne-Wilkinson: “A contention for a freestanding fiduciary duty of due skill and care involves a radical change in the law;” *Ibid.* at 205: “The liability of a fiduciary for the negligent transaction of his duties is not a separate head of liability but the paradigm of the general duty to act with care imposed by law on those who take it upon themselves to act for or advise others”; Matthew Conaglen, *Fiduciary Loyalty*, *supra* note 69 at 38: “[F]iduciary’ duties of care were recognized in the past, but such duties of care are now no longer considered fiduciary because they are not peculiar to fiduciaries.” For New Zealand see *S v Attorney-General* [2003] 3 NZLR 450 at 77, per Blackburne J.: “Negligent conduct by a fiduciary will render the fiduciary liable in negligence but is not a breach qua fiduciary, notwithstanding that the fulfilment of the role of a fiduciary is the setting for the negligent act or omission.”

¹⁰⁰ See *supra* note 91. For a criticism of this view, see William A Gregory, “The Fiduciary Duty of Care: A Perversion of Words” (2005) 38:1 Akron Law Review 181.

¹⁰¹ See Joshua Getzler, “Duty of Care” in Peter Birks and Arianna Pretto, eds, *Breach of Trust* (Oxford: Hart Publishing, 2002) 41; Paul B. Miller, “A Theory of Fiduciary Liability” (2011) 56 McGill Law Journal 235 at 282-284.

that imposed by the law of negligence, the concern with careful conduct towards another is not peculiar to fiduciary law. The differences between the duty of care imposed on fiduciaries and the duty of care in negligence is one of degree, rather than kind.¹⁰²

The duty of care owed by fiduciaries is different from the core duty that a fiduciary has, namely to exercise judgment based on relevant considerations. The substance of the ‘fiduciary’ duty of care imposes a duty to act on an informed basis – a duty to gather relevant information and request professional advice where necessary, in order to identify the relevant considerations on which the decision-making process is built. The question of the weight to be attached to each consideration for the purposes of a particular decision is part of the core judgment duty. Consequently, whether the specific duty of care that fiduciaries owe is labelled fiduciary or not, is not relevant for the purpose of this research. What matters is that the core judgment duty and the ‘fiduciary’ duty of care are different duties. One fundamental difference between the two duties concerns the consequences of breach. Failure to exercise discretion based on relevant considerations renders the act voidable,¹⁰³ a remedy that is not available for breach of duty of care by fiduciaries.¹⁰⁴

C. The duty of confidentiality

Confidentiality is sometimes seen as a component of fiduciary duties. In *Lac Minerals*, for instance, Wilson J., dissenting, held that the appellant company was bound by a fiduciary duty towards the respondent company, consisting in the obligation not to use confidential information for its own

¹⁰² Matthew Conaglen, *Fiduciary Loyalty*, *supra* note 69 at 36.

¹⁰³ See *Pitt & Anor v Holt & Anor* [2011] EWCA Civ 197 [127] per Lloyd LJ: “The trustees’ duty to take relevant matters into account is a fiduciary duty, so an act done as a result of a breach of that duty is voidable.”

¹⁰⁴ See Lionel Smith, “Can I Change My Mind? Undoing Trustee Decisions” (2008) 27 *Estates, Trusts & Pensions Journal* 285 at 302, footnote omitted: “To my knowledge, it has never been understood to be the law that a fiduciary’s decision can be avoided retroactively because it was made in breach of the duty of care, skill and diligence.”

benefit.¹⁰⁵ Although the fiduciary duty and the duty of confidentiality may coexist between the same parties at the same time, it is generally agreed that breach of confidence and breach of fiduciary duty are separate causes of action.¹⁰⁶ The doctrine of confidentiality is concerned with the preservation of information that is conveyed in confidence that it will not be misused. The fiduciary duties as a whole impose a requirement that the fiduciary exercises discretion exclusively in the interest of another. The doctrines may overlap in their scope, but they are not identical.

When fiduciaries misuse confidential information for their own benefit, both a breach of confidence and a breach of fiduciary duty may arise. Where there is no pre-existing fiduciary duty, however, misuse of confidential information cannot *create* the fiduciary duty. As Sopinka J observed, a conduct that is reprehensible under breach of fiduciary duty cannot be the very source of the duty.¹⁰⁷ In other words, for a breach of fiduciary duty to occur, there must be a pre-existing fiduciary duty.

D. The duty of candour

Sometimes the fiduciary duty is said to include a duty of candour, or a duty to disclose relevant information. In *R. v. Neil*, Binnie J., writing the unanimous decision, affirmed that a lawyer's duty of loyalty includes the duty of candour:

¹⁰⁵ *Lac Minerals Ltd. v. International Corona Resources Ltd.* [1989] 2 S.C.R. 574 at 631, emphasis in original: "[A] fiduciary duty arose in Lac Minerals Ltd... when International Corona Resources Ltd... made available to Lac its confidential information concerning the Williams property, thereby placing itself in a position of vulnerability to Lac's misuse of that information... [W]hen Corona disclosed to Lac confidential information concerning the Williams property... Lac became... subject to a fiduciary duty *with respect to that information* not to use it for its own use or benefit." See also *MacLean v Arklow Investments Ltd* [1998] 3 NZLR 680 (holding that a fiduciary duty of confidentiality existed between the parties, imposing on the fiduciary the duty not to use confidential information for ulterior purposes); *MacDonald v. Clinger* 84 A.D.2d 482 (1982) (holding that a fiduciary duty of confidentiality existed between psychiatrist and patient).

¹⁰⁶ See *Lac Minerals Ltd. v. International Corona Resources Ltd.*, per Sopinka J, for the majority; Dennis R. Klinck, "The Rise of the 'Remedial' Fiduciary Relationship: A Comment on *International Corona Resources Ltd v. Lac Minerals Ltd*" (1988) 33 McGill Law Journal 600; Peter D. Maddaugh, "Confidence Abused: *Lac Minerals Ltd. v. International Corona Resources Ltd.*" (1990) 16 Canadian Business Law Journal 198.

¹⁰⁷ *Lac Minerals Ltd. v. International Corona Resources Ltd.* [1989] 2 S.C.R. 574 at 600, citing *Tito v. Waddell (No. 2)*, [1977] 3 All E.R. 129 at 232, Megarry V.-C.

The aspects of the duty of loyalty relevant to this appeal... engage more particularly three... dimensions: (i) the duty to avoid conflicting interests...; (ii) a duty of commitment to the client's cause;... (iii) a duty of candour with the client on matters relevant to the retainer.¹⁰⁸

Similarly to the duty of good faith or the duty of confidentiality, some fiduciaries, such as lawyers, may come under a duty to disclose to their beneficiaries relevant information. This duty, however, is not reserved exclusively for fiduciaries. A duty to disclose is recognized, for example, in insurance contracts: before the contract is concluded the assured has the duty to disclose to the insurer every material circumstance.¹⁰⁹ Other examples include vendor's duty to disclose defects of title to land¹¹⁰ or the employee's duty to disclose the misconduct of other employees, especially if the employee in question has responsibility for those others.¹¹¹

E. Other duties referred to as 'fiduciary'

In addition to the duties of good faith, care, confidentiality and candour, other duties are sometimes labelled 'fiduciary': the duty of fidelity,¹¹² the duty to treat beneficiaries fairly,¹¹³ or the duty to grant the beneficiary access to information.¹¹⁴

¹⁰⁸ *R. v. Neil* [2002] 3 S.C.R. 631 at 645. For an example from US law see *Burdett v. Miller*, 957 F.2d 1375 at 1381 (7th Cr. 1992). Posner J. defined the fiduciary duty as "the duty of an agent to treat his principal with the utmost candor, rectitude, care, loyalty, and good faith - to treat the principal as well as the agent would treat himself." See also Lusina Ho and Pey-Woan Lee, "A Director's Duty to Confess: A Matter of Good Faith?" (2007) 66 Cambridge Law Journal 348 (arguing that a positive obligation to confess breach of the proscriptive rules may be founded on the basis of a director's fiduciary duty to refrain from acting with the intention to prejudice the company's interests); Richard Nolan, "A Fiduciary Duty to Disclose?" (1997) 113 Law Quarterly Review 220 (arguing that disclosure of a conflict of interest may relieve a fiduciary from liability, but does not constitute an independent duty).

¹⁰⁹ *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 AC 501 [1994] 3 All ER 581.

¹¹⁰ *Peyman v Lanjani* [1985] Ch 457 at 496.

¹¹¹ *Sybron Corp v Rochem Ltd* [1984] Ch 112 [1983] ICR 801, CA.

¹¹² See e.g. *Bristol and West Building Society v Mothew* [1998] Ch. 1 at 18: "The various obligations of a fiduciary merely reflect different aspects of his core duties of loyalty and fidelity." *Doe v. Roe*, 681 N.E.2d 640 at 645 (Ill. App. Ct. 1997), stating that a lawyer owes a fiduciary duty of "fidelity, honesty, and good faith" to the client's interests; See also Gerald H. Fridman, *The Law of Agency*, 7th ed. (London: Butterworths, 1996) 176. Robert Flannigan rejected the idea of a fiduciary duty of fidelity as a "conceptual malformation" that replicates

The tendency to regard ‘fiduciary duties’ as an open, or overly broad category has rendered this concept almost meaningless. Some courts and commentators have attempted to sidestep this difficulty by asserting that the content of fiduciary duties is inherently contextual and cannot be defined in advance.

2.2.3 ‘Fiduciary duties’ as a purely contextual concept

Another generic approach to the concept ‘fiduciary duty’ (or duties) holds that the content of this duty cannot be established in advance. In this view, the principal aim of fiduciary law is to maintain the integrity of legal relations based on trust and confidence, by imposing on fiduciaries a general prohibition of abuse of their position. The content of ‘fiduciary duties’ is purely contextual, being dictated by the circumstances of each case.

The Supreme Court of Canada has repeatedly maintained that the requirements imposed by the concept of fiduciary duties can be determined only based on the specific circumstances of the relation from which they arise. In *McInerney v. MacDonald* La Forest J., writing the unanimous decision, reiterated his statements from *Canson Enterprises*¹¹⁵ according to which “not all fiduciary relationships and not all fiduciary obligations are the same; these are shaped by the demands of the situation.”¹¹⁶ Similarly, in *M.(K.) v. M.(H.)* the same justice, writing for the majority, asserted that

the function of the conventional fiduciary accountability. See Robert Flannigan, “The [Fiduciary] Duty of Fidelity” (2008) 124 L.Q.R. 274 at 297.

¹¹³ See e.g. Tamar Frankel, *Fiduciary Law* (New York: Oxford University Press, 2011) 106-107: “The following discussion divides fiduciary duties as: (i) the duty of loyalty, relating to entrusted property and power; (ii) the duty of care... Based on the duty of loyalty are a number of additional duties: (i) the duties to follow and abide by the directives of entrustment...; (ii) the duty to act in good faith...; (iii) the duty not to delegate... (iv) the duty to account and disclose relevant information... ; (v) the duty to treat entrustors fairly.” See also Finn, *supra* note 85 at 59.

¹¹⁴ See e.g. the unanimous decision of the Supreme Court of Canada in *McInerney v. MacDonald* [1992] 2 S.C.R. 138 at 149, emphasis added: “[C]ertain duties do arise from the special relationship of trust and confidence between doctor and patient. Among these are the duty of the doctor to act with utmost good faith and loyalty, and to hold information received from or about a patient in confidence and the obligation to grant access to the information the doctor uses in administering treatment.”

¹¹⁵ *Canson Enterprises Ltd. v. Boughton & Co* [1991] 3 S.C.R. 534.

¹¹⁶ *McInerney v. MacDonald* [1992] 2 S.C.R. 138 at 149.

the substance of the fiduciary obligation in any given case is not derived from some immutable list of duties attached to a category of relationships... Rather, the nature of the obligation will vary depending on the factual context of the relationship in which it arises.¹¹⁷

The context-driven approach to the content of fiduciary duties is not limited to the Canadian common law. In the landmark Australian decision in *Hospital Products*, Mason J made a similar remark:

The categories of fiduciary relationships are infinitely varied and the duties of the fiduciary vary with the circumstances which generate the relationship... [I]t is now acknowledged generally that the scope of the fiduciary duty must be moulded according to the nature of the relationship and the facts of the case.”¹¹⁸

The same view has been expressed in English fiduciary law. Len Sealy, one of the pioneers of fiduciary law theory emphasized that the rules and remedies applicable to fiduciaries are intrinsically contextual:

The mere statement that John is in a fiduciary relationship towards me means no more than that in some respects his position is trustee-like; it does not warrant the inference that any particular fiduciary principle or remedy can be applied.¹¹⁹

The persistent ‘contextual’ approach to fiduciary duties has undermined significantly the efforts to understand the conceptual foundation of fiduciary law. From a purely theoretical perspective, it is counter-intuitive to speak of a particular legal concept without ascribing it a specific content. Saying that what a fiduciary duty entails is different in each context amounts

¹¹⁷ *M.(K.) v. M.(H.)* [1992] 3 S.C.R. 6 at 66. Robert Flannigan expressed a similar view: “The content of a fiduciary obligation is traditionally defined by a number of specific rules, for example, the duty not to misuse property or the duty to not make secret profits. [T]he various specific rules are but illustrations of the many different ways in which fiduciaries may abuse the trust reposed in them... [T]here can be no prior limitation on the kinds of behaviour that will offend the fiduciary obligation. *There can be no final and exhaustive definition of the precise ‘content’ of any obligation at any time...*” See Robert Flannigan, “The Fiduciary Obligation” (1989) 9 Oxford Journal of Legal Studies 285 at 320-321, emphasis added.

¹¹⁸ *Ltd v. United States Surgical Corporation* (1984) 156 CLR 41 at 102.

¹¹⁹ Len Sealy, “Fiduciary Relationships” (1962) 20 Cambridge Law Journal 69 at 73. For a similar view expressed in US law see Deborah DeMott, “Beyond Metaphor: An Analysis of Fiduciary Obligation” (1988) 1988 Duke Law Journal 879 at 909, emphasis added: “The scope of the fiduciary’s obligation, *as well as the obligation’s precise formulation*, necessarily varies with the context of the relationship.”

to denying its existence as an autonomous legal concept. The fiduciary duty could be considered contextual in the sense that the core abstract requirement that it imposes may materialize into different requirements in different contexts. This does not mean that the fiduciary duty, *in abstracto*, does not have a specific, normative content.¹²⁰

A variation of the contextual approach to fiduciary duties holds that the severity of these duties (generally understood as proscriptive duties only) *varies in intensity* according to the type of fiduciary relation. The trust is seen as the strictest, or most severe, manifestation of fiduciary duties.¹²¹ This view increases the confusion surrounding the concept of fiduciary duty. It is uncontested that the proscriptive duties can be *relaxed*, by authorizing the fiduciary to derive certain benefits from his position. This does not mean, however, that the fiduciary relation as a whole is ‘less intense’. The core feature that makes the relation fiduciary, namely the exercise of discretion in another’s benefit remains unaltered – the fiduciary is still required to act in what he judges to be the best interests of the beneficiary.¹²²

Another theory that negates the normative relevance of fiduciary duties proposes a shift of the analytical focus from the fiduciary duty of loyalty to abuse of power. Jay Shepherd, the proponent of this view, maintained that breach of duty of loyalty occurs whenever the fiduciary abuses his power by obtaining an unauthorized personal benefit or other

¹²⁰ As Moses LJ put it in *Foster v. Bryant*, [2007] EWCA Civ 200 at para. 97: “[I]t is, perhaps, worth acknowledging, that the oft-repeated reminder that, resolution of issues of breach of fiduciary duty by a director are ‘fact-sensitive’ or ‘fact specific’ tend to make one almost nostalgic for the days when there were inflexible rules, inexorably enforced by judges who would have shuddered at the re-iteration of the noun-adjective.”; see also *In Plus Group Ltd v. Pyke* [2002] EWCA Civ 370 at para. 80: “The fiduciary duty of a director to his company is uniform and universal. What vary infinitely are the elements of fact and degree which determine whether the duty has been breached.”

¹²¹ See e.g. Austin W. Scott, “The Trustee’s Duty of Loyalty” (1936) 49 Harvard Law Review 521 at 521: “A trustee is in a fiduciary relation to the beneficiaries of the trust. There are other fiduciaries such as guardians, executors or administrators, receivers, agents, attorneys, corporate directors or officers, partners, and joint adventurers. In some relations the fiduciary element is more intense than in others; it is peculiarly intense in the case of a trust.”

¹²² See also Lionel Smith, “The Motive Not the Deed”, *supra* note 69 at 77: “The obligation of loyalty [understood as the obligation to act with the proper motive] is irreducible and cannot be put on a scale. It applies, or it does not, to a particular decision.”

advantages. In other words, the concept of abuse of power is sufficient to capture the wrong that the so-called duty of loyalty aims to prevent.¹²³

Shepherd's theory is built around a very broad concept of power. He described power as an ability to act in the interests of another, which gives its holder the possibility to use it in his own interests. The power may be legal or factual, direct or indirect. It can be transferred not only expressly, but also informally (e.g. when an individual relies on another), or totally unconsciously (in situations where the various inequalities between two people, such as inequalities of education, intelligence, experience, economic power or mental stability, give one party power over another).¹²⁴ In his view, a fiduciary relationship exists whenever one person acquires such a power coupled with a duty of loyalty, requiring the transferee to utilize the power in the best interests of another. The duty of loyalty is attached to the power by the transferor of the power, and accepted by the fiduciary implicitly when accepting the power.¹²⁵

Shepherd's theory of fiduciary relations is highly problematic. First, his notion of power is too broad. It encompasses any situation in which one person gains a position of advantage over another, such as situations covered by unconscionability or undue influence. The latter doctrines, however, are distinct from the law of fiduciary relations.¹²⁶ Moreover, the possibility to transfer an indirect or factual power unconsciously renders this concept virtually limitless. Furthermore, since the power may be indirect or factual, it is difficult to see how the transferor could attach a duty to many instances of 'power'. Finally, the idea of implicit acceptance of an encumbered power

¹²³ Jay C. Shepherd, *The Law of Fiduciaries* (Toronto: Carswell, 1981) 127-128: "[O]nce we have found the duty [of loyalty] we must forget about it... Instead of concentrating on the duty and all that it entails in determining breach, it makes more practical sense to concentrate on the implications of the powers transferred. The process of finding a breach is a process of identifying a causal link between the powers transferred and the benefit or other advantages obtained by the fiduciary. Breach of fiduciary duty is essentially an abuse of power."

¹²⁴ *Ibid.* at 98-100.

¹²⁵ *Ibid.* at 100: "Since the power is only offered with the duty attached, acceptance of the power is necessarily acceptance of the duty." *Ibid.* at 107: "Once the fiduciary decides to use the powers, he is under a positive duty to use them 'only in the interests of the beneficiary'."

¹²⁶ See e.g. *Hodgkinson v. Simms* [1994] 3 S.C.R. 377 at 406: "whereas undue influence focuses on the sufficiency of consent and unconscionability looks at the reasonableness of a given transaction, the fiduciary principle monitors the abuse of a loyalty reposed."

renders any person being in a superior position towards another a potential fiduciary, which renders the concept ‘fiduciary’ meaningless.

Due to its generality and vagueness, Shepherd’s ‘power’ cannot be used as an analytical tool for understanding the foundations of fiduciary relations. Anticipating this criticism, Shepherd conceded that his view may be too broad. Consequently, he argued that in certain situations that may fall under his definition of power, the public policy prevents the duty of loyalty from arising.¹²⁷ Unfortunately, this reference to public policy accentuates the imprecision of Shepherd’s theory, rather than bringing clarifications.

2.2.4 ‘Fiduciary duties’ as the sum of the proscriptive duties and a core duty of loyalty

A more profound approach to the ‘fiduciary duty’ separates the duties specific to persons in a fiduciary position into two main groups. On the one hand, there are the traditional proscriptive duties. On the other hand there is a core duty binding on fiduciaries, referred to by some authors as the ‘duty of loyalty’, which is different from the proscriptive duties and which justifies their existence. The proscriptive duties are connected with the core duty in the sense that they play a protective or prophylactic role: they aim to prevent violations of the fundamental fiduciary duty. The views differ, however, as concerns the content of the core duty. This duty has been defined as the duty to act (or to refrain from acting) with the proper motive,¹²⁸ the duty to preserve and promote the interests of the beneficiary,¹²⁹ or the duty to look after the beneficiary’s interests.¹³⁰ Some commentators have even argued that

¹²⁷ Jay Shepherd, *supra* note 123 at 102-103.

¹²⁸ See Lionel Smith, *supra* note 69 at 55-65 (“Very often, the core of the duty of loyalty is thought to be the duty to avoid certain situations... There are notoriously two main things that a fiduciary may not do. The ‘no-conflict’ rule says that a fiduciary must avoid any conflict of interest and duty, and indeed any conflict of duty and duty. The ‘no-profit’ rule requires the fiduciary to avoid making any [unauthorized] profit... So this unusual case of a ‘prophylactic’ rule in private law is often identified as the hallmark of the fiduciary duty... I’m not sure this is right... There is more to loyalty than avoiding things... [T]he duty of loyalty is one that is met or not met based on the motives with which the fiduciary acts. It is a duty to act (or not) with the right motive.”).

¹²⁹ Peter Birks, “The Content of Fiduciary Obligation” (2000) 34 *Israel Law Review* 3 at 28.

¹³⁰ Andrew Burrows, “We Do This at Common Law but That in Equity” (2002) *Oxford Journal of Legal Studies* 1 at 8-9. A very common, but vague, formulation of the core duty is

the fiduciary duty of loyalty comprises a requirement to bring about an actual benefit for the beneficiary.¹³¹

The theories connecting the proscriptive duties to a fundamental ‘fiduciary duty’ represent the only approach that can provide a cogent understanding of fiduciary relations. Nevertheless, these theories appear to be outside the current dominant understanding of the ‘fiduciary duty’. The main reason why these theories await due recognition is the fact that they do not offer persuasive explanations concerning *why* the core duty needs the special protection of the prophylactic duties. The justifications proposed by these theories for the need of this enhanced protection (such as the need to protect the beneficiary, to maintain the appearance of propriety, or the need to bypass evidentiary difficulties concerning the fiduciary’s actual motive) resemble those of the strictly proscriptive approach, in the sense that they are external to the core duty.

The position adopted by this dissertation falls into the ‘core duty’ approach to fiduciary duties. The dissertation will argue that the core duty binding on a fiduciary is the duty to exercise discretion or judgment appropriately.¹³² In contrast to the existing theories on fiduciary duties, the proposed theory explains the existence and the strictness of the proscriptive duties based on the substance of the core duty that they aim to protect. The

“a duty to act for the benefit of the beneficiary”, without further explanations. See e.g. *Ermineskin Indian Band and Nation v Canada*, [2009] 1 SCR 223 at para 125, per Rothstein J: “[T]he duty of loyalty ... requires the trustee to avoid conflicts of interest. A fiduciary is required to avoid situations where its duty to act for the sole benefit of the trust and its beneficiaries conflicts with its own self-interest or its duties to another.”

¹³¹ Deborah DeMott, for instance, asserted that “[t]he fiduciary’s duties go beyond mere fairness and honesty; they oblige him to act to further the beneficiary’s best interests.” Deborah DeMott, “Beyond Metaphor: An Analysis of Fiduciary Obligation” (1988) *Duke Law Journal* 879 at 888. This view conflates the duty of loyalty with other non-fiduciary duties that a fiduciary may have. Courts and commentators largely reject the understanding of the duty of loyalty in terms of actual results as overly vague, misleading and as creating a non-justiciable standard. See James Edelman, “When Do Fiduciary Duties Arise?” (2010) 126 *Law Quarterly Review* 302 at 322: “The difficulty with the duty to act in the ‘best interests’ of another is... that the duty is extremely vague.” S. E. K. Hulme, “The Basic Duty of Trustees of Superannuation Trusts: Fair to One, Fair to All?” (2000) *Trust Law International* 130 at 130: The ‘best interests’ duty is “unhistorical, simplistic, true in part only and misleading.”; In *KLB v British Columbia* [2003] 2 S.C.R. 403 at para. 46, the Supreme Court of Canada rejected a result-based fiduciary duty as a standard that cannot be quantified or enforced.

¹³² The duty to exercise discretion appropriately will be explained in detail in Chapter 4. At this point, it should be noted that ‘appropriately’ refers to the factors taken into account when deciding what is in the best interests of the beneficiary, rather than pointing to the substantive merits of a given decision. The latter aspect is covered by the duty of care.

proscriptive duties are meant to protect this core duty by eliminating the possibility that the fiduciary's decision-making process be flawed by self-interest, either as a non-relevant factor that is consciously taken into account, or as a factor that interferes with the proper exercise of judgment at a subconscious level. The connection between the proscriptive duties and the core duty to exercise proper judgment allows for original insights into the historical development of fiduciary duties. It also shows that the proper understanding of the notion of 'conflict of interest' makes possible a trans-systemic analysis of fiduciary duties. Beside the protection of the core duty, the proscriptive rules serve other *secondary* purposes. They aim to reinforce the beneficiaries' confidence in an increasingly professionalized body of fiduciaries. These external aspects, while not the core justification of the rule, are important *effects*.

2.3 The convoluted development of the proscriptive duties

Irrespective of the labels that they use, most fiduciary duty theories share the view that a person in a fiduciary position is bound by strict proscriptive duties. The basic common foundation of these theories could be enunciated as follows: in a jural relation where one party acquires certain prerogatives or qualities (such as power or discretion to affect the other party's interests, superior information, limited access to the other party's assets, the first party is the recipient of the other's trust and confidence or reasonable expectations of loyalty), the first party, the fiduciary, becomes subject to strict proscriptive duties.

In a broad sense, the proscriptive duties forbid the fiduciary from being in a situation of 'conflict of interest'. The meaning of 'conflict of interest' could be regarded as the point where the different approaches to the nature and content of the 'fiduciary duty' start to diverge. In a loose, but frequent formulation, 'conflict of interest' is used to refer to situations where the fiduciary's personal interests and the interests of the beneficiary point in

opposite directions (the *conflicting interests* approach).¹³³ This superficial understanding of the specific ‘conflict’ that fiduciary law regulates is specific for the theories limiting the notion of ‘fiduciary duty’ to the proscriptive duties.

In a more precise approach, ‘conflict of interest’ is understood as the opposition between the fiduciary’s interests and his ‘duty’ (the *conflict between interest and duty* approach). Very often, the ‘duty’ side of the conflict of interest is interpreted broadly, as encompassing all duties that a fiduciary owes. Consequently, although they refer to a conflict between interest and *duty*, these theories are very similar to the conflicting interests approach: the fiduciary duty must prevent fiduciaries from being swayed by self-interest from the proper performance of their duties to beneficiaries.¹³⁴

Very few theories interpret the notion of ‘conflict of interest’ as opposition between *interest and core duty*. This technical understanding of ‘conflict of interest’ is the only viewpoint that can elucidate the essence of a fiduciary’s role and why fiduciaries are subjected to such strict proscriptive duties.

The failure to understand properly the core conflict that is specific for persons in a fiduciary position is the main cause of the confusion that currently surrounds the notion of fiduciary duty. Since the very early stages of the development of rules concerning trustees and other fiduciaries, judges and commentators were in agreement that the fiduciary’s ‘temptation’ to act

¹³³ See e.g. Irit Samet, “Guarding the Fiduciary’s Conscience: A Justification of a Stringent Profit-stripping Rule” (2008) 28 Oxford Journal of Legal Studies 763 at 765: “The basic principle which governs the relationship between a fiduciary and a principal is the ‘no conflict’ rule, according to which fiduciaries are under an obligation to refrain from any conflict between their interests and the interests of their principal.” Karen E. Boxx, “Of Punctilios and Paybacks: The Duty of Loyalty Under the Uniform Trust Code” (2002) 67 Missouri Law Review 279 at 279: “The trust law concept of the duty of loyalty acknowledges that human nature will cause any person to favor his or her *personal interests* over the *interests of another*, and it is this assumption of disloyalty that gives rise to the strict prohibitions of trustee conflicts of interest required under the label of duty of loyalty”; Tamar Frankel, “Fiduciary Law” (1983) 71 California Law Review 795 at 811: “An ideal fiduciary is one whose interests do not conflict with those of the entrustor... When the fiduciary’s interests coincide with those of the entrustor, the entrustor is partially protected because as the fiduciary acts in his own interest he will automatically act in the interest of the entrustor.” *Thorp v. McCullum*, 6 Ill. (1 Gilm.) 614 at 626 (1844): “Between two conflicting interests, it is easy to foresee, and all experience has shown, whose interests will be neglected and sacrificed.”

¹³⁴ See e.g. Matthew Conaglen, *Fiduciary Loyalty*, *supra* note 69; Paul D. Finn, *Fiduciary Obligations*, *supra* note 85.

self-interestedly must be strictly curbed. Some legal scholars of the 18th century observed that this strict prohibition is needed in order to prevent distortion of the fiduciary's judgment. Throughout the 19th century, however, this insight lost its vigour, and public policy arguments became the most prominent justification of the need to control fiduciaries. As the focus shifted away from the need to ensure a proper exercise of judgment, to the need to prevent temptation of abuse, courts and commentators referred to the conflict specific to persons in a fiduciary position in a non-technical manner, by using interchangeably the ideas of 'conflicting interests' and 'conflict between interest and duty'.

The concern with preventing abuse of position was built around the central idea that it is wrongful for a fiduciary to obtain an unauthorized benefit from his position. The strategic position that trustees or other fiduciaries have, it is argued, coupled with the inherent weakness of the human nature to resist self-interested conduct, gives them the opportunity to exploit to their advantage their position or the property under their administration. Moreover, because of the inequality of the fiduciary relation, the fiduciary can conceal his advantage-taking from the beneficiary and from the court. Hence, to allow potential conflicts between the fiduciary's interests and those of the beneficiary would mean to open the door to exploitation that cannot be discovered.

In the first half of the 19th century, three main related themes emerged from the decisions of the Court of Chancery as justifications for this strict observance of the 'principle' that proscribes the appearance of self-interested behaviour: (i) the inherent human incapacity to resist the temptation of self-interest; (ii) the fiduciary's peculiar ability to conceal his wrongdoing; (iii) the need to sacrifice potentially honest transactions in order to discourage all persons in a fiduciary position from attempting to act self-interestedly.¹³⁵

¹³⁵ Charles Mitchell identified two traditional reasons for the strictness of the rule against unauthorized benefits: "The courts have traditionally given two reasons for this strict approach: first, that fiduciaries must be given 'an incentive... to resist the temptation to misconduct themselves'; and secondly, that a principal would often face insuperable evidential difficulties, were he required to prove that his fiduciary had acted in bad faith and had failed to do everything she could have done." (Charles Mitchell, "Causation, Remoteness and Fiduciary Gains" (2006) *King's Law Journal* 325 at 325-326).

*Keech v. Sandford*¹³⁶ is among the earliest cases that provide a firm articulation of the deterrence theme. In this “extraordinarily cryptic case,”¹³⁷ Lord Keeper King emphasized that trustees are strictly prohibited from taking in their own name a lease no longer available to the beneficiary of the trust. The rationale for this strict prohibition appears to be one of policy. The decision provides a strong warning against trustees not to use the office for their own benefit:

I very well see, if a trustee, on the refusal to renew, might have a lease to himself, few trust estates would be renewed to *cestui que use*... 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 rule should be strictly pursued, and not in the least relaxed; for it is very obvious what would be the consequence of letting trustees have the lease, on refusal to renew to *cestui que use*.¹³⁸

The peculiar strictness of this rule has two manifestations. First, Lord Keeper King argued that it is preferable to abandon a lease that could not be renewed for the benefit of a *cestui que trust*, rather than allow the trustee to take it in his own name. Second, a trustee who takes over such a lease is liable to hold it for the benefit of the *cestui que trust*, although he was not motivated by the desire to defraud the beneficiary: “[T]hough I do not say there is a fraud in this case, [the trustee] should rather have let it run out, than

¹³⁶*Keech v. Sandford* (1726) Sel Cas Ch 61.

¹³⁷ Joshua Getzler, “Rumford Market and the Genesis of Fiduciary Obligations” in A Burrows and Lord Rodger of Earlsferry, eds, *Mapping the Law: Essays in Honour of Peter Birks* (Oxford Oxford University Press, 2006) at 581. For historical insights into the rationale behind *Keech* see Walter G. Hart, “The Development of the Rule in *Keech v Sanford*” (1905) 21 Law Quarterly Review 258; Stephen Cretney, “The Rationale of *Keech v. Sandford*” (1969) 33 Conveyancer 161; Dennis R. Paling, “The Pleadings in *Keech v. Sanford*” (1972) 36 Conveyancer 159.

¹³⁸*Keech v. Sandford* (1726) Sel Cas Ch 61. As Joshua Getzler observed, this rule has been interpreted as aimed to deter potential fiduciary misbehavior: “Historically the *Rumford Market* case has been received as embodying a prophylaxis, or preventive sanction through profit-stripping that takes away all incentive for a fiduciary to consider how he might gain from his position.” (Joshua Getzler, *supra* note 137 at 586). White and Tudor’s notes to this case specify that the strict prohibition of benefits established in *Keech* applies to any person “clothed with a fiduciary or quasi fiduciary character”: “Whenever a person clothed with a fiduciary or quasi fiduciary character or position gains some personal advantage by availing himself of such character or position, a constructive trust is raised by Courts of Equity, such person becomes a constructive trustee, and the advantage gained must be held by him for the benefit of his *cestui que trust*.” (Frederick T. White and Owen D. Tudor, *A Selection of Leading Cases in Equity: With Notes*, ed. by Thomas Snow *et al.*, vol. 2, 7th ed. (London: Sweet and Maxwell, 1897) 695.

to have had the lease to himself.” In the absence of a more detailed reporting of this case, it is difficult to identify the underlying reason for the harshness of this rule binding trustees and other fiduciaries.¹³⁹

In *Whelpdale v. Cookson*¹⁴⁰ Lord Chancellor Hardwicke made a similarly elusive reference to the core justifications of the strictness of the proscriptive rules, by invoking the need to prevent unwanted consequences on other fiduciary relations and the evidentiary difficulties related to proving an actual benefit:

Lord Chancellor said, he would not allow it to stand good, although another person being the best bidder bought it for him at a public sale; for he knew the dangerous consequences; nor is it enough for the trustee to say, you cannot prove any fraud, as it is in his own power to conceal it.¹⁴¹

Another early use of the deterrence argument comes from Lord Kames. In his treatise on Equity, Kames argued that allowing trustees to draw direct or indirect benefits from their position would have “poisonous” consequences. Although a particular benefit may appear as innocently obtained in a given situation, allowing such benefit would encourage other

¹³⁹ *Ibid.* In *Ex parte Bennett* (1805) 10 Ves. Jun. 382 at 395 Lord Eldon referred to a similar scenario and reinforced the rationale of *Keech*: “[The trustee of a lease] should rather have let [the lease] run out, than to have had the lease to himself... The principle is unalterably laid in the prior decisions; especially in that, where it was held, that, to protect the purity of transactions between trustee and the *Cestui que Trust*, a trustee should not take for his own benefit even property, which the owner refused to sell to the *Cestui que Trust*. That was a church lease. The trustee applied for a renewal; and the lessor declared, he would not renew for the benefit of the infant *Cesui que trust*. The trustee then took it, and rightly in point of moral honesty, for his own benefit: but this court said, it has so little power of obtaining a complete discovery in all cases, that *the property should be thrown back to the lessor, rather than the trustee should have it.*” (emphasis added). The strict rule established in *Keech* was subsequently extended beyond leases, to a general prohibition from obtaining unauthorised benefits binding on persons in a fiduciary position. In the second edition of his famous trust law treatise, Thomas Lewin noted that the principle of *Keech* might be pursued into numerous other instances: “if a factor agent, or other confidential person, acquire an advantage to himself by the abuse of his fiduciary character, he is accountable for those profits to his employer or other person whose interests he was bound to advance.” (Thomas Lewin, *A Practical Treatise on the Law of Trusts and Trustees*, 2nd ed., (London: Maxwell, 1842) 179).

¹⁴⁰ *Whelpdale v. Cookson* (1747) 1 Ves 8.

¹⁴¹ *Ibid.* The need to sacrifice the cases where trustees act honestly in self-dealing transactions, in order to preserve the “general policy” is invoked by Lord Thurlow in *Fox v. Mackreth* (1788) 2 Cox 320 at 326: “if a trustee, though strictly honest, buys an estate himself, and then sells it for more, yet according to the rules of a Court of Equity, from general policy, and not from any peculiar imputation of fraud, a trustee shall not be permitted to sell to himself, but shall remain a trustee to all intents and purposes.”

trustees to focus on obtaining selfish benefits rather than on their duties towards the beneficiary.

[E]quity... prohibits a trustee from making any profit by his management directly or indirectly. However innocent an act of this nature may be in itself, it is poisonous with regard to its consequences; for if any opportunity be given for making profit in this manner, a trustee will lose sight of his duty, and soon learn to direct his management chiefly or solely for his profit.¹⁴²

Although he mentioned the dangers that self-interest poses to trustee's 'duty', Lord Kames did not elaborate on the particular duty that is peculiarly susceptible to be breached by self-interest. Instead, he concentrated on the more obvious result of allowing innocent benefits to stand, namely the enhanced opportunities for future misuse of a fiduciary position.

Nevertheless, Lord Kames made a valuable, albeit insufficiently detailed (and often overlooked) observation. He asserted that the principle that prohibited trustees or tutors from purchasing property under their management was the same principle that prohibited persons occupying a judicial office from purchasing land that is subject of a law suit:

It is for the same reason that a member of the college of justice is prohibited by statute from purchasing land the property of which is subject to a law-suit; and that a factor upon a bankrupt estate is prohibited from purchasing the bankrupt's debts.¹⁴³

It is very likely that the principle to which Lord Kames alludes is the natural justice maxim that no person can be judge in his own cause.¹⁴⁴ Stated differently, this maxim prohibits a person required to exercise impartial judgment to have a personal interest in the outcome of his decision. This maxim was invoked by several other treatises and court decisions of the late 18th century as the core justification of the proscriptive rules. At the beginning of the 19th century, however, under Lord Eldon's Chancery tenure,

¹⁴² Lord Henry Home Kames, *Principles of Equity*, vol. 2, 2nd ed. (Edinburgh: A. Kincaid & J. Bell, 1767) 255.

¹⁴³ *Ibid.* at 256.

¹⁴⁴ For more details on this maxim see Chapter 5 below.

the deterrence and evidentiary difficulty themes gained primacy and pushed aside the ‘judge in his own cause’ idea.

John Erskine provided a similar explanation for the civil law rule that prohibits tutors and curators from obtaining a personal benefit in relation to their position. The civil law forbids such benefits in order to prevent the misuse of the knowledge of the minor’s estate that tutors and curators acquired:

Neither tutors nor curators can be *auctores in rem suam*. They cannot, contrary to the nature of their trust, interpose their authority to any deed of the minor, in which themselves have an interest, or which tends to produce an obligation against him in their own favour, *more than they can be judges or witnesses in their own cause*... If it were otherwise, a tutor, through the knowledge of the minor’s affairs, and concealing them from others, might raise to himself a fortune, by such purchases, at his ward’s cost.¹⁴⁵

Just like Kames, Erskine connected the strict prohibition of self-interest with the established natural law prohibition of being both judge and party in the same case, without further explaining *how* the natural law maxim applies to a fiduciary position. The explanations offered by these two prominent Scottish jurists on the justification of the proscriptive rules have been referred to as entirely relevant for the English law:

[T]he analogy of the law of England appears perfectly to agree in the same doctrine... The Scotch authorities agree with the English both in the doctrine and the principle and the reason of the thing... [Mr. Erskine’s] reasons speak the same language that occurs in the English cases.¹⁴⁶

The danger of temptation, the ease of concealment and the primacy of the ‘principle’ over actual honesty are the main arguments put forth by the appellants in *York Buildings Company v Mackenzie*.¹⁴⁷ Because humans are inclined to act for their own benefit, persons charged to act for another must

¹⁴⁵ John Erskine, *An Institute of the Law of Scotland: In the Order of Sir George Mackenzie’s Institutions of That Law*, vol. 1 (Edinburgh: John Bell, 1773) 123, emphasis added.

¹⁴⁶ *York Buildings Company v Mackenzie* (1795) 8 Brown PC 42 at 67.

¹⁴⁷ *York Buildings Company v Mackenzie* (1795) 8 Brown PC 42.

be subject to “the highest quality of legal disability” to purchase property under their administration,¹⁴⁸ in order to prevent “the danger of temptation”:

He that is entrusted with the interest of others, cannot be allowed to make the business an object of interest to himself; because from the frailty of nature, one who has the power, will be too readily seized with the inclination to use the opportunity for serving his own interest at the expense of those for whom he is entrusted. The danger of temptation... does, out of the mere necessity of the case, work a disqualification.¹⁴⁹

The impossibility to resist temptation which arises in the case of purchase of trust property is caused by the fact that the trustee fills both the role of seller and that of buyer. The two roles are antagonistic, and create in the trustee’s person a situation of *conflicting interests* with respect to the purchase price: the interest of a seller and that of a buyer point into opposite directions.¹⁵⁰ After referring to the conflicting interests that characterize the position of seller and buyer, the appellants’ counsels observed that the strictness with which the law prohibits self-dealing is justified by the need to ensure that this situation of conflicting interests does not interfere with the trustee’s discharge of “the duty of his trust”:

This conflict of interest is the rock, for shunning which, the disability under consideration has obtained its force by making that person, who has the one part entrusted to him, incapable of acting on the other side, that he may not be seduced by temptation and opportunity from the duty of his trust.¹⁵¹

¹⁴⁸ *Ibid.* at 63.

¹⁴⁹ *Ibid.* at 63. Although the case concerned a ‘common agent’, the appellants’ reasons refer broadly to every person entrusted to perform a task for another: “The office of a common agent has already been described in this case... He is a trustee (in technical style) who is vested with property in trust for others; but every man has a trust, to whom a business is committed by another, or the charge or care of any concern is confided or delegated by commission.” (*ibid.* at 64).

¹⁵⁰ “Accordingly, when the civilians say that the different parties in a contract are so distinct and separate, though the contract is but one [they mean that] the part which the seller and the buyer have to act stand in direct *opposition to each other in point of interest*, it being the object of the seller to sell as high as he can, and of the buyer to buy as cheap as he can.” (*ibid.* at 65-66, emphasis added).

¹⁵¹ *Ibid.* at 66.

The appellants' arguments suggest that the situation of conflicting interests that characterizes a sale contract is dangerous for persons in a fiduciary position *because it interferes* with the proper performance 'duty of their trust'. This interpretation is supported by the underlying reason that these arguments provide for the prohibition of self-dealing, namely that no person can be both judge and party in the same cause. In other words, a person who has a duty to make a judgment concerning another's interests is not allowed to have a personal interest in the outcome of the judgment, because such an interest would interfere with his duty to provide an unbiased judgment: "The ground on which the disability or disqualification rests, is no other than that principle which dictates that a person cannot be both judge and party."¹⁵² This brief reference to the prohibition of being both decision-maker and interested party in the same matter, without further explanations, may suggest that the principle was well-known and accepted by the legal scholars of the time. Unfortunately, like Kames' and Erskine's remarks, the appellants' arguments do not make a firm connection between the conflicting interests situation and the core duty of a person called to exercise proper judgment. The subsequent cases have carried forward the strong rhetoric concerning the dangers of temptation to act self-interestedly, but have lost sight of the insight that temptation must be avoided in order to ensure proper judgment.

The connection between the danger of self-interest and the main duty of a person in a fiduciary position is obscured further by the second justification of the strictness of the proscriptive rules provided for in *York Buildings*, namely the particular ease with which fiduciaries can conceal their self-interested actions or intentions. In the case of a common agent, his privileged insight into the real value of the property he is charged to sell places him in a strategic position to misuse this information for his own benefit:

¹⁵² *Ibid.* at 63. In the case of a common agent, his unbiased judgment is required in order to ensure an objective and accurate valuation of the property under sale: "A common agent... is an agent or solicitor in the court of session, and is elected by the creditors, and afterwards approved by the court. He is equally charged with the interests of the creditors and of the debtor... It is his duty to make particular enquiries into the nature and advantages of the property to be sold and he has the conduct of the proof of the value." (*ibid.* at 49).

[T]he common agent had better opportunities than any other person to become acquainted with the estate... [H]e might conceal its value, and in general might conduct the previous proceedings in such a manner, as when it comes to auction would throw it into his own hands at a low price... [T]he best security for his being actually faithful was to remove from him all temptation, by absolutely incapacitating him to purchase... [N]othing less than incapacity being able to shut the door against temptation where the danger is imminent, and the security against discovery great... The wise policy of the law has therefore put the sting of a disability into the temptation as a defensive weapon against the strength of the danger which lies in the situation.¹⁵³

The decisions issued by Lord Eldon at the beginning of the nineteenth century have played a key role in the establishment of the ‘danger of temptation’, ‘security against discovery’ and ‘primacy of principle’ themes as the most prominent justifications of the proscriptive duties.¹⁵⁴

In *Ex parte Lacey*¹⁵⁵ Lord Eldon asserted that assignees under a commission of bankruptcy cannot purchase an interest the bankrupt’s estate sold under the commission. This prohibition does not depend on the morality of a particular transaction, but rests on the general principle that fiduciaries cannot do “any thing for their own benefit,” irrespective of the apparent honesty of the transaction.¹⁵⁶ The general principle is justified by the difficulty of proving the actual fairness of each transaction in which the fiduciary has a personal interest. Consequently, for policy reasons,

¹⁵³ *Ibid.* at 62-64.

¹⁵⁴ These ideas appear also in *Lister v. Lister* (1802) 6 Ves. Jun. 631 at 631-633, where Sir W. Grant, Master of the Rolls asserted that “[the] general rule upon a purchase of trust property by the trustees on their own account [is] that at the option of the cestuy que trust it shall be re-sold... The rule is a rule of general policy, to prevent the possibility of fraud and abuse; for it may not always be possible to know whether property was undersold.”

¹⁵⁵ *Ex parte Lacey* (1802) 6 Ves. Jun. 626.

¹⁵⁶ “As to the purchase of the debts by the assignee, as assignees cannot buy the estate of the bankrupt, so also they cannot for their own benefit buy an interest in the bankrupt’s estate; because they are trustees for the creditors. In that respect there are no differences between assignees and executors... I do not say that there may not be cases of that kind, in which a moral view of the transaction between the executor and the creditor may not be blamable; but the court must act upon general principles.... Unless the policy of the law makes it impossible for them to any thing for their own benefit, it is impossible to see, in what cases the transaction is morally right.” (*ibid.* at 628).

transactions that are not ‘morally blamable’ must be sacrificed in order to ensure the effectiveness of the ‘principle’.¹⁵⁷

In *Ex parte James*¹⁵⁸ Lord Eldon reiterated the view that purchases by trustees and other persons in trust-like positions of property under their administration should be strictly prohibited in all instances, irrespective of the trustee’s honesty and regardless of whether the trustee has obtained or not an advantage from the sale:

This doctrine as to purchases by trustees, assignees, and persons having a confidential character, stands much more upon general principle than upon the circumstances of any individual case. It rests upon this; that the purchase is not permitted in any case, however honest the circumstances; the general interests of justice requiring it to be destroyed in every instance; as no court is equal to the examination and ascertainment of the truth in much the greater number of cases.¹⁵⁹

By virtue of their position, trustees acquire detailed knowledge of the value of the property they administer, which puts them in a strategic position to use this information for their own benefit while maintaining the appearances of fairness. Consequently, a strict deterrent principle is required for all trustees, even if in some cases the application of this principle causes

¹⁵⁷ Lord Eldon added that the same policy renders voidable the transactions between the trustee and the *cestui* with regard to the trust property. Unless the trustee renounces completely his office before transacting with the beneficiary, the law will infer that the trustee has misused the information he acquired concerning the trust property in order to obtain a secret advantage from the purchase (*ibid.* at 626-627).

Beside the court’s inability to detect every instance of an actual benefit being obtained by the assignee, Lord Eldon indicated that the strict prohibition to purchase bankrupt’s estate is based also on the policy reason that other potential bidders might be discouraged to participate to the public sale: “If persons who are trustees to sell an estate, are there professedly as bidders to buy, that is a discouragement to others to bid. ... [T]he sale might be prejudiced by the mere circumstance, that the agent for the vendor appeared as bidder.” (*ibid.* at 628).

¹⁵⁸ *Ex parte James* (1803) 8 Ves. Jun. 338.

¹⁵⁹ *Ibid.* at 345. The circumstances of a case, which demonstrate the trustee’s moral uprightness, are irrelevant in the face of the need to maintain the firmness of the ‘principle’: “My opinion in this case is purely upon the principle... I have no reason to think that the sale was not fairly had for what was considered at the time by all the parties a good price... [P]rinciple requires... that an assignee under a Commission of Bankruptcy cannot buy the property sold under it, unless he shakes off the character altogether; putting himself altogether of the trust. It is not my opinion that it must be shown, that the trustee has made an advantage...” (*ibid.* at 348). Lord Eldon’s reference to the primacy of principle over the particular circumstances in which the conflict of interest occurred contrast sharply with the emphasis that modern fiduciary law places on the factual circumstances of each case.

losses to trust beneficiaries. The deterrence theme and the evidentiary difficulty theme are combined to justify the strictness of the proscriptive duties:

The principle is, that as the trustee is bound by his duty to acquire all the knowledge possible, to enable him to sell to the utmost advantage to the *cestui que trust*, the question, what knowledge he has obtained... no court can discuss with competent sufficiency or safety to the parties... Therefore the courts have said, it is better for the general interests of justice, that in some cases a loss should be sustained by the *cestui que trust*, than a rule should be established, which would occasion loss in much more numerous cases. The sale by auction is evidence of fairness unquestionably: but that makes no difference as to the principle.¹⁶⁰

The only scenario in which courts are willing to scrutinize the merits of a transaction in which a trustee, in his private capacity, acquires a benefit in relation to the trust property is if the trustee resigns this office with the beneficiary's free and fully informed consent.¹⁶¹

In *Ex parte Bennett*,¹⁶² Lord Eldon observed that the rule against profits applied to trustees and other fiduciaries does not depend on an actual benefit accruing to such persons. The two core justifications of this rule require that any *possibility* of benefit be removed:

Lord Rosslyn said more than once, that, to affect the sale, the trustee must make an advantage. The principle is deeper: viz. that, if a trustee can buy in an honest case, he may in a case, having that appearance; but which from the infirmity of human testimony may be grossly otherwise... Under such circumstances, the safety of mankind requires the court to act upon general principle.¹⁶³

¹⁶⁰ *Ibid.* at 348-349.

¹⁶¹ “[A] person, who had a confidential situation previously to the purchase, [must] at the time of the purchase shake off that character by the consent of the *cestui que trust*, freely given, after full information.” (*ibid.* at 352-353). In *Coles v. Trecothick* (1804) 9 Ves. Jun. 234 at 246-247 Lord Eldon specified that a trustee may buy from the *cestui que trust* provided that there is a “distinct and clear contract, ascertained to be such after a jealous and scrupulous examination of all the circumstances, providing, that the *cestui que trust* intended, the trustee should buy; and there is no fraud, no concealment, no advantage taken, by the trustee of information, acquired by him in the character of trustee.”

¹⁶² *Ex parte Bennett* (1805) 10 Ves. Jun. 382.

¹⁶³ *Ibid.* at 385-396. Lord Eldon illustrated the impossibility of proof of the advantage obtained by a trustee or of the fairness of a self-dealing transaction as follows (this example was used before Lord Eldon by Lord Thurlow in *Fox v. Mackreth* (1791) 2 Cox 320 at 321): “A man, employed to sell, may in the investigation undertaken under the obligation of his

Beside his traditional arguments, Lord Eldon provided another explanation for the need to proscribe self-dealing. He observed that, once a trustee allows a personal interest to arise in himself in relation to a duty that he must discharge for the benefit of the beneficiary, due to “human infirmity” the trustee will not be able to prevent such interest from interfering with the optimal discharge of his duty:

[U]ntil by contract he shall... shake off the character of trustee, and put himself in circumstances in which he shall be no longer the person intrusted to sell, he shall not buy for himself. Why? The reason is that it would not be safe, with reference to the administration of justice in the general affairs of trust, that a trustee should be permitted to purchase; for human infirmity will in very few instances permit a man *to exert against himself* that providence, which a vendor ought to exert, in order to sell to the best advantage; and which a purchaser is at liberty to exert for himself, in order to purchase at the lowest price.¹⁶⁴

Temptation, difficulty of proof, and public policy appear prominently in the U.S. landmark case *Davoue v. Fanning* as justifications of the proscriptive rules.¹⁶⁵ After canvassing the most important English cases regarding the trustee’s prohibition to purchase trust property, Chancellor Kent concluded:

However innocent the purchase may be in a given case, it is *poisonous in its consequences*. The *cestui que trust* is not bound to prove, nor is the Court bound to judge, that the trustee has made a bargain advantageous to himself. The fact may be so, and yet the party not have in his power, distinctly and clearly, to show it. There may be fraud... *and the party not be able to prove it*. It is to guard against this uncertainty and hazard of abuse, and to *remove the trustee from temptation*, that the rule does and will permit the *cestui que trust* to come, at his own option, and without showing actual injury, and insist upon having the experiment of another sale. This is a remedy which goes deep, and touched the very root of the evil.¹⁶⁶

duty as trustee, have learnt, that the value of the estate consists of a mine: all the rest of the world may be ignorant of that circumstance; and he may buy without communicating it; and it will rest entirely upon his honour and integrity, whether this Court can get a discovery of the fact, that he acquired that knowledge before the sale; and never communicated it.” (*Ex parte Bennett* (1805) 10 Ves. Jun. 382 at 394).

¹⁶⁴ *Ibid.* at 394, emphasis added.

¹⁶⁵ *Davoue v. Fanning* (1816) 2 John. Ch. Rep. 252.

¹⁶⁶ *Ibid.* at 261, emphasis added.

Once it became settled that the absolute prohibition of self-interested acts has primacy over the actual circumstances of the case, the courts refused to allow any suggestion being raised that the self-interested transaction may be fair to the beneficiary. In *Wormely v. Wormely*,¹⁶⁷ Johnson J. of the U.S. Supreme Court asserted that the issue of the fairness of a self-dealing transaction cannot be taken into account by the court:

[T]here are canons of the court of equity which have their foundation not in the actual commission of fraud, but in that hallowed orison 'lead us not into temptation.' One of these is that a trustee shall not be permitted to mix up his own affairs with those of the cestui que trust. Those who have examined the workings of the human heart well know that in such cases, the party most likely to be imposed upon is the actor himself, if honest, and if otherwise, that the scope for imposition given to human ingenuity will enable it generally to baffle the utmost subtlety of legal investigation. Hence the fairness or unfairness of the transaction or the comparison of price and value is not suffered to enter into the consideration of the court on these occurrences...¹⁶⁸

The language in *Wormely* and in some of the cases analyzed previously suggests that the strict proscriptive rules are meant to prevent not only situations where fiduciaries yield to temptation and use their 'human ingenuity' to hide the unauthorized benefit from the 'eye of the court', but also the cases where, due to the limitations of the human 'conscience' or 'heart', self-interest tends to interfere with the proper discharge by a fiduciary of his duty. In *Hamilton v. Wright*,¹⁶⁹ Lord Brougham underlined that the focus of the rule against conflicts of interest is the tendency that self-interest has to interfere with the trustee's duty to the trust:

When [Thomas Wright] accepted the trust, it became his duty as trustee to do nothing for the impairment or destruction of the trust,

¹⁶⁷ *Wormely v. Wormely* (1823) 21 U.S. 8 Wheat. 421.

¹⁶⁸ *Ibid.* at 464, emphasis added. Johnson J's reference to 'the workings of the human heart' may betray influences of natural law or natural justice philosophical ideas, where heart and conscience were closely-linked concepts. See generally Dennis R. Klinck, *Conscience, Equity and the Court of Chancery in Early Modern England* (Surrey, England: Ashgate Publishing, 2010) 199.

¹⁶⁹ *Hamilton v. Wright* (1842) 9 Cl & Fin 111.

nor to place himself in a position inconsistent with the interests of the trust... There cannot be a greater mistake than to suppose... that a trustee is only prevented from doing things which bring an *actual loss* upon the estate under his administration. It is quite enough that the thing which he does has a tendency to injure the trust; a *tendency to interfere with his duty*.¹⁷⁰

Regrettably, Lord Brougham's argument shifted to the traditional justifications of the prohibition of self-interested acts (i.e. need to prevent trustee's misuse of information for his own benefit; the court's inability to ascertain when such misuse occurs; and the need to sacrifice potentially honest transactions in order to prevent the greater evil of undetected misbehavior) without further clarifications concerning *how* self-interest tends to interfere with the trustee's duty.¹⁷¹

The idea that any investigation into the actual fairness of a self-dealing transaction is inadmissible ascribed a procedural nature to the proscriptive rules, and obscured further their connection with a core duty: whenever a conflict of interest existed, no further investigation into the substantial merits of the transaction was allowed. The peculiar strictness of this rule resides not only in its procedural nature, but also in the fact that the courts were willing to sacrifice transactions profitable to the beneficiary, in the name of the 'principle':

So strictly is this principle adhered to, that *no question is allowed to be raised as to the fairness or unfairness of a contract so entered into*. It obviously is, or may be, impossible to demonstrate how far in any

¹⁷⁰ *Ibid.* at 122-123, emphasis added. According to Story, this rule applies to any person in a fiduciary position. See Joseph Story, *Commentaries on Equity Jurisprudence as Administered in England and America*, vol. 1, 6th ed. (Boston: Little, Brown, 1853) 361-362: "[I]t may be laid down as a general rule, that a trustee is bound not to do any thing, which can place him in a position inconsistent with the interests of the trust, or which has a tendency to interfere with his duty in discharging it. And this doctrine applies, not only to trustees strictly so called, but to other persons standing in like situation."

¹⁷¹ *Hamilton v. Wright* (1842) 9 Cl & Fin 111 at 124: "Nor is it only on account of the conflict between his interest and his duty to the trust that such transactions are forbidden. The knowledge that he acquires as trustee is of itself sufficient ground of disqualification, and of requiring that such knowledge shall not be capable of being used for his own benefit to injure the trust; the ground of disqualification is not merely because such knowledge may enable him to obtain an undue advantage over others... [T]he conduct of the trustee not being blamable in the purchase, is nothing to the purpose; for the Court must act... upon the general principle; and unless the policy of the law makes it impossible for the trustee to do anything for their own benefit, it will be impossible for the Court to see in what cases the transaction is morally right, and in what cases it is not."

particular case the terms of such a contract have been the best for the interest of the *cestui que trust*, which it was possible to obtain. It may sometimes happen that the terms on which a trustee has dealt or attempted to deal with the estate or interest of those for whom he is a trustee, have been as good as could have been obtained from any other person - *they may even at the time have been better*. But still so inflexible is the rule that no inquiry on that subject is permitted. The English authorities on this head are numerous and uniform.¹⁷²

The increasing emphasis on the procedural nature of the proscriptive rules and on their inflexibility led to a quasi-total overshadowing of the core reason for which the ‘principle’ was established. Although some landmark decisions referred to a ‘conflict between interest and duty’, the general explanation of the strict proscriptive duties tended to focus exclusively on the need to counteract the inherent tendency of human nature to yield to the temptation of selfishness:

It is an inflexible rule of a Court of Equity that 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... [This rule is] 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. It has, therefore, been deemed expedient to lay down this positive rule.¹⁷³

In rare instances, the judges alluded to a vital link between the strict prohibition of self-interest and the need to ensure a proper exercise of judgment:

[T]he Court of Chancery exercised an exclusive jurisdiction in cases which although classified in that Court as cases of fraud, yet did not necessarily import the element of *dolus malus*. *The Court took upon itself to prevent a man from acting against the dictates of conscience*

¹⁷² *Aberdeen Railway Co v. Blaikie Brothers* (1854) 1 Macq 461, at 471-472. In *Parker v. McKenna* Lord Cairns LC adopted a similar view: “No man can in this Court, acting as agent, be allowed to put himself in a position in which his interest and his duty will be in conflict... The Court will not inquire, and is not in a position to ascertain, whether the bank has lost or not lost by the acts of its directors. All that the Court has to do is examine whether a profit has been made by an agent, without the knowledge of his principal, in the course and execution of his agency...” (*Parker v. McKenna* (1874) LR 10 Ch App 96 at 118).

¹⁷³ *Bray v. Ford* [1896] AC 44 at 51-52, per Lord Herschell.

as defined by the Court, and to grant injunctions in anticipation of injury, as well as relief where injury had been done. Common instances of this exclusive jurisdiction are cases arising out of breach of duty by a person standing in a fiduciary relation.¹⁷⁴

Just like Johnson J's reference to "the workings of the human heart" or Lord Heschhell's allusion to "human nature being what it is", Viscount Haldane's observation that the primary role of the Court of Chancery was to prevent persons from acting "against the dictates of conscience" has remained largely inconsequential. In the absence of more profound explanations of the antagonism between self-interest and proper exercise of judgment, the references to human nature or human conscience became metaphors for the inherent human selfishness. The core idea that carried the day was that, as a matter of policy, the strict proscriptive rules were required in order to prevent fiduciaries from abusing their position in manners that, due to difficulties of proof, may escape the scrutiny of the court.

The idea that the strict proscriptive rules are the expression of a policy aimed to prevent fiduciaries from being tempted to act self-interestedly has survived to the present day as the most conspicuous explanation of the fiduciary duty.¹⁷⁵

The focus on the need to prevent self-interest led to a distortion of the idea of conflict of interest. Consequently, it became habitual to refer interchangeably to conflict between interest and duty or to conflicting interests, without a clear understanding of the particular nature of the conflict that is specific for fiduciaries.

This inappropriate understanding of the core fiduciary conflict appears in the earliest treatises on equity. In his annotations to one of the

¹⁷⁴ *Nocton v. Lord Ashburton* [1914] 1 AC 932 at 952, per Viscount Haldane L.C.

¹⁷⁵ See e.g. *Midcon Oil & Gas Limited v. New British Dominion Oil Company Limited and Thomas L. Brook*, [1958] S.C.R. 314 at 341, per Rand J., dissenting: "The loyalty of a fiduciary... means that he must divest himself of all thought of personal interest or advantage that impinges adversely on the interest of the beneficiary or that results from the use, in any manner or degree by the fiduciary, of the property, interest or influence of the beneficiary. Equity, in applying the rule as one of fundamental public policy, does so ruthlessly to prevent its corrosion by particular exceptions; by an absolute interdiction it puts temptation beyond reach of the fiduciary by appropriating its fruits."; Matthew Conaglen, *Fiduciary Loyalty*, *supra* note 69 at 73: "The fundamental basis of the fiduciary conflict principle is a prophylactic desire to insulate the fiduciary from such temptations, so as better to ensure that the fiduciary will comply with his non-fiduciary duties."

earliest Equity treatises (*A Treatise on Equity*, nominally ascribed to Henry Ballow), John Fonblanque emphasized that the strict prohibitions to which Equity subjects trustees are meant to keep them “within the line of their duty” by preventing their personal interest from entering into conflict with that of the beneficiary:

A court of equity watches the conduct of a trustee with jealousy... Trustees cannot act for their own benefit in a contract on the subject of the trust. They cannot be allowed to raise an *interest* in themselves *opposite to that* of those for whom they act. The object of the rule is to keep trustees *within the line of their duty*.¹⁷⁶

This description of the conflict of interest suggests that Equity forbids conflicting interests in trusts and other fiduciary relations in order to ensure that fiduciaries are not distracted from their ‘duty’. The spirit of this formulation appears to be that there is a fundamental incompatibility between self-interest and the essence of the fiduciary position. However, the key explanation, namely that self-interest is incompatible with exercising judgment over the interests of another, is not articulated expressly in this passage of Ballow, or in other similar texts. Nevertheless, the ambiguous terms ‘duty’ could be interpreted as referring to the duty to exercise discretion appropriately.

Due to this uncertainty, the idea that self-interest must be forbidden in order to keep the trustee ‘in line of his duty’ has been interpreted as pointing towards the ‘need to deter abuse of position’ argument.¹⁷⁷

A similarly inconsistent reference to the conflict that fiduciaries must avoid is present in some early theoretical justifications of the gratuitous

¹⁷⁶ Henry Ballow, *A Treatise of Equity with the Addition of Marginal References and Notes by John Fonblanque*, vol. 2, 4th ed. (Brookfield, Mass: E&L Merriam, 1835) 445, emphasis added. See also Thomas Lewin, *A Practical Treatise on the Law of Trusts and Trustees*, 1st American ed. (Philadelphia: John S. Littell, 1839) 146-147, emphasis added: “It is a general rule established to keep trustees *in the line of their duty*, that they shall not derive any the least advantage from the administration of the property committed to their charge... And the principle applies not only to express trustees, but also to such as are clothed with the same character by construction of law...”

¹⁷⁷ For another early reference to the conflict between interest and “duties” see Leopold G. Robbins, *Bytherwood & Jarman’s System of Conveyancing: A Selection of Precedents in Conveyancing*, vol. 5, 4th ed. (London: H. Sweet, 1888) 96: “Nothing could be more dangerous than to permit the trustees to place themselves in a situation in which their own personal interest is in direct variance with the duties of their office.”

nature of the office of trustee. Trustees were not entitled to remuneration for fear that, if allowed, “the trust estate might be loaded and rendered of little value.”¹⁷⁸ Thomas Lewin believed that the true rationale of this rule was to avoid a conflict between trustee’s interest and the duties of his office:

But the true ground is, that if the trustee were allowed to perform the *duties of the office*, and to claim compensation for his services, his *interest would be opposed to his duty*; And, as a matter of prudence, the court will not allow a trustee or executor to place himself in such a situation. And the rule applies not only to trustees in the strict and proper sense of the word, but to all who are virtually invested with a fiduciary character...¹⁷⁹

Lewin’s reference to trustee’s duty could be interpreted as pointing to a core duty, rather than to any duty that a trustee owes. A similar alternation between ‘interest-duty conflict’ and ‘conflicting interests’ is found in George Spence’s *Treatise on Equity*:

The principle of these decisions as regards trustees and executors and persons in fiduciary situations, is, that where property in which others are interested is committed to the charge of any person, *his first duty is to make the most of the property committed to his charge*... If a person so circumstanced were permitted in any way to deal with the property with reference to his own individual interests... he would be placed in such a situation as that *his interests might*, in reference to the conduct of the trust, by possibility come into conflict with those of his cestui que trust; and in such a conflict the *personal interest of the trustee would in all probability prevail*, against which the court will in all cases endeavor to provide; and, such being the principle, the circumstances of the particular case, generally speaking, can have no influence on the decision.¹⁸⁰

Spence’s formulation of the situation of conflict of interest comes closer to the idea of a core duty to exercise judgment. The duty to ‘make the most of the property’ implies that the fiduciary has discretion concerning the

¹⁷⁸ *Robinson v. Pett* (1734) 3 P. W. 251, per Lord Talbot. See also *How v. Godfrey*, (1678) Rep.t. Finch 361 per Lord Nottingham. In addition to the fear of depleting the trust estate, another reason for this rule was the impossibility to evaluate the quantum of the remuneration. See *Attorney General v. Governors of Harrow School*, (1754) 2 Ves. Sen. 551.

¹⁷⁹ Thomas Lewin, *A Practical Treatise on the Law of Trusts and Trustees*, 2nd American ed. (Philadelphia: T. & J. W. Johnson, 1858) 454, emphasis added.

¹⁸⁰ George Spence, *The Equitable Jurisdiction of the Court of Chancery*, vol. 2 (Philadelphia: Lea and Blanchard, 1850) 298-299.

most appropriate way to administer the property, and that he must exercise this discretion appropriately. The subsequent reference to conflicting interests, however, obscures the connection between self-interest and exercise of discretion, by shifting the focus to the conflict between the trustee's and the fiduciary's interests.

Similarly, in *Aberdeen Railway Co v Blaikie Brothers*,¹⁸¹ one of the early landmark cases of fiduciary law, Lord Cranworth referred to the possibility of conflicting interests as sufficient to trigger fiduciary's liability:

Such agents have duties to discharge of a fiduciary nature towards their principal. And it is a rule of universal application, that no one, having such duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a *personal interest conflicting*, or which possibly may conflict, *with the interests of those whom he is bound to protect*.¹⁸²

Although in this passage he speaks of conflicting interests, in a subsequent passage Lord Cranworth referred to a conflict between interest and duty:

[Mr Blaikie's] *duty* to the Company imposed on him the obligation of obtaining these chairs at the lowest possible price. His *personal interest* would lead him in an entirely opposite direction, would induce him to fix the price as high as possible. This is the very evil against which the rule in question is directed...¹⁸³

The improper understanding of the conflict of interest that is relevant for fiduciary law has been amplified throughout the twentieth century. The Law and Economics theories of fiduciary duties have contributed significantly to obscuring the true nature of this conflict, by predicating their approach on the tendency to cheat inherent in each person who acquires management powers over someone else's assets.

The standard Law and Economics approach to fiduciary duties is based on two key concepts: separation between ownership and control over an asset and the agency costs that such separation engenders. The premise for

¹⁸¹ *Aberdeen Railway Co v Blaikie Brothers* (1854) 1 Macq 461.

¹⁸² *Ibid.* at 471-472, emphasis added.

¹⁸³ *Ibid.* at 472, emphasis added.

the separation of the two prerogatives is that one party, who owns property (in the sense of controlling and deriving the residual benefit from such property), but who lacks the necessary resources to manage it, delegates open-ended management power to another person. In such a legal relationship, the manager has the incentive to cheat by misappropriating the profits derived from the asset, or otherwise using his position for personal gain. Due to high transaction costs and to the limits of human rationality, the agreement between the owner and the manager is essentially incomplete: it cannot address every contingency that may occur and every action that may be feasible in any possible situation, with respect to the manager's actions. Furthermore, it would be costly or impracticable for the owner to monitor and effectively discipline the manager's performance. Consequently, the law intervenes and fills the gaps in the agreement between the owner and the manager, by imposing on the latter strict proscriptive duties. The actual content of these duties is spelled out *ex post* by the courts, who decide what the proscriptive duties entail in a particular circumstance.¹⁸⁴

Frank Easterbrook and Daniel Fischel, two of the most prominent representatives of the economic analysis of fiduciary duties, explain the conflict of interest regulated by fiduciary duties as follows:

The fiduciary principle is an alternative to elaborate promises and extra monitoring... Socially optimal fiduciary rules... preserve the

¹⁸⁴ See Adolf Berle and Gardiner Means, *The Modern Corporation and Private Property*, rev. ed. (New York: Harcourt, Brace & World, 1968); Frank H. Easterbrook and Daniel R. Fischel "Contract and Fiduciary Duty" (1993) 36 *Journal of Law and Economics* 425; Robert Cooter and Bradley Freedman, "The Fiduciary Relationship: Its Economic Character and Legal Consequences" (1991) 66 *New York University Law Review* 1045; Michael C. Jensen and William H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" (1976) 3 *Journal of Financial Economics* 305; Anthony Duggan summarized the Law and Economics view of fiduciary duties as follows: "The paradigm fiduciary relationship involves the transfer to B of assets or some sort of enterprise to control and manage on A's behalf. The separation of asset or enterprise ownership from management and control gives B an incentive to cheat by misappropriating assets or otherwise using her position for personal gain... Fiduciary law imposes an obligation of loyalty to prevent B from making personal gains while acting on A's account and to prevent conflicts of interest. The aim is to deter B from exploiting the relationship to her own advantage... Fiduciary obligations perform a gap-filling function, like contractual implied terms. They avoid the need for the parties to agree in detail on everything B can or cannot do in the course of the relationship... The courts supply the missing details by spelling out, *ex post*, what B's duty of loyalty means in particular circumstances." (Anthony Duggan, "Contracts, Fiduciaries and the Primacy of the Deal" in *Exploring Private Law* (Cambridge: Cambridge University Press, 2010) 275 at 278-279).

gains resulting from the separation of management from risk bearing while limiting the ability of managers to give priority to their own interests over those of investors. Fiduciary principles contain antitheft directives, constraints on conflict of interest, and other restrictions on the ability of managers to line their own pockets at the expense of investors... *Managers must prefer investors' interests to their own in the event of conflict. That is the core of the duty of loyalty.*¹⁸⁵

The main weakness of the Law and Economics understanding of fiduciary duties is the use of the 'hypothetical bargain' scenario to attempt to demonstrate that fiduciary duties (understood as proscriptive duties) are implied terms in certain agreements. Firstly, it is established that fiduciary duties occur in relations that are not contractual in nature, in a legal meaning of the term 'contract' (such as the relation between tutor and pupil or trustee and an underage beneficiary). Secondly, the proscriptive duties are binding on every person in a fiduciary position, unless there is an express agreement that relaxes these duties. The fact that the beneficiary of a fiduciary relation is insufficiently knowledgeable to bargain for proscriptive duties does not mean that the fiduciary does not owe such duties.¹⁸⁶

This incoherent approach to the notion of 'conflict of interest' has been carried forward into the contemporary fiduciary law. Section 175(1) of the UK Companies Act of 2006, for example, defines director's duty to avoid conflicts of interest in terms of *conflicting interests*: "A director of a company must avoid a situation in which he has, or can have, a direct or

¹⁸⁵ Frank H. Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law* (Harvard: Harvard University Press, 1996) 92-104, emphasis added. For an innovative critique of the contractarian theory of fiduciary duties see Gregory S. Alexander, "A Cognitive Theory of Fiduciary Relationships" (2000) 85 Cornell Law Review 767 (arguing that courts apply different cognitive processes when analyzing breaches of fiduciary duty and, respectively, breaches of contract).

¹⁸⁶ For other critiques of the hypothetical bargain see e.g. Deborah A. DeMott, "Beyond Metaphor: An Analysis of Fiduciary Obligation" (1988) 5 Duke Law Journal 879 at 892: "[T]he 'hypothetical bargain' view of fiduciary obligation does not help to explain the law. For one thing, how hypothetical is the bargain? If it is an approximation of something that particular parties would have agreed to, the content of the bargain will, like actual bargains, reflect many factors, including the scarcity of the subject matter of the bargain, the parties' relative skills in negotiation, and their relative degrees of aversion to risks of varied sorts. In the absence of an actual bargain, one cannot know the import of each of these factors. On the other hand, if the 'hypothetical bargain' represented by fiduciary obligation is truly hypothetical, and not an approximation of what particular parties would have agreed to, why characterize it as a 'bargain' at all?"; See also Scott FitzGibbon "Fiduciary Relationships Are Not Contracts" (1999) 82 Marq. L. Rev. 303; Victor Brudney, "Corporate Governance, Agency Costs, and the Rhetoric of Contract" 85 (1985) Columbia Law Review 1403.

indirect interest that conflicts, or possibly may conflict, with the interests of the company.” In Section 175 (7), however, the conflict is between interest and duty, or duty and duty: “Any reference in this section to a conflict of interest includes a conflict of interest and duty and a conflict of duties.”

The proper use of the notion ‘conflict of interest’ is not just a matter of formulation. It affects the understanding of the foundation of fiduciary law and of the development of its specific rules. As the next section shows, an inadequate understanding of this concept can have severe consequences on the proper development of the fiduciary law.

2.4 The misunderstanding of ‘conflict of interest’: modern examples

These early hesitations concerning the essence of the ‘conflict’ which is prohibited by the proscriptive duties have perpetuated themselves in many subsequent cases and theories, which failed to take into account the core duty that characterizes a fiduciary position.

2.4.1 Misunderstandings of the ‘duty’ side of the ‘conflict of interest’ in the theoretical approaches to fiduciary law

The disregard of the essential link between fiduciary’s self-interest and his core duty to exercise proper judgment is reflected in the views of the notion of ‘conflict of interest’ adopted by the early attempts to find the theoretical foundation of fiduciary duties. Referring to the rule prohibiting fiduciaries to conclude self-interested contracts, Len Sealy observed that:

It is common to say that this situation involves a conflict between the fiduciary’s ‘interest’ and his ‘duty,’ but, if we use this terminology, we must remember that many fiduciaries are under no ‘duty’ or obligation to act at all, and that there is no other sanction to compel the performance of the *supposed duty*, except that of setting aside the contract.¹⁸⁷

¹⁸⁷ Len S. Sealy, “Some Principles of Fiduciary Obligation” (1963) 21 Cambridge Law Journal 119 at 124, emphasis added.

Similarly, Paul Finn, another path-breaking author on fiduciary obligations, argued that the ‘duty’ side of the no-conflict rule has no normative relevance. The ‘duty’ that enters into conflict with self-interest is not a duty in the technical sense, but refers to everything that the fiduciary does or must do as a result of his undertaking to act in the interests of another:

The term ‘duty’ in the [conflict] rule is used in no technical sense... [A]ll the powers, all the authorities, all the discretions the fiduciary’s undertaking authorizes him to exercise for and on behalf of his beneficiary are as much embraced by the conflict rule as are any specific duties he has undertaken to discharge.¹⁸⁸

The main flaw of this kind of argument is that it reduces the notion of conflict of interest to an opposition between any duty that a fiduciary (or any other person, for that matter) owes and an interest that points in the opposite direction. This view creates insurmountable difficulties as concerns the justification of the proscriptive duties. Why does the law prohibit self-interested acts with respect to a duty discharged by a fiduciary, but not with respect to the same duty exercised by a non-fiduciary? As long as no connection between the proscriptive duties and a core duty is made, this question is bound to receive the same unsatisfactory answers: protection of vulnerable persons or prevention of temptation.

The absence of a core fiduciary duty is one of the main flaws of Finn’s theory. In Finn’s view, the fiduciary obligation can be defined in general terms as the obligation “to act honestly in what [the fiduciary] alone considers to be the interests of his beneficiaries.”¹⁸⁹ The obligation to act in the interests of the beneficiary is a general obligation that circumscribes the fiduciary’s autonomy, by ensuring that his actions are oriented towards the beneficiary’s interests.¹⁹⁰ The general fiduciary obligation has no normative relevance: it is expressed in an unlimited number of specific duties, which set

¹⁸⁸ Paul Finn, *Fiduciary Obligations*, *supra* note 85 at 203.

¹⁸⁹ *Ibid.* at 15.

¹⁹⁰ *Ibid.* at 13.

the benchmark for actions that are *not* in the beneficiary's best interest.¹⁹¹ As long as these specific duties are not breached, the fiduciary alone must determine what actions are in the best interests of the beneficiary. Finn's theory is important because it accentuates the element of discretion, or autonomy that fiduciaries have in determining how to act in the best interests of the beneficiary. The main shortcoming of his theory is the failure to articulate the exercise of discretion that each fiduciary has into a core duty. Although Finn observed that Equity "channels the direction of [the fiduciary's] activities" he stopped short of formulating this action as a self-standing, core fiduciary duty to exercise proper judgment.¹⁹² Consequently his approach to the notion of conflict of interest failed to make the connection between the strict prohibition of self-interest and the essence of a fiduciary position.

A similar approach to the notion of 'conflict of interest' underlies a very recent theory of fiduciary obligations, proposed by Matthew Conaglen.¹⁹³ The central thesis of Conaglen's theory is that the no-conflict and no-profit principles provide a subsidiary and prophylactic form of protection to non-fiduciary duties. They increase the likelihood of a proper performance of the non-fiduciary duties, by seeking to avoid influences or temptations that are likely to interfere with the proper performance of the fiduciary's non-fiduciary duties.¹⁹⁴ Consequently, in Conaglen's view, the 'conflict of interest' concept opposes fiduciary's self-interest and any duty that he may have by virtue of his position:

¹⁹¹ Although Finn believed that the content of the fiduciary obligation cannot be identified by an exhaustive enumeration of the specific duties that it entails, he nevertheless identified eight main specific fiduciary duties. See *supra* note 85.

¹⁹² *Ibid.* at 13. Nevertheless, Finn accentuated the importance of the exercise of conscientious judgment. "To the extent that [the fiduciary] has discretions, he can make choices. Equity's concern is to ensure that is and when choices are to be made, they will be made by the fiduciary, and will be made for and in the beneficiaries' interests." (*ibid.* at 16). Concerning the duty not to fetter discretion, Finn remarked that "[t]he only constraining influence upon his discretion must be his *conscientious* appreciation of the beneficiary's interests." (*ibid.* at 25, emphasis added). Furthermore, Finn observed that, as a consequence of the centrality of discretion, a person will cease to be liable as fiduciary when he is expressly obliged to act under dictation in some matter. In such cases (e.g. a court appointed receiver, a trustee who must follow the beneficiary's orders) the person ceases to act as fiduciary and acts only in a ministerial capacity. He is not personally liable for any wrong caused by implementation of improper directions unless he actually knew them to be improper, and he had the right to refuse to act on directions which seemed to be improper (*ibid.* at 24).

¹⁹³ Matthew Conaglen, *Fiduciary Loyalty*, *supra* note 69.

¹⁹⁴ *Ibid.* at 61-76.

[T]he fiduciary conflict principle makes perfect sense if it is understood as the proposition that a fiduciary owes a *fiduciary* duty to avoid conflicts between his non-fiduciary duty and his personal interest...¹⁹⁵ [T]he fiduciary's self-interest is inconsistent with his non-fiduciary duty, and the reason fiduciary doctrine prohibits that is because it creates 'a temptation not faithfully to perform his duty'.¹⁹⁶

The central theme of Conaglen's theory is the need to remove the 'temptations', 'incentives' or 'propensities' that create in a fiduciary a risk of breach of non-fiduciary duties. The concern is that, "the fiduciary might be swayed by interest away from proper performance of his non-fiduciary duties,"¹⁹⁷ "human nature being what it is."¹⁹⁸ Conaglen's explanations of the nature and function of the proscriptive duties are essentially detailed re-statements of the traditional 'danger of temptation' theme. The main flaw of this theme is that it does not explain *why* the law is so concerned with the temptation to breach a non-fiduciary duty in the case of fiduciaries and not in the case of other persons that owe non-fiduciary duties. In the absence of a more profound explanation, Conaglen's theory is based on the assumption that humans are prone to act self-interestedly. By adopting an overly broad understanding of the 'duty' side of the conflict of interest, Conaglen's view falls into the current of thought arguing that the principal focus of fiduciary law is to mitigate the conflicts between the several interests of the fiduciary and the beneficiary.¹⁹⁹

¹⁹⁵ *Ibid.* at 69.

¹⁹⁶ *Ibid.* at 98, citations omitted.

¹⁹⁷ *Ibid.* at 72.

¹⁹⁸ *Ibid.* at 105.

¹⁹⁹ For other critiques of Conaglen's theory see Rebecca Lee, "In Search of the Nature and Function of Fiduciary Loyalty: Some Observations on Conaglen's Analysis" (2007) 27 Oxford Journal of Legal Studies 327; Deborah A. DeMott, "Disloyal Agents" (2007) 58 Alabama Law Review 1049; Joshua Getzler, "Am I My Beneficiary's Keeper? Fusion and Loss-Based Fiduciary Remedies" in Simone Degeling and James Edelman, eds., *Equity in Commercial Law* (Sydney: Thomson, 2005) 239. For Conaglen's reply to some of the critiques, see Matthew Conaglen, *Fiduciary Loyalty*, *supra* note 69 at 97-105.

2.4.2 Consequence of the misunderstanding of ‘conflict of interest’: the proscriptive duties are unjustifiably strict

These hesitations concerning the notion of conflict of interest and the fiduciary’s duty the performance of which is affected by his self-interest determined an increasing number of courts and commentators to call into question the necessity to maintain the strictness of the proscriptive duties in a modern legal system.

Jay Shepherd, one of the earliest authors of a general theory of fiduciary duties, argued that the no-conflict rule, prohibiting fiduciaries to be in a conflict of interest is mistaken.²⁰⁰ In Shepherd’s view, a situation of conflict of interests arises whenever the fiduciary is faced with a choice between his interests and the beneficiary’s interests.²⁰¹ As a consequence of this erroneous definition, Shepherd found no logical rationale to punish fiduciaries simply for facing such a choice. The mere fact of *being* in a situation where a fiduciary is faced with a choice of using his powers in his own interest versus the interest of the beneficiary is not reprehensible. It is only when the fiduciary *chooses* to use the power in his interests, and therefore the conflict ceases to exist, that the fiduciary’s liability arises:

The conflict rule and the profit rule say essentially the same thing: a fiduciary is liable for choosing against the interests of his beneficiary... They are not based on a prohibition against conflicts of interest, nor on a rule against profiting from one’s fiduciary position. Both rules are red herrings.... [T]he days of the conflict rule and the profit rule have ended. Neither, after all, is even remotely correct, and

²⁰⁰ Arguably, Shepherd’s view that the duty of loyalty has no normative salience and that the focus of fiduciary law should be instead on the beneficiary’s equitable ownership of powers led him to describe the conflict situation as the co-existence of the diverging interests of the fiduciary (as the legal owner of the power) and the beneficiary (as equitable owner, or the owner of the ‘fruits’ of the power). For details on Shepherd’s theory of ‘transfer of encumbered power’ see *supra* note 123.

²⁰¹ “[A] conflict of interest can only exist when a fiduciary is faced with a choice between his beneficiary’s interests and his personal interests.” (*ibid.* at 339); “A conflict of interest exists whenever a fiduciary is faced with a choice between the interests of the beneficiary and any other interests, including his own.” (*ibid.*). Sometimes Shepherd referred to ‘conflict of interest’ as a situation of conflict between the fiduciary’s interests and his *duty* to the beneficiary (presumably any duty that the fiduciary owes): “[A] conflict of interest exists whenever an individual is faced with a choice between his own interest and his duty to another.” (*ibid.* at 148). Since in his view the duty of loyalty has no normative relevance, the reference to conflict between interest and ‘duty’ is equivalent to the reference to ‘conflicting interests.’

whatever practical utility the courts have found in using them is overwhelmingly destroyed by the confusions these faulty analyses engender.²⁰²

Shepherd's conclusion is based on his personal understanding of the mechanism of a fiduciary relation, rather than on orthodox grounds. The essence of Shepherd's theory is that 'power' (in the sense that he ascribes to this concept) is a species of property that can be beneficially owned by one person while exercised by another. In the case of a fiduciary relation, the fiduciary is the legal owner of the power, while the beneficiary has equitable ownership of the power, which gives him ownership of the profits that it generates. The beneficiary is entitled to these profits regardless of whether he could have enticed those profits out of the power himself,²⁰³ and irrespective of the fiduciary's state of mind when using the power.²⁰⁴ As a consequence of this understanding of a fiduciary relation, Shepherd found no logical explanation for the traditional strict 'no-conflict' rule.²⁰⁵

By way of exception to his main viewpoint, Shepherd accepted that, in several limited cases, the strict no-conflict rule should be maintained, in the sense that the fiduciary should not be allowed to be in a position where he could decide against the beneficiary's interests. In these situations, although "there has not yet been any breach of duty,"²⁰⁶ the presence of an inchoate threat of misuse of powers gives the beneficiary the right to seek in court an order removing the fiduciary from his office, whenever the beneficiary cannot dismiss the fiduciary unilaterally.²⁰⁷ These extreme cases encompass

²⁰² *Ibid.* at 150-151. "Until that choice is made, the beneficiary has nothing to claim. It is only when the choice is made contrary to the duty, *and therefore the conflict ceases to exist*, that the fiduciary's liability arises. The legal system pounces on the fiduciary who has actualized his conflict of interest not the fiduciary who is faced with it. When we say 'a fiduciary may not put himself in a position where his interest and his duty conflict' we are completely wrong. Of course he can have a conflict of interest, whether passive or active. What he cannot do is choose in favour of his interest." (*ibid.* at 149). Shepherd restated this idea in the chapter dedicated to conflicts of interest: "The mainstream of the law of fiduciaries is, as we have seen, generally unconcerned with the existence of a conflict of interest, instead concentrating on proscribing the actual choice against the interests of the beneficiaries. For the most part, it is unnecessary to deal with the situation of a fiduciary faced with a conflict of interest." (*ibid.*).

²⁰³ *Ibid.* at 118.

²⁰⁴ *Ibid.* at 134.

²⁰⁵ For a critique of Shepherd's theory see *supra* note 123.

²⁰⁶ *Ibid.* at 150.

²⁰⁷ *Ibid.* at 342.

two main scenarios. First, the fiduciary should not be allowed to exercise his powers when there is a sufficiently serious potential for misuse of powers, due to the “seriousness of the temptation facing the fiduciary.”²⁰⁸ In the second case, the no-conflict rule should be preserved because “*the fiduciary would not know* when his self-interest had influenced the use of his fiduciary powers.”²⁰⁹

Unfortunately, Shepherd did not elaborate on the idea that self-interest may cause an unconscious bias in fiduciaries. A possible explanation of this silence is the minimal significance that he ascribed to the concept of discretion’ and to the fiduciary’s decision-making role. In his view, discretion and power are not separate elements. When one person has a power, it is entirely unnecessary to add that the power is coupled with a discretion.²¹⁰ Although Shepherd agreed that the fiduciary is under a duty to use the powers in the best interests of another, he did not analyze this duty further than the duty not to use the power in the fiduciary’s interests. Determining the best use of powers, however, implies a judgment to be made by the fiduciary concerning the purpose for which the power was granted. Shepherd does not address this problem, neither in the context of the duty of care nor in the context of the duty of loyalty. Had he done that, he may have come to the conclusion that discretion, in the sense of ability to decide on the most appropriate course of action is a crucial aspect of fiduciary’ role. Consequently, he might have conferred more weight to the potential that self-interest has to interfere with the appropriate use of fiduciary powers.

The failure to understand correctly the conflict of interest that is specific for fiduciary positions determined some authors to argue that the proscriptive duties should be relaxed. The prominent trust law scholar John Langbein, for example, claimed that the ‘no further inquiry’ rule, according to which transactions involving trust property entered into by a trustee are

²⁰⁸ *Ibid.* at 341.

²⁰⁹ *Ibid.* at 151.

²¹⁰ “The nature of any power is such that there is a discretion in the person holding it that is greater or lesser depending on circumstances. That discretion is not something separate, but is merely descriptive of the extent of the power itself.” (*ibid.* at 84, criticizing Weinrib’s focus on discretion; see Ernest J. Weinrib, “The Fiduciary Obligation” (1975) 25 University of Toronto Law Journal 1).

voidable without further proof, is archaic, and must be modified.²¹¹ Langbein argued that neither the ‘evidentiary difficulties’ nor the ‘deterrence’ themes justify the maintenance of the ‘no further inquiry’ rule. He observed that the strict proscriptive duties were developed to compensate for the Chancery’s defective civil procedure concerning investigations of issues of fact. Due to the contemporary “revolution in equity fact-finding” brought by the modernization of civil procedure, the comprehensive requirements regarding appropriate recordkeeping by trustees and the trustee’s duty of disclosure, the concern that the beneficiaries or the court are not able to prove trustee’s self-interested acts no longer justifies the strict proscriptive duties. Another consequence of the modernization of the fact-finding process is the fact that a very strict deterrence of trustee self-interested acts is no longer necessary. Moreover, the strict prohibitions cause over-deterrence by preventing trustees from engaging in transactions that could benefit both the beneficiary and the trustee.²¹²

Consequently, the ‘no further inquiry’ rule must be replaced with a regime that allows trustees to retain profits obtained from their position, as long as they can prove, if challenged in court, that the conflicted transaction was prudently undertaken in the beneficiary’s best interest.²¹³ He contended that the replacement of the ‘sole interest’ rule with the ‘best interest’ rule would create more value for trust beneficiaries than the ‘no further inquiry rule’ currently does.²¹⁴ Corporate law, Langbein argued, is an instructive

²¹¹ John H. Langbein, “Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?” (2005) 114 Yale Law Journal 929.

²¹² *Ibid.* at 987-990.

²¹³ *Ibid.* at 980-981: “Fixing the sole interest rule is not hard. Change the force of the presumption of invalidity that attaches to the conflicted transaction from conclusive to rebuttable. In place of ‘no further inquiry’ allow inquiry. Allow a trustee who is sued for a breach of the duty of loyalty to prove that the conflicted transaction was prudently undertaken in the best interests of the beneficiary.”

²¹⁴ *Ibid.* at 951: “[The] preoccupation with prophylaxis follows naturally enough from the two suspect assumptions... that when a trustee has a conflict it must be harmful to trust beneficiaries, and that a conflicted trustee can easily conceal wrongdoing... The counterargument, of course, is that in cost-benefit terms, the value of beneficiary-regarding conduct now foreclosed under the sole interest rule outweighs any losses that might arise from changing the force of the presumption of wrongdoing from conclusive to rebuttable.”

example of the desirability of replacing the ‘sole interest’ with the ‘best interest’ rule.²¹⁵

The main flaw of Langbein’s theory is that his analysis of the ‘sole interest’ rule is premised on the erroneous view that this rule aims to prevent a conflict between the trustee’s and the beneficiary’s several interests:

The sole interest rule prohibits the trustee from placing himself in a position where his personal interest... conflicts or possibly may conflict with the interests of the beneficiary... What is troubling about the sole interest rule is not its sensitivity to the dangers of conflicting or overlapping interests, but its one-sidedness in failing to understand that *some conflicts are not harmful, and indeed that some may be positively beneficial*.²¹⁶

Langbein’s approach to the conflict specific to fiduciaries prevented him from addressing the relation between trustee’s self-interest and his core

²¹⁵ *Ibid.* at 962 “[T]he successful experience with ridding corporation law of the sole interest rule is highly instructive for trust law.”

²¹⁶ *Ibid.* at 931-934, emphasis added. Langbein observed that people routinely solve conflict of interest situations in their daily personal and professional lives (such as the conflict that parents face when deciding how to allot their time between their children and their personal needs, or the conflict that a manager faces when deciding how much time to devote to the corporation, as opposed to his personal business). “Much of what daily life is about is managing such conflicts, by setting and adjusting priorities appropriate to the circumstances.” (*ibid.* at 935). A similar conflict situation occurs in the case of non-trust service providers. In this case, the conflict consists in “the risk that the conflicted service provider is trying to sell me excessive or unneeded [services].” (*ibid.* at 936). The customer protection authorities, Langbein argued, allow these ‘conflicts’ because “in the aggregate and ex ante, allowing such conflicts is more beneficial on cost-benefit grounds than prohibiting them.” (*ibid.*). Legal and reputational constraints deter such professional service providers from abuse, while allowing them to profit from their services. Langbein’s examples of ‘conflict of interest’ situations are confused. His personal and family life examples concern a conflict between personal interest and *duty* towards another, rather than a prioritization of tasks. The service provider examples are not relevant, since fiduciary law allows professional fiduciaries to obtain authorized benefits, such as remuneration for their services. For a critique of Langbein’s ‘best interest’ rule see also Melanie B. Leslie “In Defense of the No Further Inquiry Rule: A Response to Professor John Langbein” (2006) 47 William and Mary Law Review 541. Leslie identified several weak points of Langbein’s theory: (i) he does not prove that the ‘no further inquiry rule’ overdeters to any significant degree; (ii) his proposal would significantly underdeter trustee opportunism; (iii) his proposal would be more harmful to trust beneficiaries as a class; (iv) the existing exceptions to this rule do not impact its vitality. In Leslie’s view, there are several important reasons to maintain the ‘no further inquiry’ rule. First, this rule is justified by the beneficiary’s inability to monitor the fiduciary. Second, it compensates for the lack of external pressures on trustees, caused by the absence of a market for beneficial interests in trusts, and disciplines the business environment by “telegraphing, in no uncertain terms, that unauthorized self-dealing is unacceptable” (*ibid.* at 565). Leslie’s analysis is incomplete, because she does not investigate the main reason why the strict rule was introduced by the Court of Chancery. Her argument provides only collateral reasons for maintaining the strictness of the rule, rather than explaining its core purpose.

duty. The conflict that fiduciary law aims to prevent is not premised on the opposition between the fiduciary's interests and those of the beneficiary, but on the incompatibility between trustee's self-interest his core duty. Consequently, conflicts of interest are detrimental to the fiduciary's exercise of judgment, and only indirectly to the beneficiary's interests.

In addition, his theory is terminologically incoherent. If the 'sole interest rule', as he defined it, is concerned with conflicting interests, then a transaction where the trustee's and the beneficiary's interests are aligned (the transaction is in the best interests of the beneficiary and serves the trustee's personal interests as well) is not a situation of conflicting interests and should fall outside his understanding of the 'sole interest rule'. Consequently, there is no 'positively beneficial conflict of interest', and there is no need to replace the sole interest rule.

The 'best interest defense' is another weak point of Langbein's theory. In his view, a conflicted transaction should be allowed to produce effects as long as "a trustee, who had not sought advance approval... would be allowed to prove that the conflict was in the best interests of the beneficiary."²¹⁷ The 'best interest' defense is untenable. Compliance with the fiduciary's obligation to act in the best interests of the beneficiary cannot be evaluated based on its results. Trustees, like other fiduciaries, do not have an obligation to achieve the best results possible for their beneficiaries. Their core obligation concerns the *process* of adopting a decision, and not its *result*.²¹⁸ A trustee may not always be able to prove, and courts may not always be well-equipped to determine *ex post*, if a transaction is objectively in the *best* interest of the beneficiary. Consequently, what the trustee must prove is the fact that he discharged his core duty appropriately, in the sense of acting in what *he perceived* to be the best interests of the beneficiaries.

²¹⁷ John H. Langbein, *supra* note 211 at 981.

²¹⁸ With regard to the fiduciary duty that parents owe to their children, in *K.L.B. v. British Columbia* [2003] 2 S.C.R. 403 at 431-432 McLachlin J. observed that the parental fiduciary duty cannot be understood as a duty to advance the interests of the child. The duty to act in the best interests of the children cannot be interpreted in terms of results. 'Acting in the children's best interests', although a laudable objective, is not a legal or justiciable standard by which to regulate conduct. Otherwise, parents' liability as fiduciaries would be result-based: they would be in breach of fiduciary duty every time the best interests of a child have not in fact been promoted.

Moreover, courts throughout common law jurisdictions have constantly refused to second-guess the merits of a fiduciary's decision, as long as the fiduciary remained within the legal boundaries of his discretion. Courts and commentators increasingly recognize that the core fiduciary obligation is an obligation to act in what *fiduciaries* perceive to be the best interests of the beneficiary. Lionel Smith, for instance, asserted that “the heart of the fiduciary obligation is the surveillance and the justiciability of motive. [The fiduciary] must act (or not act) in what *he perceives to be* the best interests of the beneficiary.”²¹⁹

Because the duty to act in the beneficiary's interests is assessed based on the fiduciary's motivation and not on an objective standard, judges in both UK and US have been reluctant to substitute the fiduciary's interpretation of the beneficiary's best interests with their own view of the best interests. In *Re Smith and Fawcett Ltd*²²⁰ Lord Greene MR underlined that directors are required to act “bona fide in that they consider – *not what a court may consider* – is in the interests of the company, and not for any collateral purpose.”²²¹

Similarly, in *Regentcrest Plc v. Cohen*,²²² Jonathan Parker J. emphasized that a court will not second-guess a director's honest judgment concerning what the best interests of the corporation are:

The duty imposed on directors to act bona fide in the interests of the company is a subjective one... The question is not whether, viewed objectively by the court, the particular act or omission which is challenged was in fact in the interests of the company; still less is the question whether the court, had it been in the position of the director

²¹⁹ Lionel Smith, “The Motive Not the Deed”, *supra* note 69 at 67. In the case of a dispositive power, the content of the core fiduciary duty is slightly different. It is usual to distinguish the administrative powers of a trustee (or another fiduciary) from the dispositive powers. In the first case, the core fiduciary duty compels the trustee to exercise the power in what he perceives to be the best interests of the beneficiary. In the second case, the duty requires him to exercise the power in what he perceives to be the fulfillment of the purpose for which it was granted (see Lionel Smith, “Understanding the Power” (William Swadling, ed., *The Quistclose Trust: Critical Essays* (Oxford: Hart Publishing, 2004) 67 at 70-71). In both types of power, the fiduciary's own judgment is vital: he must apply his mind as to what are the best interests of the beneficiaries or the best way to fulfill the purpose for which the power was granted.

²²⁰ *Re Smith and Fawcett Ltd* [1942] Ch 304.

²²¹ *Ibid.* at 306, emphasis added.

²²² *Regentcrest Plc v. Cohen* [2001] 2 B.C.L.C. 80.

at the relevant time, might have acted differently. Rather, the question is whether the director honestly believed that his act or omission was in the interests of the company. The issue is as to the director's state of mind.²²³

The US corporate law has a similar position. In *Kahn v. Portnoy*²²⁴ the Delaware Court of Chancery underlined that corporate directors must act “in the good faith belief that [their] actions are in the corporation's best interest.”²²⁵ In *Stone v. Ritter*²²⁶ the Delaware Supreme Court expressed the same view: “A director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are in the corporation's best interest.”²²⁷

Consequently, the reference to corporate law does not work in favour of Langbein's ‘best interest’ rule.²²⁸ A trustee's duty of loyalty is similar: it imposes the obligation to act in what the trustee believes to be the best interests of the beneficiary, and the court will defer to the trustee's honest judgment.²²⁹

The idea of relaxing the proscriptive rules found support not only from academic commentators, but also from judges. In *Murad v. Al-Saraj*,²³⁰ for instance, the justices of the English Court of Appeal affirmed in *obiter* that the time may be ripe for the English courts to relax the traditional strict standard of liability imposed by the ‘no-profit’ rule. In *Murad*, the Court of Appeal questioned the justification of the irrelevance of the fiduciary's motivation for the disgorgement of an unauthorized profit. Arden LJ observed that the traditional rationale for the irrelevance of the fiduciary's honesty in obtaining an unauthorized profit, namely the need for deterrence combined with the evidentiary difficulties, is obsolete and can no longer

²²³ *Ibid.* at 105b.

²²⁴ *Kahn v. Portnoy*, 2008 WL 5197164 (Del. Ch. 2008).

²²⁵ *Ibid.* at para. 7.

²²⁶ *Stone v. Ritter* 911 A.2d 362 (Del. 2006).

²²⁷ *Ibid.* at 969-970.

²²⁸ Langbein argued that trust law should abandon the sole interest rule following the model set by corporate law: “Accordingly, the successful experience with ridding corporation law of the sole interest rule is highly instructive for trust law.” (John H. Langbein, *supra* note 211 at 962).

²²⁹ See Lionel Smith, “Can I Change My Mind? Undoing Trustee Decisions” (2008) 27 Estates, Trusts and Pensions Journal 284 at 301.

²³⁰ *Murad v. Al-Saraj* [2005] EWCA Civ 959.

justify the stringency of the rule. A satisfactory degree of deterrence can be achieved by putting on fiduciaries the burden to prove that they acted in good faith and for the benefit of the beneficiaries. Furthermore, the flexibility of the contemporary civil procedure rules will adequately protect the principal, and strike the right balance between the interests of the parties.²³¹ The relaxation of this rule would allow the courts to avoid overly harsh consequences, and tailor remedies that reflect the justice of the case.

Lord Justice Jonathan Parker joined Justice Arden, in her *obiter* pleading for a relaxation of the proscriptive rules, and stated that the contemporary commercial reality no longer requires the very strict no-conflict rule.²³² Starting from the same premise, Lord Justice Clarke, in partial dissent, proposed another way in which the no-conflict rule should be relaxed. In contrast to the majority opinion, which claimed that fiduciaries must be given the chance to prove that they acted in good faith in the beneficiary's interest, Clarke LJ was of the view that a fiduciary should have the right to persuade the court that it is inequitable to order him to account for all of the profits. The fiduciary's fraudulent behaviour should not be a bar to this right, but it should be a factor to be taken into account by judges when determining the part of the profit that the fiduciary should be allowed to retain.²³³

²³¹ *Ibid.* at para. 82: "It may be that the time has come when the court should revisit the operation of the inflexible ['no-profit'] rule of equity in harsh circumstances, as where the trustee has acted in perfect good faith and without any deception or concealment, and in the belief that he was acting in the best interests of the beneficiary... [I]t would not be in the least impossible for a court in a future case, to determine as a question of fact whether the beneficiary would not have wanted to exploit the profit himself, or would have wanted the trustee to have acted other than in the way that the trustee in fact did act. Moreover, it would not be impossible for a modern court to conclude as a matter of policy that, without losing the deterrent effect of the rule, the harshness of it should be tempered in some circumstances. In addition, in such cases, the courts can provide a significant measure of protection for the beneficiaries by imposing on the defaulting trustee the affirmative burden of showing that those circumstances prevailed."

²³² *Ibid.* at para. 121: "[T]he inflexibility of the 'no conflict' rule may, depending on the facts of any given case, work harshly so far as the fiduciary is concerned. It may be said with force that that is the inevitable and intended consequence of the deterrent nature of the rule. On the other hand, it may be said that commercial conduct which in 1874 was thought to imperil the safety of mankind may not necessarily be regarded nowadays with the same depth of concern... I can envisage the possibility that at some time in the future the House of Lords may consider that the time has come to relax the severity of the 'no conflict' rule to some extent in appropriate cases."

²³³ *Ibid.* at paras. 157-159.

Charles Mitchell agreed with Arden LJ's statement that the 'no-profit' rule should be relaxed, in order to prevent excessive harsh outcomes for fiduciaries. In his view, the courts should have the power to alter the severity of the rule artificially, either by narrowing the scope of the fiduciary's undertaking, so that fiduciary's gains would fall outside the scope of his duty, or by readjusting the requirement of remoteness by deeming the gains to be too remote a consequence of the breach to justify ordering the fiduciary to turn them over.²³⁴

At first sight, it is tempting to agree that the inflexible no-profit rule is anachronistic and therefore should be adapted to the new commercial realities. Based solely on the traditional explanations for the strictness of the proscriptive duties (i.e. deterrence and evidentiary difficulties), one may be tempted to agree that punishing a fiduciary who obtained a gain while acting in good faith in the interests of the beneficiary is unjustifiably harsh. The relaxation arguments provided by judges and commentators, however, are premised on a superficial understanding of the role that the proscriptive duties serve. While it is true that the traditional justifications are weak, this does not automatically mean that the rules themselves are groundless.

The arguments put forth by the majority and the dissent opinions in *Murad* for the relaxation of the proscriptive rules are the inevitable consequence of the pervasiveness of the deterrence and evidential themes as justifications of the strictness of these rules. The primacy of these explanations, in its turn, was made possible by the continuing disregard of the fiduciary's decision-making role. The abandonment of this conventional justification of the proscriptive rules' peculiar strictness should not mean that the rules are groundless. A proper understanding of the notion of conflict of interest shows that there is a more profound reason why no actual or potential gain should be allowed: the mere possibility of a gain accruing to fiduciaries from their position, even if not at the beneficiary's expense, affects the way in which the fiduciary exercises professional judgment over the beneficiary's interests.

²³⁴ Charles Mitchell, "Causation, Remoteness and Fiduciary Gains" (2006) King's Law Journal 325 at 339.

The statement that self-interested conduct of persons in a fiduciary position is nowadays subject to a lesser concern flies in the face of the increasing preoccupation of professional ethics with conflicts of interest. As the next chapter will show, professions are increasingly concerned with the negative effects that self-interest has on the professional's judgment. Various methods of managing situations of conflict of interest have been advanced, in order to ensure that the judgment of the professional providers of services is not affected by extraneous factors (such as financial self-interest) and to reinforce the public's confidence in the reliability of the professions in general. The professional ethics' concern with self-interest is not premised on the idea of deterrence, but on the more profound insight that a person who must exercise judgment on behalf of another is subject to the conscious or subconscious influence of his own interests and beliefs. In order to preserve the objectivity and reliability of his judgment, the professional is bound by duties to avoid or to manage situations of conflict of interest. As the Harvard psychology professor Daniel Gilbert put it, "[b]ecause the brain cannot see itself fooling itself, the only reliable method for avoiding bias is to avoid the situations that produce it."²³⁵ The core of this insight is not new. The idea that the objectivity of one's judgment or conscience can be affected by self-interest has been the subject of philosophical debates for centuries.²³⁶ Because it does not take into account the contemporary research on conflicts of interest, Parker LJ's firm statement in *Murad* that the strictness of the no-conflict rule is "the inevitable and intended consequence of the deterrent nature of the rule"²³⁷ perpetuates the entrenched and misguided view that the main role of the proscriptive rules is to discourage abuse of fiduciary position.

Beside this substantial flaw, the proposals to relax the proscriptive duties expressed in *Murad* do not answer the question of whether it is appropriate to put the beneficiary in a position where he has to counter the fiduciary's arguments. This question is important for at least two reasons. First, many beneficiaries may be ill-equipped to challenge the fiduciary's

²³⁵ Daniel Gilbert, "I'm OK, You're Biased", *The New York Times* sec. 4, p. 12 (April 16, 2006).

²³⁶ See Chapter 5 for more details.

²³⁷ *Supra* note 232.

demonstration that he acted in good faith in the beneficiary's best interests. One obvious aspect of this inequality is information asymmetry concerning the fiduciary's actual motives and what actions were the most appropriate to advance the beneficiary's interests. Another aspect is the fiduciary's ability to 'seed' evidence (e.g. by alterations in record-keeping) that would influence even the most sophisticated fact-finding mechanisms that courts can now apply.²³⁸ The second reason pertains to a more fundamental level: an important effect of the strict proscriptive duties is the creation for the beneficiary of an entitlement not to have to wonder about the fiduciary's motive while exercising discretion. This entitlement requires fiduciaries not only to discharge appropriately their core duty, but also to be seen doing that.²³⁹ In the contemporary world, where many professional providers of services occupy fiduciary positions, the appearances of propriety are very important. As mentioned before, the procedural and policy arguments are only secondary explanations of the strict regime of the proscriptive duties. The main rationale why these duties should remain strict concerns the beneficiary's right to the fiduciary's best judgment.

Another flaw of the proposals to relax the proscriptive rules is the pure instrumentalist approach. Allowing the courts to set aside these strict rules whenever they consider adequate, without a solid principle to justify such a decision would amplify the uncertainty that currently affects fiduciary law.

*3464920 Canada Inc. v. Strother*²⁴⁰ is another recent example where the traditional strictness of the no-conflict rule was called into question. Writing the dissenting judgment, McLachlin C.J.C. argued that fiduciary law aims to prevent *actual* conflicts in interest, and not mere potential conflicts. The Chief Justice of the Supreme Court of Canada emphasized that the existence of an actual conflict between self-interest and duty of loyalty, or between duties of loyalty to different beneficiaries, is the benchmark for determining whether the fiduciary defaulted on his duty of loyalty. Adopting a

²³⁸ See Robert Flannigan, "The Strict Character of Fiduciary Liability" (2006) New Zealand Law Review 209 at 236.

²³⁹ Lionel Smith, "The Motive Not the Deed", *supra* note 69 at 75.

²⁴⁰ *3464920 Canada Inc. v. Strother* [2007] 2 S.C.R. 177.

more general benchmark for breach would render the fiduciary duty excessively broad.²⁴¹

McLachlin C.J.C.'s opinion is based on a gravely mistaken understanding of the 'conflict of interest' that is specific for fiduciaries. The first mistake concerns the conflict between interest and duty. Such a conflict occurs not because the self-interest and the 'duty' are 'irreconcilable', in the sense of being implacably opposed. A conflict occurs whenever the self-interest points in a direction that is contrary to the 'duty' in the sense that it has the potential to affect the adequate discharge of the latter. Fiduciary law does not attempt to reconcile opposed interests, but to protect the core fiduciary duty from actual or potential interfering interests.

The second grave mistake concerns McLachlin C.J.C.'s understanding of the conflict between duty and duty. Citing Binnie J's opinion in *R. v. Neil*,²⁴² the Chief Justice asserted that "[w]hether an interest is 'directly' adverse to the 'immediate' interests of another client is determined with reference to the *duties* imposed on the lawyer by the relevant contracts of retainer."²⁴³ McLachlin C.J.C.'s understanding of a conflict between 'duty' and 'duty' based on the conflicting interests of the different beneficiaries is erroneous. As the majority opinion in *Strother* pointed out, the existence of conflicting business interests of different clients is not sufficient to create a conflict between duty and duty. Such a conflict does not require finding irreconcilable contractual duties. Rather, it only requires a finding that the fiduciary is in a position where his core fiduciary duty to one beneficiary might interfere with the proper performance of his core fiduciary duty to the other beneficiary.²⁴⁴

²⁴¹ *Ibid.* at 249-251, emphasis added: "When does a conflict of interest arise?... The answer is that a conflict arises when a lawyer puts himself or herself in a position of having *irreconcilable* duties or interests... It follows that the first question where conflict of interest is alleged is what duty the lawyer owed to the client alleging the conflict. The second question is whether the lawyer owed a duty to another client, or held a personal interest, that conflicted with the first duty... Insistence on *actual* conflicting duties or interests based on what the lawyer has contracted to do in the retainer is vital. If the duty of loyalty is described as a general, free-floating duty owed by a lawyer or law firm to every client, the potential for conflicts is vast."

²⁴² *R. v. Neil* [2002] 3 S.C.R. 631 at para. 29.

²⁴³ *Strother*, *supra* note 240 at para. 140.

²⁴⁴ *Ibid.* at para. 61. See Remus Valsan and Lionel Smith, "The Loyalty of Lawyers: A Comment on 3464920 *Canada Inc. v. Strother*" (2008) 87 Canadian Bar Review 247.

As these examples illustrate, the main cause of the confusion that dominates the current understanding of the fiduciary duty is the widespread disregard of the vital connection that exists between the proscriptive duties and the duty to exercise proper judgment, which is the core ‘fiduciary duty’.

2.4.3 Consequence of the misunderstanding of ‘conflict of interest’: the direct aim of the strict proscriptive duties is to deter fiduciary misbehaviour

Deterrence is one of the most frequently invoked policy explanations for the strictness of the proscriptive duties, and, at the same time, one of the weakest arguments. As Section 2.3 above illustrates, throughout the development of the rules governing fiduciary relations the courts have constantly maintained that the very strict no-conflict and no-profit duties must be maintained to ensure that fiduciaries will not be tempted to abuse their position in order to obtain unauthorised benefits. This justification of the stringency of the proscriptive duties has maintained its vigour. Prominent contemporary fiduciary law scholars continue to explain these duties by invoking the need to discipline fiduciaries and deter wrongdoing.

Robert Flannigan, for instance, believes the very strict no-conflict rules are meant to act as a “sledge-hammer... designed to eliminate incentives for opportunistic manipulation...”²⁴⁵ Only indiscriminate punishment of actual and potential situations of conflict of interest can annihilate fiduciaries’ incentives to take their chances and pursue unauthorized benefits.²⁴⁶ Similarly, Garry Watt emphasized that the role of fiduciary law is not to achieve a balance between the parties to a fiduciary relation, but to set an example and to encourage good behaviour, by insisting that nothing short of exemplary propriety on the fiduciaries’ part will be allowed.²⁴⁷ Tamar Frankel, a leading US scholar on fiduciary duties, went

²⁴⁵ Robert Flannigan, “The Strict Character of Fiduciary Liability” [2006] New Zealand Law Review 209 at 217.

²⁴⁶ *Ibid.*

²⁴⁷ Gary Watt, *Trusts and Equity*, 2nd ed. (New York: Oxford University Press, 2006) 337-338, emphasis added: “[The fiduciary duty] is not concerned to achieve fairness between the

even further, and claimed that fiduciary law is akin to the criminal law of embezzlement, and should follow the latter's underlying policy.²⁴⁸

These strict deterrence theories are premised on an image of a fiduciary that is at the opposing end of what a person in a position of trust and confidence should be: relations that in theory are founded on trust and confidence are approached with a cynical presumption of dishonesty. Fiduciaries are often portrayed as pathological exploiters of others' weaknesses, possessing special skills of "fabrication and colouration" of appearances of propriety.²⁴⁹ The law's response to this broad scope and appetite for exploitation is a policy of fear: fiduciaries that look suspicious and fiduciaries proven guilty must be sledge-hammered collectively in order to discipline other present and future fiduciaries.

The deterrence theory suffers from several major flaws. From a historical point of view, it is open to debate whether a policy of disciplining

trustee and the beneficiaries of the trust or between a fiduciary and his principal. On the contrary, it is a rule of public policy that is strictly applied against trustees in *order to set an example and to encourage good behavior* in all who hold positions of trust... Insistence on exemplary fiduciary propriety encourages other persons in positions of trust to fulfill requirements of their office." Watt named this policy "the policy of exemplary fiduciary propriety." (*ibid.* at 338).

²⁴⁸ Tamar Frankel, "Fiduciary Duties as Default Rules" (1995) 74 Oregon Law Review 1209 at 1223-1225, footnotes omitted: "[T]he main purpose of fiduciary law is to reduce entrustors' risk from embezzlement of their entrusted property or interests, and to reduce the costs of monitoring fiduciaries... Because... fiduciary law is akin to the criminal law of embezzlement and the tort of conversion, the dividing line between mandatory and default rules, as well as the treatment and policy underlying default rules in embezzlement and conversion, could help guide the treatment of fiduciary rules." See also *Green and Clara Pty Ltd v Bestobell Industries Pty Ltd (No 2)* [1984] WAR 32 at 38, per Brinsden J: "[Fiduciary law] is prophylactic, not restitutionary. There is a penal element in it calculated to deter others from behaving in the same way."

²⁴⁹ See e.g. Robert Flannigan, "The Strict Character of Fiduciary Liability", *supra* note 245 at 211, emphasis added: "[A] corrupt motive can be made undetectable. That is the particular facility of fiduciaries. The nature of their functional limited access provides both the opportunity and the means to covertly engage their self-interest. It is that *capacity for fabrication and colouration* that drives consensus to a strict liability. In a real sense, *we are prey to fiduciary appetites for unauthorised gain*. To a duplicitous fiduciary, the grant of access amounts to an invitation to mould a personal benefit. We have concluded that we will not entertain or accept apologia for a conflict or a benefit because we recognise that we are unable to decipher the pretence or illusion of manipulated relations." (*ibid.*). Flannigan's view of the need for strict rules pushes the traditional deterrence and evidentiary difficulties themes to their extreme. Whereas Lord Eldon's landmark judgments at the beginning of the nineteenth century acknowledge that many fiduciaries who obtained benefits from their position without the slightest moral fault may nevertheless fall under the strict rule, Flannigan depicts fiduciaries as sly predators with special appetites for unauthorized gains, which must be punished by intransigent rules. The exaggeration of the severity of the misbehaviour that the proscriptive rules aim to address cannot be used as a substitute for a principled explanation of these rules.

fiduciaries was the main reason for the *introduction* of these strict rules. The elusive reporting of *Keech v. Sandford*,²⁵⁰ the first and foremost landmark case of fiduciary law, suggests that Lord Keeper King invoked the deterrence theme not as the rationale for the existence of the strict proscriptive duties, but as an important reason for *maintaining* them: “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 rule *should be strictly pursued, and not in the least relaxed.*”²⁵¹ This statement can be interpreted as demonstrating that, by the time of this decision, the strict prohibition of self-interest for persons in a position of trust was an established and rigid rule. As mentioned before, some of the earliest references to the core principle behind this strict rule point to the maxim that no person can be judge in his own cause, which is a principle with roots in Roman law and natural law philosophy.²⁵²

The landmark fiduciary law cases of the nineteenth century, however, showed little or no concern for the reason why these rules exist. They focused, instead, on expanding them to persons in trust-like positions, and on restating constantly the need to maintain their strictness. Consequently, maintaining these strict rules in order to protect fiduciary relations became one of the most prominent ideas associated with the law of fiduciary relations. Many modern commentators have attempted to explain the conceptual foundations of fiduciary duties starting from this important *effect*, rather than searching for a deeper reason for the *creation* of these rules. The excessive emphasis on the social desirability of maintaining these strict rules obliterated the connection between the prohibition of self-interest and the main role of a person in a fiduciary position. Moreover, the deterrence explanation of fiduciary duties is built on an erroneous view of the fiduciary’s role. A correct understanding of the purpose of the strict proscriptive duties must start from the core feature that makes a person a fiduciary.

These rules apply to trustees and persons in trust-like positions due to a specific feature that only these positions have. As illustrated in chapter 1

²⁵⁰ *Keech v. Sandford* (1726) Sel Cas Ch 61.

²⁵¹ *Ibid.*

²⁵² For more historical detail see Chapter 5 below.

above, throughout the twentieth century, courts and commentators have constantly attempted to identify the quintessential feature of a fiduciary relation, which is able to differentiate fiduciary relations from other private law relations and to justify the strictness of the duties binding on fiduciaries. The view adopted in this dissertation is that the essential feature of a fiduciary relation is revealed by a proper understanding of the concept of conflict of interest: conflict between self-interest and duty to exercise proper judgment. Consequently, attempting to justify the existence and the strictness of the proscriptive duties *solely* based on the premise that a fiduciary has enhanced opportunities to cheat, embezzle, or shirk his duties behind the beneficiary's back is a superficial understanding of the essence of a fiduciary position and of the specific detrimental effect that self-interest may have on the proper performance of the fiduciary's mission. Refraining from stealing, embezzling or converting another's property is not a duty that one has by virtue of occupying a fiduciary position; it is a general duty binding on all legal actors. The enhanced probability for such acts to occur (the 'temptation of self-interest') in the case of persons in a fiduciary position is not sufficient to turn the 'don't misappropriate' requirement into a fiduciary duty.

The most blatant flaw of the deterrence argument is its incompatibility to the private law methodology. The imposition of strict proscriptive duties on a party to a private law relation in order to discipline persons in similar positions is against the internal rationality of private law. Private law is concerned primarily with correcting bilateral injustices between parties to a legal relation, and not with regulating the conduct of all legal actors through incentives.²⁵³ Furthermore, the deterrence argument does not explain why no inquiry is allowed into the fiduciary's motives or good faith, once a reasonable possibility of conflict has been found to exist. If the law aims to deter fiduciaries from improperly using their powers, punishing an innocent fiduciary is not good deterrence. The 'deterrence at all costs approach' would in fact produce the opposite results. Punishing the potentially innocent would signal to the guilty that what matters is not the

²⁵³ See Ernest J. Weinrib, *The Idea of Private Law* (Harvard: Harvard University Press, 1995); Lionel Smith, "The Motive Not the Deed", *supra* note 69 at 61.

actual guilt or innocence, but how their actions appear to the outside world.²⁵⁴

At a more general level, the deterrence explanations of fiduciary duties are based on assumptions that cannot be tested. A sound theory of fiduciary law cannot be built on the premise that persons who gain access to another's assets are ruthless exploitations, as Flannigan argues, or on the need to destroy temptations of self-serving acts that arise inevitably due to human nature, as Conaglen posits. The mere idea that private law would go as far as to establish a presumption of guilt and to proscribe the mere temptation to act in a certain way is quite puzzling. References to temptations or appetites for unauthorized gains are incompatible with sound legal theory and should be abandoned.

2.4.4 Consequence of the misunderstanding of 'conflict of interest': the direct aim of the strict proscriptive duties is to protect vulnerable beneficiaries

As mentioned before, the failure to connect the proscriptive duties to a core characteristic of the fiduciary position has driven the 'conflicting interests' theories towards policy justifications for the strictness of these duties. According to one policy approach, the strict proscriptive duties are part of the law's response to "the plight of vulnerable people in power-dependency relationships."²⁵⁵ Early 'vulnerability' theories argued that the strict proscriptive duties play a protective role with respect the beneficiary's person: they aim to protect beneficiaries against fiduciaries' abuses, manifested as undue influence,²⁵⁶ or undue advantage-taking.²⁵⁷ It is now

²⁵⁴ Jay C. Shepherd, *supra* note 123 at 144.

²⁵⁵ *Hodgkinson v. Simms* [1994] 3 S.C.R. 377, at para. 42, per La Forest J.

²⁵⁶ See e.g. George Spence, *The Equitable Jurisdiction of the Court of Chancery*, vol. 1 (Philadelphia: Lea and Blanchard, 1846) 625: "The Court of Chancery has... from a period that cannot be traced, entertained jurisdiction on grounds of public policy, irrespective of the particular circumstances of the case, to declare void transactions which have taken place under circumstances [that] are peculiarly open to fraud and undue influence. Thus the Court of Chancery will not permit any person standing in a fiduciary situation, or who, from the relation in which he stands to another, is capable of exercising an undue influence over his mind, to derive profit from any transaction which takes place during the continuance of such fiduciary character in the one case, or which may be supposed to have taken place by reason of such opportunities of undue influence in the other."

settled that fiduciary relations are distinct from the equitable doctrines of undue influence and unconscionability.²⁵⁸

In a more recent ‘vulnerability’ theory, the role of fiduciary duties is considered to be to protect *inherently* vulnerable persons, who do not have other means to protect their interests. In *Frame v. Smith*,²⁵⁹ for instance, Wilson J., writing the minority opinion laid down a ‘rough and ready guide’ that could help the judges impose fiduciary obligations in new relations. She observed that the relations where a fiduciary duty has already been recognized share the following features:

- (1) The fiduciary has scope for the exercise of some discretion or power.
- (2) The fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary’s legal or practical interests.
- (3) The beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power.²⁶⁰

²⁵⁷ Joseph Story, *Commentaries on Equity Jurisprudence as Administered in England and America* vol. 1, 9th ed. (Boston: Little, Brown, 1886) 265-266: “[The doctrine of constructive fraud is] founded in an anxious desire of the law to apply the principle of preventive justice so as to shut out the inducements to perpetrate a wrong, rather than to rely on mere remedial justice after a wrong has been committed. By disarming the parties of all legal sanction and protection for their acts, they suppress the temptations and encouragements which might otherwise be found too strong for their virtue... [Some cases of constructive fraud] grow out of some special confidential or fiduciary relation between all the parties or between some of them, which is watched with especial jealousy and solicitude because it affords the power and the means of taking undue advantage or of exercising undue influence over others.”

²⁵⁸ See e.g. *Hodgkinson v. Simms* [1994] 3 S.C.R. 377, at para. 26-27. La Forest J., writing the majority decision observed that the feature that distinguishes fiduciary relations from the related equitable doctrines is “the presence of loyalty, trust, and confidence.” Furthermore, “whereas undue influence focuses on the sufficiency of consent and unconscionability looks at the reasonableness of a given transaction, the fiduciary principle monitors the abuse of a loyalty reposed.” Although his identification of the core focus of the fiduciary principle is erroneous, the core idea that the fiduciary principle is an autonomous doctrine is valid.

²⁵⁹ *Lac Minerals Ltd. v. International Corona Resources Ltd.* [1987] 2 S.C.R. 99.

²⁶⁰ *Ibid.* at 143. Justice Wilson based her guide on insights from a similar test for the imposition of fiduciary obligations, adopted by the High Court of Australia in *Hospital Products Ltd. v. United States Surgical Corp.* (1984), 55 A.L.J. 417 at 432, *per* Gibbs C.J.: “...there were two matters of importance in deciding when the court will recognize the existence of the relevant fiduciary duty. First, if one person is obliged, or undertakes, to act in relation to a particular matter in the interests of another and is entrusted with the power to affect those interests in a legal or practical sense, the situation is... analogous to a trust. Secondly... *the reason for the principle lies in the special vulnerability of those whose interests are entrusted to the power of another to the abuse of that power.*” Mason J. in the same case stated that the critical feature in these relationships is that “[t]he relationship... gives the fiduciary a special opportunity to exercise the power or discretion to the detriment of that other person who is accordingly *vulnerable to abuse* by the fiduciary of his position.” (*ibid.* at p. 454). The three-pronged test proposed in *Hospital Products* and *Frame* resembles closely the test enunciated almost two decades earlier by Wolinski and Econome. They argued that the relations in which the strict

Concerning the third element of her guide, Wilson J. defined vulnerability as “the inability of the beneficiary (despite his or her *best* efforts) to prevent the injurious exercise of the power or discretion combined with the *grave* inadequacy or absence of other legal or *practical* remedies to redress the wrongful exercise of the discretion or power.”²⁶¹

Similarly, in *Lac Minerals Ltd. v. International Corona Resources Ltd.* Sopinka J, writing the majority decision, took the view that vulnerability or dependency is the single indispensable requirement for the imposition of a fiduciary duty.²⁶² He suggested that, in order for fiduciary duties to apply, dependency or vulnerability must pre-exist or be inherent in the fiduciary relationship between the parties, such as in the case of parent and child or priest and penitent.²⁶³ This vulnerability, he argued, is absent where the parties are commercial actors who have full access to contractual measures to prescribe their mutual obligations. If one party fails to take advantage of such measures, it means that vulnerability is not inherent, but gratuitously incurred, and therefore is not subject to the protection of fiduciary duties.²⁶⁴

proscriptive duties have been applied share three general characteristics: “One party (hereinafter termed ‘adviser’) has: (1) Power over the other, *more vulnerable party* (the ‘reliant’); (2) Who is characterized by relative weakness, and; (3) The adviser has the *discretion to reach out and knowingly exploit his power for his own financial advantage* and the reliant party’s corresponding financial loss.” (Sidney M. Wolinsky and Janet Econome, “Seduction in Wonderland: The Need For a Seller’s Fiduciary Duty Toward Children, (1977) 4 Hastings Constitutional Law Quarterly 249 at 266, emphasis added).

²⁶¹ *Ibid.* at 137, emphasis added.

²⁶² *Lac Minerals Ltd. v. International Corona Resources Ltd.* [1989] 2 S.C.R. 574 at 599: “The one feature, however, which is considered to be indispensable to the existence of the [fiduciary] relationship... is that of dependency or vulnerability.”

²⁶³ *Ibid.* at 606.

²⁶⁴ *Ibid.* La Forest J, dissenting, argued that vulnerability could be a relevant circumstance only when determining if new *categories* of relationships should be taken to give rise to fiduciary obligations. In this sense, the vulnerability of the abstract class of beneficiaries of the obligation is a relevant consideration. Vulnerability cannot be, however, a decisive element in finding a fiduciary obligation in a particular, *ad hoc* relation: “Persons are vulnerable if they are susceptible to harm, or open to injury. They are vulnerable at the hands of a fiduciary if the fiduciary is the one who can inflict that harm... Beneficiaries of trusts... are a *class* that is susceptible to harm, and are therefore protected by the fiduciary regime... Each director... owes a fiduciary duty to [the] company.... [T]he fiduciary obligation is owed because, *as a class*, corporations are susceptible to harm from the actions of their directors. I cannot therefore agree with my colleague, Sopinka J., that vulnerability or its absence will conclude the question of fiduciary obligation.” (*ibid.* at 663). In *Hodgkinson v. Simms* [1994] 3 S.C.R. 377, Justice La Forest, writing the majority opinion, emphasized that the fiduciary relation is part of a broader family of equitable doctrines, in which the law intervenes to protect a vulnerable person. Vulnerability is the “golden thread” that unites the causes of action of breach of fiduciary duty, undue influence, unconscionability and negligent

This view has been criticized for focusing on a general, pre-existing notion of inequality and vulnerability, rather than on the inequality that has been created pursuant to the fiduciary relationship. Protection of inherently vulnerable persons is the concern of other common law concepts such as unconscionability, undue influence or good faith. As Ernest Weinrib rightfully observed, in contrast to notions of conscionability, the fiduciary relation looks to the relative position of the parties that *results* from the agreement rather than the relative position that precedes the agreement.²⁶⁵

In one of the most recent decisions on fiduciary law principles, the Supreme Court of Canada affirmed the irrelevance of the pre-existing vulnerability of one of the parties for the purpose of determining the existence of a fiduciary duty in a given relation. In *Galambos v. Perez*, Cromwell J., writing for the court, emphasized that the essential elements required for the existence of a fiduciary relation are one party's undertaking to act in the interests of the other, coupled with the first party's discretionary power to affect the legal or practical interests of the other.²⁶⁶ Although Cromwell J insisted on the primacy of undertaking and power, he did not discard vulnerability altogether. Analyzing the normative relevance of vulnerability, he emphasized that vulnerability *may be relevant* insofar as it *results* from the relationship which creates the fiduciary duty. The pre-existing disparity between the parties' bargaining powers is not an essential element for identifying the existence of a fiduciary duty. Subsequently, however, he implied that vulnerability may be an important element: "Thus, while vulnerability in the broad sense resulting from factors external to the

misrepresentation. Because it is a common theme to a multitude of equitable doctrines, vulnerability is not the hallmark of the fiduciary duty, but a relevant element that demonstrates its existence. (*ibid.* at para. 25). Sopinka and McLachlin JJ, dissenting, restated their view of the importance of the inherent, or extreme vulnerability: The judges specified that vulnerability should not be taken to mean 'weakness', but the complex situation where one party has ceded power to the other and is, hence, literally 'at the mercy' of the other." (*ibid.* at para 130). In order for the dependency and reliance to create the fiduciary obligation, they need to be complete, or 'at the extreme': "Phrases like 'unilateral exercise of power', 'at the mercy of the other's discretion' and 'has given over that power' suggest a total reliance and dependence on the fiduciary by the beneficiary. In our view, these phrases are not empty verbiage... Reliance is not a simple thing... To date, the law has imposed a fiduciary obligation only at the extreme of total reliance." (*ibid.* at para 132).

²⁶⁵ Ernest J. Weinrib, "The Fiduciary Obligation" *supra* note 210 at 6.

²⁶⁶ *Galambos v. Perez* [2009] 3 S.C.R. 247. For a more detailed presentation of *Galambos* see Chapter 1 above.

relationship is a *relevant consideration*, a *more important one* is the extent to which vulnerability arises *from* the relationship.”²⁶⁷

Cromwell J’s apparently ambivalent attitude towards the relevance of vulnerability for the existence of a fiduciary relation and for the imposition of fiduciary duties has created room for misinterpretation of his view of fiduciary relations. One of the most recent theories of fiduciary relations does just that. In his recent study of fiduciary relations, Paul Miller uses *Galambos* in support of his view that beneficiary’s inherent vulnerability is the key reason why the law imposes strict fiduciary duties.²⁶⁸ In Miller’s view, in a fiduciary relation “the parties are unequally situated, with the beneficiary dependent upon, and vulnerable to, the fiduciary in the exercise of power by the fiduciary.”²⁶⁹ Miller contended that his view

is implicit in Justice Cromwell J’s analysis of the significance of vulnerability to fiduciary liability [expressed in *Galambos*]. Upon rejecting the notion that fiduciary liability is responsive to brute vulnerability, he indicates that fiduciary duties are founded upon the inherent vulnerability of the beneficiary to the fiduciary.²⁷⁰

Similar to McLachlin CJ’s approach in *Elder Advocates*,²⁷¹ Miller regards vulnerability as a consequence of the existence of discretionary power that justifies the strictness of fiduciary duties. In both McLachlin’s and Miller’s theories, vulnerability does not seem to be an essential element for the existences of fiduciary duties, as undertaking and discretionary power are. Protection of vulnerable fiduciaries is only a goal that enforcement of fiduciary duties aims to achieve.²⁷²

In the light of Cromwell J’s main analysis of the essential elements of a fiduciary relation it is manifestly clear that he did not intend to make

²⁶⁷ *Ibid.* at 277.

²⁶⁸ Paul B. Miller, “A Theory of Fiduciary Liability” (2011) 56 McGill Law Journal 235.

²⁶⁹ *Ibid.* at 268.

²⁷⁰ *Ibid.* at 269, relying on *Galambos v. Perez* [2009] 3 S.C.R. 247 at 277.

²⁷¹ See *Alberta v. Elder Advocates of Alberta Society* [2011] 2 S.C.R. 261. For more details concerning this decision see *supra* note 54 and the text associated with it.

²⁷² See Paul B. Miller, *supra* note 268 at 280: “The duty of loyalty conditions the exercise of discretionary power, requiring it not to be exercised other than for the benefit of the beneficiary. It responds to and reflects a *kind of vulnerability* peculiar to the fiduciary relationship; namely, the inherent susceptibility of the beneficiary to exploitative exercise of discretionary power by the fiduciary.” Miller further clarified that the vulnerability that is relevant for the purpose of fiduciary duties is the vulnerability that is the correlative of the discretionary power that the fiduciary has, and not circumstantial vulnerabilities “that subsist independently of the fiduciary relationship” (*ibid.*).

vulnerability a central requirement for finding a fiduciary duty. His statements concerning vulnerability could be interpreted as an observation that this feature is often present in a relation that meets all the core requirements for the creation of a fiduciary duty, namely power and undertaking.

Another group of theories that resemble the vulnerability approach claim that the proscriptive duties are meant to protect the beneficiary against abuses by the fiduciary due to the former's *reasonable reliance* or *reasonable expectation* that the fiduciary will act solely in the beneficiary's best interests. In general terms, the reliance and reasonable expectation line of argument holds that the proscriptive duties are imposed when one party places trust and confidence in another and relies on the other party not to abuse this confidence. Consequently, the law imposes the proscriptive duties in order to protect the beneficiary's vulnerability resulting from reasonable reliance or reasonable expectation that the trust and confidence reposed in another will not be abused.

Paul Finn is one of the most prominent proponents of the reasonable expectation theory.²⁷³ Finn argued that the most important indicator of a fiduciary relation is the 'fiduciary expectation,' which entitles one party to expect that the other will act in the first party's interests for the purpose of the relationship to the exclusion of his own several interests.²⁷⁴ Due to this 'fiduciary expectation' the trusting party relaxes his self-vigilance and independent judgment, and becomes vulnerable to abuse.²⁷⁵ Consequently, the law enforces the strict proscriptive duties in order to protect the reliant or vulnerable beneficiary.²⁷⁶

²⁷³ Paul D. Finn, "Contract and the Fiduciary Principle" (1989) 12 U.N.S.W.L.J. 76

²⁷⁴ Paul D. Finn, "The Fiduciary Principle", *supra* note 85 at 88.

²⁷⁵ "What in the end one is seeking to identify is a relationship in which one party has in fact relaxed, or is justified in believing he can relax, his self-interested vigilance or independent judgment because, in the circumstances of the relationship, he reasonably believes or is entitled to assume that the other is acting or will act in his (or in their joint) interests. The trust reposed or invited, the ascendancy acquired, etc. must in the circumstances be of such a nature as to be capable of sustaining this conclusion." (*Ibid.* at 94).

²⁷⁶ La Forest J. of the Supreme Court of Canada is one of the most enthusiastic supporters of the reliance / reasonable expectation justifications of the proscriptive duties. In *Lac Minerals Ltd. v. International Corona Resources Ltd* [1989] 2 S.C.R. 574, La Forest J., dissenting, observed in *obiter* that the essential requirement for the imposition of proscriptive duties in an *ad hoc* fiduciary relation is that one party is reasonably entitled to expect that the other

It is worth noting that Finn's 'fiduciary expectation' theory is a significant departure from his earlier view. In his landmark monograph on fiduciary obligations, Finn asserted that the word 'fiduciary' does not describe a unitary class of relations to which a single set of rules and principles apply. On the contrary, 'fiduciary' is only "a veil behind which individual rules and principles have been developed."²⁷⁷ One cannot disagree that the word 'fiduciary' has been used in so many different contexts that it has lost any technical value. This does not mean, however, that no substantial similarities exist among relations where fiduciary duties have been imposed. Otherwise it would be difficult to see how 'fiduciary duties' could represent an autonomous legal concept.

The vulnerability theories (including the 'reasonable reliance', 'reasonable expectations' and 'fiduciary expectations' theories) attempt to explain the imposition of strict proscriptive duties based mainly on the position of the beneficiary, without analyzing in sufficient depth the element that generated such vulnerability. The beneficiary's reliance on the fiduciary, or his reasonable (or fiduciary) expectation of loyalty, could be a *consequence* of the fiduciary having assumed a position or a task that gives him discretion with respect to the most appropriate manner to advance the

party will act in the former's best interests for the purposes of their relationship. This reasonable expectation stems from the circumstances of the relation, and is justified by elements such as trust, confidence, ascendancy, influence, vulnerability, or dependency. Vulnerability, therefore, may be relevant in *ad hoc* cases only to the extent to which it supports a reasonable expectation of loyalty (*ibid.* at 656-663). In *Hodgkinson v. Simms* [1994] 3 S.C.R. 377, La Forest J. expressed, in a rather ambiguous manner, the idea that the strict proscriptive duties are meant to protect the beneficiary's reasonable reliance/expectation. First, La Forest affirmed that the fiduciary duty is imposed to protect the beneficiary's *reasonable expectation* that the fiduciary will act in the former's best interests. The reasonable expectation, in its turn, is evidenced by the presence of *indicia* such as "[d]iscretion, influence, vulnerability and trust." (*ibid.* at para. 32). In another paragraph, he claimed that the fiduciary duty is created by "*the reasonable expectations of the parties*" to that relation, which, in their turn, depend on factors such as "trust, confidence, complexity of subject matter, and community or industry standards." (*ibid.* at para. 35, emphasis added.)

²⁷⁷ Paul D. Finn, *supra* note 85 at 1: "[I]t is meaningless to talk of fiduciary relations as such. Once one looks to the rules and principles which actually have evolved, it quickly becomes apparent that it is pointless to describe a person – or for that matter a power – as being fiduciary unless at the same time it is said for the purposes of which particular rules and principles that description is being used... [T]he modern usage of 'fiduciary'... is not definitive of a single class of relationships to which fixed rules and principles apply. Rather its use has generally been descriptive, providing a veil behind which individual rules and principles have been developed. This conclusion – an incontestable one – is the starting point of this work."

best interests of the beneficiary. Any attempt to explain the strictness of the proscriptive rules having the beneficiary's relative dependency (expressed either as vulnerability or as reliance) as the main working tool leaves out the only essential element that has explanatory power, namely the core duty that a fiduciary must discharge.

Vulnerability and reliance theories are among the weakest explanations of the proscriptive duties. The attempts to understand fiduciary relations based on vulnerability or reliance have been criticized as either too broad or too narrow. On the one hand, some theories are too broad because they encompass situations of vulnerability that form the main focus of other doctrines. The protection of the weak, vulnerable or disadvantaged could be seen as a remote objective of fiduciary law, but it is too general to indicate the special nature of fiduciary duties. There are a multitude of legal doctrines that aim to prevent the 'plight of vulnerable people.' Fiduciary duties form only a part of this broader family of doctrines. Similarly, reliance on another's integrity is a phenomenon that characterizes a large part of the civil and commercial relations that are not fiduciary. As Jay Shepherd observed, "[i]t is patent that people go around relying on others all the time, without necessarily creating a fiduciary relationship as a result."²⁷⁸

Second, the vulnerability and reliance theories are too narrow. Persons occupying a fiduciary position continue to be bound by strict fiduciary duties even if the beneficiaries have lost confidence in them (such as the case of a child or the patient of a physician) and even if the beneficiary is not vulnerable in any meaningful sense (e.g. a big corporation who hires a lawyer for low-stake litigation). Moreover, in some fiduciary relations (such as the trust) the beneficiaries may be unborn or unascertained.

2.4.5 Consequence of the misunderstanding of 'conflict of interest': the direct aim of the strict proscriptive duties is to protect valuable social relations

The language of public policy has been omnipresent throughout the development of fiduciary law. Since the early stages of the development of

²⁷⁸ Jay C. Shepherd, *supra* note 123 at 58.

the legal rules concerning fiduciaries, public policy was one of the main justifications for the strictness of the proscriptive duties.

Lord Keeper King's concern that allowing a trustee to receive an innocent benefit would send off the wrong message to other trustees is well known: "I very well see, if a trustee, on the refusal to renew, might have a lease to himself, few trust estates would be renewed to *cestui que* use... [I]t is very obvious what would be the consequence of letting trustees have the lease, on refusal to renew to *cestui que* use."²⁷⁹ Equally famous is Lord Eldon's remark from *Ex parte Bennett*, according to which the maintenance of the strict prohibition of unauthorized advantages is required for "the safety of mankind."²⁸⁰

A few late-eighteenth century courts and commentators have observed that this strict prohibition binding persons in a fiduciary position draws its roots from a well-known natural law axiom, which affirms that no person who has a duty to make a judgment with respect to another's interests is allowed to have a personal interest in the outcome of his judgment. As the medieval natural law philosophers have observed, self-interest is one of the causes of erroneous judgments of conscience, irrespective of the person's conviction that what his conscience tells him is the right thing to do.

This core insight became lost in the rapid development of fiduciary law, although references to 'human nature being what it is' or to 'human fallibility' lingered in some fiduciary law texts. During this process of development, the strict policy against self-interest was detached from the core element that generated the 'conflict of interest', namely the proper exercise of judgment. The idea that self-interest must be strictly prohibited for all

²⁷⁹*Keech v. Sandford* (1726) Sel Cas Ch 61. See also *York Buildings Company v Mackenzie* (1795) 8 Brown PC 42 at 62-64: "The wise policy of the law has therefore put the sting of a disability into the temptation as a defensive weapon against the strength of the danger which lies in the situation." *Fox v. Mackreth* (1788) 2 Cox 320, 326, per Lord Thurlow: "If a trustee, though strictly honest, buys an estate himself, and then sells it for more, yet according to the rules of a Court of Equity, from general policy, and not from any peculiar imputation of fraud, a trustee shall not be permitted to sell to himself, but shall remain a trustee to all intents and purposes." *Lister v. Lister* (1802) 6 Ves. Jun. 631 at 631-633, per Sir W. Grant, Master of the Rolls "[The] general rule upon a purchase of trust property by the trustees on their own account [is] that at the option of the cestuy que trust it shall be re-sold... The rule is a rule of general policy, to prevent the possibility of fraud and abuse; for it may not always be possible to know whether property was undersold."

²⁸⁰*Ex parte Bennett* (1805) 10 Ves. Jun. 382 at 396

persons occupying a fiduciary position endured, and was gradually clothed in more ‘mundane’ policy justifications: the need to deter abuse of position and, more recently, the need to maintain the integrity of valuable social institutions.

Paul D. Finn is one of the most prominent proponents of public policy explanations of the proscriptive duties. The enforcement of strict proscriptive duties is justified “self-evidently”,²⁸¹ by the policies aimed to maintain the integrity and utility of relationships valuable for the society. The fiduciary principle is

an instrument of public policy. It has been used, and it is demonstrably used, to maintain the integrity, credibility and utility of relationships perceived to be of importance in society. And it is used to protect interests, both personal and economic, which the society deems valuable... [A]s perceptions of social interests and values change so also can the ambience of the fiduciary principle itself.²⁸²

Ernest Weinrib, another prominent scholar of fiduciary law, approached the fiduciary duty from the perspective of the social justice purposes that judges should promote in enforcing this duty. The underlying rationale of the fiduciary obligation, he contended, is not “individualistic private ordering.”²⁸³ The law in this area serves an educative or pedagogic function, aiming to raise “the morality of the marketplace”²⁸⁴ by raising the standards of commercial dealings “above ordinary market temptations.”²⁸⁵ In order to achieve these policy goals, the fiduciary obligation protects business structures, by restricting the fiduciary’s opportunity for profit.²⁸⁶

Weinrib’s focus on public policy caused him to underestimate the importance of another policy objective that he linked with the fiduciary

²⁸¹ Paul D. Finn, “Contract and the Fiduciary Principle” *supra* note 273 at 84.

²⁸² Paul D. Finn, “The Fiduciary Principle” *supra* note 85 at 26.

²⁸³ Ernest J. Weinrib *supra* note 210 at 3.

²⁸⁴ *Ibid.*

²⁸⁵ *Ibid.* at 6.

²⁸⁶ *Ibid.* at 11-16: “A sophisticated industrial and commercial society requires that its members be integrated rather than autonomously self-sufficient, and through the concepts of commercial and property law provides mechanisms of interaction and interdependence. The fiduciary obligation... constitutes a means by which those mechanisms are protected. As such the fiduciary obligation is only one thread in the net thrown up by the common law for the protection of business structures... [T]he profit rule is the verbal formula through which the principal’s business structure is protected.”

obligation, namely the need to control fiduciary's discretion. Weinrib identified the no-conflict rule as the irreducible core of the fiduciary obligation.²⁸⁷ Its purpose is to control discretion, understood as the leeway that one party has to affect the legal position of the other party to a legal relation. Control of discretion, Weinrib observed, has been the main concern of the no-conflict duty from the early stages of the enforcement of this duty in the Court of Chancery: "The need to control discretion has been a justification for the imposition of the harsh rule concerning fiduciaries since the beginning."²⁸⁸ Consequently, the strict prohibition of self-interest is justified by its potential to prejudice the proper exercise of discretion:

Given the dependence of one side on the discretion exercised by the other, the circumstances were appropriate for the imposition of the standard of the fiduciary so as to obviate *the danger that discretion's exercise might be prejudiced by self-serving considerations*.²⁸⁹

Unfortunately, Weinrib diluted the value of this important insight by his insistence on the primacy of public policy in the analysis of the fiduciary obligation. The need to control discretion is ultimately only a particular instance of the broader policy aim of "preserving an ordered framework for commercial activity."²⁹⁰

²⁸⁷ *Ibid.* at 16: "Avoidance of the conflict of duty and interest has been considered to be a goal so obviously worthy of promotion by the courts that it has constantly secured judicial approbation.... [T]he principle itself has become established as the irreducible core of the fiduciary obligation."

²⁸⁸ *Ibid.* at 4; See also *ibid.* at 7: "The reason that agents, trustees, partners, and directors are subjected to the fiduciary obligation is that they have a leeway for the exercise of discretion in dealings with third parties which can affect the legal position of their principals." *Ibid.* at 15-16: "[B]oth historically and conceptually the factor of discretion control has played so central a role in the elucidation of the fiduciary obligation."

²⁸⁹ *Ibid.* at 7, emphasis added. Weinrib previously adumbrated that the mere possibility of self-interested conduct taints the exercise of discretion and renders pointless the inquiry into the fiduciary's good faith: "The fiduciary obligation is the law's blunt tool for the control of this discretion. Its operation circumvents the need for inquiring into the good faith of the agent's behaviour by concentrating on the possibility that delegated discretion may be influenced by considerations of personal advantage." (*ibid.* at 4).

²⁹⁰ *Ibid.* at 15. The connection between the prohibitions of self-interest and the proper exercise of discretion is further obscured by the idea that the fiduciary obligation aims to protect vulnerable beneficiaries: "[T]he hallmark of a fiduciary relation is that the relative legal positions are such that one party is at the mercy of the other's discretion..." (*ibid.* at 7). "The wide leeway afforded to the fiduciary to affect the legal position of the principal in effect puts the latter at the mercy of the former, and necessitates the existence of a legal device which will induce the fiduciary to use his power beneficently..." (*ibid.* at 4-5).

The public policy justification of the proscriptive duties is a recurring theme in the decisions of the Supreme Court of Canada. Once more, Justice La Forest is one of the most devoted supporters of public policy. In *Hodgkinson v. Simms*, for instance, La Forest J. argued that imposition of fiduciary duties is justified by the court's desire "to regulate an activity that is of great value to commerce and society generally."²⁹¹ Furthermore,

[t]he desire to protect and reinforce the integrity of social institutions and enterprises is prevalent throughout fiduciary law... The reason for this desire is that the law has recognized the importance of instilling in our social institutions and enterprises some recognition that not all relationships are characterized by a dynamic of mutual autonomy, and that the marketplace cannot always set the rules.²⁹²

Fiduciary duties and public policy are closely intertwined in the US law as well. In the landmark case *Guth v. Loft Inc.*, the Delaware Court of Chancery argued that the strict rule against unauthorized profits rests on the policy of preventing abuse of fiduciary position:

The [no-profit] rule, inveterate and uncompromising in its rigidity, does not rest upon the narrow ground of injury or damage to the corporation resulting from a betrayal of confidence, but upon a broader foundation of a wise public policy that, for the purpose of removing all temptation, extinguishes all possibility of profit flowing from a breach of the confidence imposed by the fiduciary relation.²⁹³

As these examples demonstrate, public policy is a recurring theme in the analysis of fiduciary obligations. These references to public policy shift

²⁹¹ *Hodgkinson v. Simms* [1994] 3 S.C.R. 377 at para. 45.

²⁹² *Ibid.* at 422. Similarly, McLachlin J. argued in that the best approach to distinguish the fiduciary duty from contractual or delictual obligations is "to look to the policy behind compensation for breach of fiduciary duty and determine what remedies will best further that policy." (*Canson Enterprises Ltd. v. Boughton & Co* [1991] 3 S.C.R. 534 at 545).

²⁹³ *Guth v. Loft, Inc.* 23 Del.Ch. 255 at 270 (Del. Ch. 1939). US scholars appear to be very fond of public policy as the main explanation for the purpose of fiduciary duties. See e.g. Robert A. Prentice, "Permanently Reviving the Temporary Insider" (2011) 36 Journal of Corporation Law 344 at 373-374, footnotes omitted: "[F]iduciary duties are usually established as a matter of public policy... Fiduciary duties are largely a creation of the judiciary and based upon courts' understanding of what policy would best advance the public interest." Kent Greenfield and John E. Nilsson, "Gradgrind's Education: Using Dickens and Aristotle to Understand (and Replace?) the Business Judgment Rule" (1997) 63 Brooklyn Law Review 799 at 858-859: "The proper test for deciding the contours of corporate fiduciary duty doctrine should mirror the test for most other public policies: which set of legal rules gets us closer to the kind of society we want?"

the focus of the analysis from private law concepts to the socially desirable results that the law should pursue. The protection of certain social values is, without a doubt, a *consequence* of enforcing the proscriptive duties. The desire to protect such values, however, cannot be an indicator of the core reason why fiduciaries are subjected to strict proscriptive duties.²⁹⁴ Public policy considerations should not be invoked as a substitute for strong concepts and principles that are congruent with the spirit of private law. As Donovan Waters observed, “community standards are for the legislature, not for the courts, to adopt.”²⁹⁵

2.4.6 Consequence of the misunderstanding of ‘conflict of interest’: all fiduciary duties are voluntarily undertaken

As mentioned in Section 1.3 above, the latest unanimous decisions of the Supreme Court of Canada emphasized that, in order for fiduciary duties to exist, an undertaking by the fiduciary to act in the best interest of the fiduciary is required.²⁹⁶ The emphasis on undertaking as a central prerequisite for the enforcement of fiduciary duties, without a distinction between the core duty and the prophylactic duties, may lead to the false conclusion that all fiduciary duties are voluntarily assumed. The unqualified statements of the Supreme Court Justices may be interpreted as a victory of the contractarian or purely voluntary nature of fiduciary duties.

Once the notion of conflict of interest is understood correctly, however, it becomes clear that the proposition that *all* fiduciary duties are purely voluntary is indefensible. The two types of duties that compose the category of fiduciary duties serve different goals and have different natures.

²⁹⁴ See Remus Valsan and Lionel Smith, “The Loyalty of Lawyers: A Comment on 3464920 Canada Inc. v. Strother”, *supra* note 244 at 267: “In the end, it is probably a mistake to try to explain and justify the scope and incidence of fiduciary obligations by reference to public policy considerations. Fiduciary obligations are private law relationships; they would properly be applicable between a trustee and his beneficiary even if they were the only two people in the jurisdiction. The public effects are merely that; they are effects, not constitutive reasons for fiduciary obligations.”

²⁹⁵ Donovan W.M. Waters, “Case Comment – *Lac Minerals Ltd. v. International Corona Resources Ltd.*” (1990) 69 Can. Bar Rev. 455 at 481.

²⁹⁶ *Galambos v. Perez* [2009] 3 S.C.R. 247 and *Alberta v. Elder Advocates of Alberta Society* [2011] 2 S.C.R. 261.

The core duty is assumed voluntarily – the fiduciary must express his will to exercise his best judgment in a specific matter or position. This manifestation of will can be embodied in an agreement or in a unilateral act.²⁹⁷ The prophylactic duties, however, arise differently. It is difficult to imagine that any fiduciary would undertake an obligation not to be biased or not to let self-interest influence his judgment. The prophylactic duties are imposed by law, whenever a discretionary power over the interests of another has been undertaken.

James Edelman has recently restated the traditional contractarian view of fiduciary obligations.²⁹⁸ In Edelman's view, fiduciary duties are best understood as terms expressed or implied into voluntary undertakings.²⁹⁹ Stated differently, fiduciary duties are express or implied terms comprised in a voluntary manifestation of will. Voluntary undertakings can be manifested in various forms. The most obvious form is contract. Other common forms of voluntary undertakings are non-contractual deeds or unilateral undertakings made without consideration.³⁰⁰

Since they are express or implied terms in voluntary undertakings, Edelman argued, fiduciary duties have nothing special compared to other voluntary obligations:

[I]t does not matter which duties are described as fiduciary because they arise in the same manner as any other consensual duty... [T]he duties commonly recognised as fiduciary are expressed or implied into voluntary undertakings by the standard principles of construction and implication.³⁰¹

Edelman further pointed out that the duties that are most commonly labelled as fiduciary are: the no-conflict duty, the no-profit duty, the duty to act in the best interests of the beneficiary and the duty of good faith.³⁰² The no-conflict duty, in Edelman's view, has two facets: a duty to avoid actual or potential conflicts between fiduciary's self-interest and "his duty to his

²⁹⁷ See *Galambos v. Perez* [2009] 3 S.C.R. 247 at [34].

²⁹⁸ For a discussion of the contractarian theory and the arguments brought against it see *supra* notes 184-186 and the text associated thereto.

²⁹⁹ James Edelman, "When Do Fiduciary Duties Arise?" (2010) 126 Law Quarterly Review 302 at 303.

³⁰⁰ *Ibid.* at 306.

³⁰¹ *Ibid.* at 316

³⁰² *Ibid.*

principal”³⁰³ and a duty to avoid situations where “his duty to his principal might conflict with duties he owes to other parties.”³⁰⁴ The no-conflict duty, with its two facets, is nothing more than a particular case of construing an implied term in a voluntary undertaking.

Edelman’s improper understanding of the notion of conflict of interest allowed him to construct his purely voluntary view of fiduciary obligations. Edelman referred to conflict between interest and duty or duties, without investigating further this idea. His overall analysis seems to adopt the view that the conflict exists between the interests of the two parties to the fiduciary relation, rather than between interest and a particular duty. Understood in this broad sense, an undertaking to avoid a situation of conflict of interest is an undertaking not to breach any obligation that the fiduciary assumed. It is difficult to see what value such an undertaking can add. Any voluntary legal obligation presupposes that the person assumed it with the intention to be bound.

If the notion of conflict of interest, understood as conflicting interests, is brought to its logical consequences, the contractarian or purely voluntary theories of fiduciary obligations break down. An express or implied undertaking not to be in a position where the fiduciary’s interests are in an actual or potential conflict with the beneficiary’s interests, as circumscribed by the scope of their relation, is nothing more than an undertaking not to act contrary to the non-fiduciary duties arising from the relationship. Such an undertaking does not add any extra-protection to the already enforceable non-fiduciary duties that the fiduciary has assumed.

If conflict of interest is understood as conflict between interest and proper exercise of judgment, then the premise is set for an accurate understanding of the role and nature of the proscriptive duties. A fiduciary cannot undertake not to have his judgment influenced by personal or interests or other duties to exercise proper judgment. As Section 4.2 will show, these interests affect the *reliability* of the decision-maker’s judgment. It is simply not possible to prove *if* or *how* the decision-maker’s judgment was distorted

³⁰³ *Ibid.* at 318.

³⁰⁴ *Ibid.*

by the presence of these interests. What the fiduciary can and does undertake is an obligation to exercise judgment based on relevant considerations. In order to allow this duty to be fulfilled, the law imposes the strict proscriptive duties. They insulate the core duty against disturbing factors the effect of which cannot be gauged.

2.5 Conclusion

Too frequently the discussion of the nature and function of fiduciary duties invokes the biblical adage that no man can serve two masters.³⁰⁵ Applied in the context of fiduciary relations, this maxim is interpreted as stating simply that a person in a fiduciary position, who is charged to look after the interests of another, is not allowed to be in a position where he may be tempted to act in his own interest rather than in the interests of the beneficiary. In this superficial approach, the idea of ‘conflict of interest’ is reduced to a direct conflict between the fiduciary’s personal interests and the interests of the beneficiary.

The ‘conflicting interests’ approach justifies the existence of the proscriptive duties based on the inequality of footing existing between the parties to a fiduciary relation. The fiduciary has a privileged position, resulting from factors such as power or discretion over the beneficiary’s interests, direct control of beneficiary’s assets, or superior knowledge and skill. The beneficiary is placed on an inferior position, in the sense of being exposed to harm caused by the fiduciary. His vulnerability stems from various factors, such as inherent incapacity to protect his interests, inability to monitor the fiduciary, or reasonable expectation and reliance that the

³⁰⁵ “No one can serve two masters. Either he will hate the one and love the other, or he will be devoted to the one and despise the other.” (Matthew 6:24). Justice Harlan Stone, for instance, observed that “[t]he fiduciary principle [is] the precept as old as Holy Writ, that a man cannot serve two masters.” (Harlan F. Stone, “The Public Influence of the Bar” (1935) 48 Harv. L. Rev. 1 at 8); See also *York Buildings Company v Mackenzie* (1795) 8 Brown PC 42 at 63: “The ground on which this disability or disqualification rests, is no other than the principle which dictates that a person cannot be both judge and party. No man can serve two masters.” Austin W Scott, “The Fiduciary Principle” (1949) 37 Cal. L. Rev. 539 at 555; Jonathan Gill, “A Man Cannot Serve Two Masters: The Nature, Existence and Scope of Fiduciary Duties” (1989) 2 Journal of Contract Law 115; John C Bogle, “The Fiduciary Principle: No Man Can Serve Two Masters (2009) 36 Journal of Portfolio Management 15.

fiduciary will not abuse his position. This inequality of footing gives the fiduciary enhanced opportunities to act selfishly, and thus creates a conflict between the fiduciary's self-regarding interests and the beneficiary's interests, as circumscribed by the limits of their fiduciary relation.

Based on the idea of the conflict between the interests of the parties to a fiduciary relation, several main explanations have developed for the strictness of the proscriptive duties. One theme concerns the fiduciary's *ability to conceal his misbehaviour*. The actual motives of a fiduciary or the extent of the benefit that he stands to gain from a self-interested transaction, it is said, are in many cases inaccessible to the eye of the court, due to the infirmity of human testimony. The need to shut the door against temptation requires that an actual or potential unauthorized benefit be strictly prohibited in every case, irrespective of the fact that, in certain cases, the fiduciary's honesty is undisputed, or the transaction is profitable to the beneficiary, or the beneficiary may suffer loss by the avoidance of the transaction. Another theme justifying the strictness of the proscriptive duties, closely related to the first one, is *the need to deter* persons in a fiduciary position from considering obtaining unauthorized profits. Irrespective of the fiduciary's honesty, actual or potential self-interested acts should be prohibited due to the 'obvious consequences' that the relaxation of this rule would produce to fiduciary relations in general. The need of deterrence is so strict, that potentially honest transactions are sometimes sacrificed in order to discourage all persons in a fiduciary position from attempting to act self-interestedly.

A variation of the 'conflicting interests' approach holds that a conflict of interest involves an opposition between fiduciary's self-interest and his 'duty'. These theories share the view that the conflict of interest arises with respect to the person of the fiduciary, rather than between the fiduciary and the beneficiary. It consists in an opposition between the fiduciary's self-interest and his 'duty'. In some views, the 'duty' that conflicts with the interest is a non-technical term, designating the task that the fiduciary has undertaken, or all non-fiduciary duties that a person in a fiduciary position has. Due to this broad understanding of 'duty', the justifications offered by this approach for the existence of the proscriptive duties are very similar to the 'conflicting interests' current of thought: they focus on the need to

prevent abuse of fiduciary position. Unless one resorts to the ‘opportunity to cheat’ line of arguments, it is very difficult to find a logical opposition between the fiduciary’s self-interest and his ‘non-fiduciary’ duties that can justify the reprehensibility of self-interest even where the fiduciary acts in good faith, and even where no non-fiduciary duty has been breached. Non-fiduciary duties can be breached as a result of a decision adopted in a situation of conflict of interest, but this would be *a consequence* of the breach of a more fundamental duty, and not the result of a direct opposition between interest and non-fiduciary duty.

The ‘conflicting interests’ approach fails to capture the specific meaning that a situation of conflict of interest has in fiduciary law: that of incompatibility between the fiduciary’s self-interest and his *core duty*. Undoubtedly, in many instances where the fiduciary’s self-interest is in opposition with his core duty, there is a second-degree opposition between the fiduciary’s interests and those of the beneficiary. Focusing on this second-degree opposition instead of the main conflict, however, strips the fiduciary from his essential role, that of exercising discretion, or judgment for the benefit of the beneficiary, and inevitably creates confusion concerning what the proscriptive duties aim to protect and why they are so strict.

Besides the confusion concerning *what* the proscriptive duties aim to protect, another consequence of the failure to appreciate the proper meaning of the notion of ‘conflict of interest’ in the context of the fiduciary relation is the insufficient or unconvincing arguments concerning *why* the proscriptive duties are so strict. Aiming to explain why the law prevents fiduciaries from being tempted to abuse their position, or protects the beneficiaries from exploitation, or protects the non-fiduciary duties, the theories falling into any of these views use arguments that are *external* to the fiduciary relation. The most common justifications are based on public policy arguments (such as the need to deter other fiduciaries from abusing their position, the particular social utility of fiduciary relations, or the need to reinforce the public confidence in fiduciary relations by the maintenance of appearances of propriety) or on procedural arguments (evidentiary difficulties concerning the real motives animating a fiduciary or the actual fairness of a self-interested

transaction, or the need to avoid putting the beneficiary in a position to prove the fiduciary's actual misbehaviour).

The external, public policy, arguments put forth by the 'conflicting interests' theories leave unanswered the following fundamental question: What is so unique in the position of a fiduciary, that the law is concerned with removing *temptation* of self-interest and with preserving *appearance* of correctness? A proper understanding of the notion of 'conflict of interest', in the sense of incompatibility between a core fiduciary duty and adverse interests, is fundamental for understanding both the essential characteristic of a fiduciary position and the strictness of the proscriptive duties.

CHAPTER III: CONFLICT OF INTEREST AND PROPER EXERCISE OF DISCRETION IN THE FRENCH CIVIL LAW

3.1 Introduction

The previous chapters outlined the theories developed by common law scholars concerning the content and the purpose of ‘fiduciary duties’. Before developing the new approach to fiduciary duties in the following chapter, this chapter will focus on the ways in which the French civil law scholars have approached the issue of exercise of discretion for the benefit of another in private law relations. The relevance of the investigation of the contemporary French doctrine in this field is twofold.

The first aim is to demonstrate that regulating the exercise of discretion (or judgment, or discretionary power) in another’s benefit is not a typically common law topic. Although fiduciary duties are often considered a common law institution (due, among other factors, to their origin in the Court of Chancery and to the remedy of constructive trust) private law relations where one party has discretion over the interests of another are a universal occurrence. As this chapter will show, recent French civil law theories have tried to identify underlying rules and principles that unify all such relations. These theories are remarkably similar to some of the common law approaches to fiduciary duties: they make the connection between conflicts of interest and a core duty to act in the interests of another (referred to by many scholars as the duty of loyalty).

The second aim is to add another dimension to the relevance of this dissertation. Although the theory of fiduciary duties developed in this study is based mostly on common law sources, its relevance is not limited to the common law tradition. On the contrary: it is hoped that the conceptualization of fiduciary duties proposed by this dissertation will make possible a trans-systemic understanding of conflicts of interest and proper exercise of judgment in private law. Such an approach is especially relevant at the present time, given the continuing efforts to articulate a common body of principles for the law of obligations at EU level.

According to traditional wisdom, ‘fiduciary duties’ is a purely common law concept. Historically intertwined with the institution of trust and with the equitable jurisdiction of the Court of Chancery, the common law doctrine of fiduciary duties tends to be regarded as alien to the civilian tradition.³⁰⁶ Consequently, there has been little dialogue between the two legal traditions on this specific topic.³⁰⁷

Over the last three decades, French commentators have been increasingly preoccupied with the Anglo-American concept of fiduciary duties, as a result of innovations introduced in several legal fields, such as corporate law, financial law and trust law. In corporate law, for instance, a couple of landmark decisions issued by the Commercial Chamber of the *Cour de cassation* in 1996 and 1998 have been repeatedly interpreted as transplanting into the French law the fiduciary duties developed in the Anglo-American corporate governance regime.

In the rare instances where civilians look at the common law fiduciary duties, their investigations are very specific: they are looking at a particular legal institution (such as the trust) or legal field (such as corporate law), in a particular common law jurisdiction. What they understand to be the content of the fiduciary duties, therefore, may vary according to the scope of their inquiry. Within the specific contexts in which fiduciary duties have been recognized in the French civil law, this concept has been labelled often as an innovation of Anglo-American origin.³⁰⁸

³⁰⁶ For references to the French civil law see e.g. Ivan Tchotourian, “La sanction des conflits d’intérêts à travers la déloyauté: Approche française et nord-américaine du devoir de loyauté des dirigeants” (2008) *Bulletin Joly Bourse*, no. spécial, 599: “Le droit français ne connaît pas un corpus semblable aux fiduciary duties”; Pierre Legrand, “L’hypothèse de la conquête des continents par le droit américain (ou comment la contingence arrache à la disponibilité)” in *L’américanisation du droit, Archives de philosophie du droit*, t. 45 (Paris: Dalloz, 2001) 36 at 40: “Contrairement à ce qui se fait en droit américain, le chef de file [the lead manager institution in a syndicated loan] français n’est pas un trustee. Et il ne pourrait pas se voir imputer un devoir fiduciaire. Pour en arriver à un transfert du droit américain « tel quel », il aurait fallu transporter en droit français... l’idée de *trust* et encore l’idée d’*equity*... ce qui, a n’en pas douter, eut été parfaitement impensable.”

³⁰⁷ Unless otherwise specified, references to the civil law tradition are limited to the French civil law.

³⁰⁸ See e.g. Holger Fleischer “Legal Transplants in European Company Law: The Case of Fiduciary Duties” (2005) 2 *European Company and Financial Law Review* 378; Jean-Jacques Daigre, “Le petit air anglais du devoir de loyauté des dirigeants” in Marie-Charlotte Piniot et al, eds, *Mélanges P. Bézard* (Paris: Montchrestien, 2002) 79.

Similar to the common law scholars, civilians tend to equate fiduciary duties (or the duty of loyalty) with the duty to avoid conflicts of interest.³⁰⁹ Several recent theories, however, have investigated in more depth the duties specific to persons that have power or discretion over another's interests. These theories searched for the justification of the reprehensibility of conflicts of interest in the special position of the person on which the burden of no-conflict is placed. They underline that the person subject to the no-conflict duties has assumed a 'position' (referred to as '*mission*', '*fonction*' or, less frequently, '*charge*'), which requires him to render a specific service to the other party in circumstances in which the result to be achieved is not pre-defined strictly (a '*situation ouverte*').

The assumption of this 'position' of open ended character creates a requirement to adopt decisions (manifested in voluntary actions or abstentions) within a certain perimeter drawn by law. This perimeter is defined by a dual 'standard'. The first standard is the duty to act with prudence and diligence ('*devoir de diligence*' or '*devoir d'attention*'). The second standard concerns the determination of the aims to be achieved by the person who acts for another. The position holder must decide how to act having as sole motive the interests of the other party to the jural relation. This duty is referred to by some scholars as the duty of loyalty ('*devoir de loyauté*'). Self-interested or third party-regarding acts are the most manifest ways in which the duty of loyalty is breached.

Before presenting some of these civil law theories, a clarification is required concerning the meaning of 'loyalty' in French private law. The concept of 'loyalty' (*loyauté*) is traditionally used in the French civil law in the framework of contractual relations.³¹⁰ The general requirement of loyalty

³⁰⁹ See e.g. Francois Barrière, *La réception du trust au travers de la fiducie* (Paris: Litec, 2004) 440-442. Comparing the French *fiducie* with the common law trust, Barrière wrote: "La relation qui se noue entre le constituant-*settlor* et le fiduciaire-*trustee* est l'élément essentiel du trust et de la fiducie... La particularité de cette relation implique de mettre à la charge du fiduciaire-*trustee* des obligations afin de s'assurer de la bonne réalisation de l'affectation. Il s'agit d'une obligation à deux facettes, se composant du devoir de loyauté (i) et du devoir d'attention (ii)...Le devoir de loyauté du fiduciaire-*trustee* lui impose de toujours faire prévaloir les intérêts du trust ou de la fiducie sur ses propres intérêts. Ce devoir l'oblige, en particulier, d'éviter qu'un conflit d'intérêts survienne."

³¹⁰ The Catala Project for the reform of the law of obligations, for instance, affirms the prominence of the duty of loyalty binding on contractual parties: "the duty of loyalty, express or implied, crosses from one end to the other the law of contractual obligations." See Pierre

in contracts is construed as an application of the larger principle of good-faith. Some authors have identified two subdivisions of loyalty: (i) *loyauté du contractant*, which focuses on the attitude of a contracting party, requiring such party to act with good faith; and (ii) *loyauté contractuelle*, which imposes a general requirement of fairness and co-operation between contractual parties.³¹¹ This duty of loyalty extends beyond the actual existence of the contract, to the pre- and post-contractual relations.³¹² Since its scope covers all contractual relations, the contractual duty of loyalty is not the object of this research. This chapter will investigate, instead, the duty, which is sometimes referred to as ‘duty of loyalty’, that dictates how one party should exercise the discretion that he has over the other’s interests.

These different meanings of ‘loyalty’ are increasingly recognized in the French legal literature. French jurists often distinguish the meaning of loyalty between parties who pursue their individual interests from loyalty in jural relations where one party has ‘taken charge’ of the other party’s interests. Laurent Aynès, for instance, expressed the view that loyalty is a general duty susceptible of several nuances. In the jural relations where the parties aim to promote their selfish interests (*‘relations de méfiance’*), such being the case of most contracts, each party has a duty of loyalty towards the other, which comprises requirements of cooperation and fairness at the stage of negotiations, during the execution of the contract and at its termination. In the jural relations where one party entrusts his interests to the other, or where one party has taken charge of the other’s interests (*‘relations de confiance’*), the duty of loyalty requires the person in whom confidence is reposed to act deliberately in the interests of the confider.³¹³

Catala, “Présentation générale de l’avant projet” in “Rapport sur l’avant-projet de réforme du droit des obligations”, online at <http://www.justice.gouv.fr/publications-10047/rapports-thematiques-10049/droit-des-obligations-et-droit-de-la-prescription-11944.html> at 15; See also Denis Mazeaud, “Loyauté, solidarité, fraternité: La nouvelle devise contractuelle?” in *L’avenir du droit: Mélanges en l’honneur de François Terre* (Paris: Dalloz, 1999) 603-634.

³¹¹ See Yves Picod, *Le devoir de loyauté dans l’exécution du contrat* (Paris: L.G.D.J., 1989).

³¹² See François Terré, et al., *Les obligations* 8^e éd. (Paris: Dalloz, 2002) para. 185.

³¹³ Laurent Aynès, “L’obligation de loyauté” in *L’obligation, Archives de Philosophie du Droit*, t. 44 (Paris: Dalloz, 2000) 195 at 199 : “Nombreux sont les cas dans lesquels une personne confie ses intérêts, parfois son être même, à autrui... Toutes les fois que par convention ou par la loi, les intérêts d’une personne sont confiées à autrui, surgit une obligation de loyauté intense, qui constitue même l’obligation principale du dépositaire de la

As mentioned before, this chapter will present several theories proposed by French scholars attempting to understand the duty of loyalty that arises in the circumstances designated as *relations de confiance*. The most important conclusion that emerges is that the way in which French scholars approach the so-called '*situations ouvertes*' or '*relations de confiance*' presents many interesting similarities with the common law theories of fiduciary duties. These similarities do not appear to be generated by legal transplants or direct influence of one system over the other. They illustrate the efforts made by both traditions to understand in a systematic manner the same legal phenomenon.

3.2 The theory of fiduciary representation ('*représentation fiduciaire*')

The theory of fiduciary representation developed by Philippe Didier brings to the forefront of French civil law theory the problem of circumscribing the discretion that one person has over the interests of another.³¹⁴ Within the limited context of representation, Didier analyzes several ways in which private law can channel the decision-making process of persons who have discretion over another's interests, in order to ensure that the latter's rights are protected.

The classic French civil law commentators did not distinguish clearly mandate from representation. Throughout the twentieth century, the classic view became more nuanced. Mandate and representation have gradually become separate, albeit overlapping notions. The autonomy of the institution of representation has been traditionally justified based on the concepts of power and intention to represent another.³¹⁵ A recent study carried out by Philippe Didier has exposed the shortcomings of these conventional explanations of representation. Didier argued that, in order to explain the external aspect of the representation mechanism, it is necessary to investigate

confiance ; celui-ci doit, bien sur, exécuter sa mission : faire, ne pas faire, donner ; mais plus encore conformer sa conduite aux exigences de l'intérêt d'autrui."

³¹⁴ Philippe Didier, *De la représentation en droit privé* (Paris: L.G.D.J., 2000).

³¹⁵ For an analysis of these theories see *ibid.* at 53-98.

the internal aspect, with a view to determining why the acts between agent (*'représentant'*) and third parties are binding on the principal (*'représenté'*).

According to Didier, the starting point in understanding the binding force that external acts have on the principal is the insight that such acts are in the principal's interest, as defined by the agent. In other words, the mechanism of representation encompasses situations where the acts of one person are imputed on another because the first one was authorised to define the interests of the second in a given operation.

The definition of another's interest is a decision process whereby one person determines what course of action would be in the interests of another in a given context. The outcome of such definition is always circumstantial. The principals' interests are expressed *in concreto*, rather than in general and abstract terms.³¹⁶ Because the agent is authorized to decide with respect to the principal's interests, the former's decisions are imputed to the latter whenever the decision process meets the legality criteria.

In order to evaluate the legality of the decision process, Didier argues, a distinction should be made between 'closed situations' (*'situations fermées'*) and 'open situations' (*'situations ouvertes'*). In 'closed' situations the law declares that only one course of action is licit, and the agent's discretion is reduced to a minimum.³¹⁷

In an open situation, the person authorized to define the interests of another has the possibility to choose from an undefined number of licit courses of action. The open situation is the paradigm context in which representation operates. Because human rationality is limited, the decision maker cannot evaluate all available options in order to choose the best one. Consequently, the agent must choose the course of action that appears to him as the most preferable from among the options that he has considered. The definition of the interests of another in open situations is, therefore, highly subjective. Because the agent does not have the means to determine the

³¹⁶ *Ibid.* at 130 : "[Q]uand une personne définit l'intérêt d'une autre, elle exprime ce qu'est l'intérêt de l'autre à un instant précis... Autrement dit, le mot définition ne signifie pas une relation statique entre deux éléments, telle que peut l'être la définition terminologique, mais désigne un processus par lequel une personne habilitée va transformer un concept abstrait en un acte concret... Définir un intérêt c'est le traduire en un comportement."

³¹⁷ *Ibid.* at 163-165.

optimal result for each decision, he is expected to choose the version that appears to him the most preferable, although *in abstracto* this may not be the optimal solution.³¹⁸

Didier refers to the open situation as creating a ‘fiduciary definition of interests’ and a ‘fiduciary representation’.³¹⁹ Although the premise of the fiduciary definition of interests is that the number of licit outcomes of the definition process is unlimited, the law imposes two types of benchmarks to restrict the scope of the decision process. The first benchmark is the duty of loyalty. The duty of loyalty is a distinctive feature of the fiduciary definition of interests. It requires the agent to act intentionally in the principal’s interests. In other words, the duty of loyalty operates at the level of motives. The agent must act having what he has defined to be the interests of the beneficiary as determinant motivation.³²⁰

The definition of the duty of loyalty in terms of motives, Didier conceded, renders the proof of disloyalty extremely difficult. According to the general rules of procedure, the charge of proving the breach of loyalty is incumbent on the person who alleges it. Such a proof would require the claimant to demonstrate that, in accomplishing the contested action, the defendant had an illicit motive. In many cases it would be impossible to demonstrate this. One possible solution to this conundrum would be to reverse the burden of proof. Whenever an act performed by the agent is prejudicial to the principal, a presumption of illicit motive arises.³²¹

A second possible solution, to which Didier subscribed, is to regard the duty of loyalty as one head of a two-pronged obligation. Beside the duty of loyalty, this compound obligation comprises the duty of diligence, which

³¹⁸ *Ibid.* at 160-162.

³¹⁹ *Ibid.* at 173. Didier founded his analysis of the internal aspect of representation on the agency theory established by Jensen and Meckling. See Michael C. Jensen and William H. Meckling, “Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure”, (1976) 3 *Journal of Financial Economics* 302.

³²⁰ *Ibid.* at 173-174 : “[L]e devoir de loyauté est une exigence commune à l’ensemble des situations de représentation fondée sur la définition fiduciaire d’un intérêt. La loyauté... se manifeste par l’exigence qui pèse sur le représentant d’agir intentionnellement pour le bien du représenté. Dans le processus de formation de la décision, *la loyauté se situe au stade de motifs de l’acte*... La loyauté que l’on attend du représentant fiduciaire requiert que celui-ci prenne la recherche du bien du représenté comme motif déterminant. Si on ne retrouvait pas chez le représentant cet élément intentionnel, on serait en droit de considérer qu’il aurait commis une attente à la loyauté que l’on attend de lui.”

³²¹ *Ibid.* at 176-177.

requires the agent to act with care and competence.³²² Didier refers to the complex obligation resulting from the fusion of the duties of loyalty and diligence as the *obligation fiduciaire*, with a hat tip to the common law fiduciary obligation.³²³ The fusion between loyalty and diligence solves the problems that the purely subjective nature of the duty of loyalty poses to proving disloyalty. The content of the duty of loyalty becomes objective: it is a duty to act not in what the agent has defined as the preferable interests of the principal, but in the principal's *best* interests. The best interests are determined following the standards of care and competence established by the duty of care.³²⁴

After analyzing the core duty binding on an agent, Didier focused on the ways in which this duty could be breached. He identified two main breaches of loyalty: conflicts of interest and conflict between duties of loyalty owed to principals with conflicting interests.

Concerning conflicts of interest, Didier observed that the private law does not comprise a general set of rules applicable to all situations of conflict. In one group of cases (such as mandate or tutorship) the law expressly prohibits the agent to place himself in a situation of conflict.³²⁵ In another group of cases the law sets forth ways in which such conflicts can be managed: by replacing the agent with an independent person (e.g. in the case of a conflicted tutor) or by providing for a procedure of authorization of the conflicted transaction (e.g. in the case of business corporations). In a third group of cases (such as the case of partnerships), the law is silent with regard to situations of conflict.

In response to this heterogeneous approach, Didier argued for a uniform legal regime of private law situations of conflict of interest. The

³²² *Ibid.* at 180-182.

³²³ *Ibid.* at 185-186: "Il faut bien reconnaître l'aspect spécifique de l'obligation que l'on fait peser sur le représentant quant il intervient dans une situation ouverte. Il est difficile de la réduire à une simple juxtaposition de devoirs indépendants les uns des autres et dont on pourrait fixer une liste exhaustive. Elle apparaît plutôt comme une obligation bicéphale, une obligation juridique *sui generis*, qui regroupait deux devoirs : la loyauté et la diligence... Quant à l'emploi du vocable fiduciaire pour la qualifier, il serait un emprunt et un hommage à la Common Law qui, la première, a mis en évidence la spécificité de l'obligation qui pèse sur la personne en qui on met sa foi pour gérer son affaire. L'obligation est fiduciaire car elle définit les contours de la confiance que l'on peut faire à une personne."

³²⁴ *Ibid.* at 183-184.

³²⁵ See art. 450 of the French civil code (tutorship) and art. 1596 (mandate).

solution he proposed, however, refers only to the procedural aspect of proving disloyalty. In all situations of conflict of interest, the principal should only have to prove that the agent's actions caused the former a prejudice. The existence of the prejudice will create a presumption that the act was disloyal.

Didier's theory tackles two issues that are familiar to common law commentators on fiduciary duties: the law's control of the exercise of discretion and the situations of conflict of interest. The solutions that he proposed, however, are questionable. Concerning the exercise of discretion, the amalgamation of the duty of loyalty and the duty of diligence leads to a result that is the opposite of a *situation ouverte*, which is the point of departure of his analysis. If agents are always under a duty to act in the best interests of their principals, and such interests can be objectively determined, then only one course of action will be legitimate and the relation would be a '*situation fermée*'. Concerning the prohibition of conflicts of interest, Didier failed to make the connection between the core duty of loyalty (which he understands as the duty to act with an adequate motive) and the no-conflict duty. In other words, he did not explain why his presumption of disloyalty applies only to certain private law relations.

3.3 The theory of fiduciary contracts ('*contrats fiduciaires*')³²⁶

Sébastien Bonfils is another French scholar who proposed a unifying theory for all private law relations in which one party has discretion over the other's interests. This theory is built around the concept of fiduciary contracts. Fiduciary contracts are regarded by some commentators as an independent family of contracts.³²⁶ In the theory of fiduciary contracts proposed by Bonfils, this *sui generis* family of contracts comprises the civil law trust, fiduciary representation contracts (in the sense established by Didier) and financial intermediation contracts. In Bonfils' view, the premise

³²⁶ Traditionally, the concept of 'fiduciary contracts' comprised the contracts the breach of which could constitute abuse of confidence (punished by art. 408 of the old French Penal code), such as mandate, deposit and lease. See e.g. Louis Goutagny, *La violation des contrats fiduciaires au point de vue pénal* (Lyon: J. Thomas, 1912); Edouard Pénicaud, *De l'abus de confiance prévu et puni par l'article 408 du code pénal* (Limoges: Impr. de Perrette, 1899).

of all fiduciary contracts is that one party acquires control over the interests of the other party. The first party, or ‘the interpreter of the interest,’ falls under an obligation to act having as sole consideration the interests of the other, ‘the interest bearer.’³²⁷

Bonfils observed that the idea of one person taking charge of another’s interests presupposes that the first is holder of legal prerogatives the exercise of which is capable of producing direct effects over the other’s interests. He identified two jural techniques that allow legal prerogatives to be separated from interests: the concept of power and the concept of person.³²⁸

Concerning the first technique, Bonfils adopted the definition of legal power proposed by Emmanuel Gaillard, namely “a legal prerogative that allows its holder to act in an interest at least partially distinct from its own, by posing unilateral acts binding on another.”³²⁹ The exercise of a legal power involves a separation between legal prerogative and interest in the sense that it allows its holder to exercise the rights of another, thus creating a benefit for another. The right and the benefit that it generates, however, remain conjoined in the person of the beneficiary.³³⁰

The second technique is centered on the idea of person, or legal actor. The notion of person, Bonfils argued, is a useful tool in conceptualizing a separation between titularity of a subjective right and entitlement to the interest resulting from its exercise. Based on the principle of contractual freedom, it is conceivable that a legal actor comes under an obligation to use a right for the benefit of another.³³¹ Consequently, the existence of legal power, in the sense ascribed to it by Gaillard, is not a *sine qua non* for the premise of fiduciary contracts, i.e. that one person has scope to affect directly the interests of another. Bonfils pointed out that the French *fiducie* is an

³²⁷ Sébastien Bonfils, *Le droit des obligations dans l’intermédiation financière* (Paris: L.G.D.J. 2005) 81.

³²⁸ *Ibid.* at 47-53.

³²⁹ Emmanuel Gaillard, *Le pouvoir en droit privé* (Paris: Economica, 1985) 232.

³³⁰ “Cependant, il résulte de cette définition que cette technique ne conduit pas à un transfert du droit subjectif au profit du titulaire du pouvoir. Celui-ci ne fait qu’agir sur les droits subjectifs d’une personne. Autrement dit, intérêts et droits subjectifs restent sur la tête de la même personne.” Bonfils, *supra* note 327 at 47.

³³¹ *Ibid.* at 51: “La personne peut être une technique permettant de disjoindre le titulaire de la prérogative et l’intérêt dans lequel cette prérogative est exercée.”

illustrative example of a relation in which one person can affect the interests of another through the bias of a right. Restating the definition of the *fiducie* proposed by Witz, Bonfils underlines that the trust is a right over property in respect to which the right-holder owes a set of obligations.³³²

The premise underlying all fiduciary contracts, therefore, is that one party has control over the interests of another, either as holder of powers or as debtor of obligations in respect to rights that he holds. This premise creates a structurally imbedded conflict of interest, existing in the party who gains control over the interests of another. In Bonfils' view, the conflict consists in the opposition that exists between the interpreter's own interests and the interests of the other party. The law presumes the existence of this opposition, and compels the interpreter to act exclusively in consideration of the bearer's interests.³³³ This intervention occurs at two levels.

First, the law imposes on the interpreter two core duties: the duty to act with diligence and the duty of loyalty. The duty of diligence requires the interpreter to fulfill his office ('*mission*') with competence and care.³³⁴ The duty of loyalty is the core duty that sets apart fiduciary contracts from other types of contracts. At a general level, a duty of loyalty exists in all contractual relations. It requires the contractants to cooperate and act in good

³³² *Ibid.* at 64: "La fiducie a été définie... comme 'l'acte par lequel une personne, le fiduciaire, rendue titulaire d'un droit patrimonial, voit l'exercice de son droit limité par une série d'obligations, parmi lesquelles figure généralement celle de transférer un droit au bout d'une certaine période soit au fiduciant, soit à un tiers bénéficiaire'. On retrouve dans cette définition les trois éléments de la fiducie... En troisième lieu, elle nécessite une limitation des droits du fiduciaire par une série d'obligations." (citing Claude Witz, *La fiducie en droit privé français* (Paris: Economica, 1981) 15). Grimaldi proposed a similar definition of *fiducie*: "La fiducie peut être définie comme l'acte juridique par lequel une personne, le fiduciaire, acquiert d'une autre, le fiduciant, un droit patrimonial, mais sous des obligations qui en limitent l'exercice, et parmi lesquelles figure généralement celle de transférer ce droit, à terme, soit au fiduciant lui-même, soit à un tiers bénéficiaire." (Michel Grimaldi, *La fiducie: Réflexions sur l'institution et sur l'avant projet de loi qui la consacre* (1991) 17 Répertoire du notariat Defrénois 897 at 897).

³³³ Bonfils, *supra* note 327 at 82: "Le droit va alors faire en sorte que [l'interprète de l'intérêt] agisse 'comme si' il n'avait de considération que pour l'intérêt du [porteur de l'intérêt] 'comme si' le seul intérêt qui comptait était celui du porteur de l'intérêt, de façon à donner confiance. Les contrats fiduciaires sont des contrats dans lesquels la duplicité étant présumée, ils appellent une réaction du droit. Ils sont fondamentalement la marque exacerbée de la méfiance."

³³⁴ Bonfils notes that the standard of care binding on the interpreter is higher than the care that one has in his own affairs. He refers to the distinction between *diligentia in suis rebus* and *diligentia in alienis rebus* analyzed by Boyer and Roland. The gist of the first is promptitude, while that of the later is perseverance (Laurent Boyer and Henri Roland, "A propos du défaut de diligence" in Roger Nerson *et al*, *Mélanges dédiés à Jean Vincent* (Paris: Dalloz, 1981) 9-27).

faith with a view to achieving a common contractual interest.³³⁵ In fiduciary contracts, however, the duty of loyalty does not refer to the joint interests of contractants. *Ex hypothesi*, one party acquires control over the other's interests. Consequently, the duty of loyalty arising in fiduciary contracts requires the debtor to act "purposefully for the benefit of the creditor," to the detriment of his personal interest or that of a third person.³³⁶

The second form in which the law intervenes to ensure that the interpreter acts exclusively in the bearer's interests is an *a priori* control, aimed to prevent the risk of disloyal behaviour. These preventive measures include the prohibition of acquiring property that the interpreter is charged to sell (provided for expressly in the case of mandate by art. 1596 C.civ.), the prohibition of acquiring an interest in the goods that the interpreter must administer (e.g. the prohibition established for tutors to buy or lease goods belonging to the minor, established by art. 450 C.civ.), or the good-standing requirements established by law for professional service providers, such as lawyers, insurance brokers, or managers of companies providing financial services.

The core elements that characterize fiduciary contracts are the founding blocks for a legal regime specific to fiduciary contracts. By way of analogy, the specific rules established for discrete fiduciary contracts, such as mandate or the relation between director and corporation, should be elevated to general principles applicable to an abstract position of interest-interpreter.³³⁷

Bonfils' understanding of the fiduciary duty of loyalty resembles closely the view adopted by many common law scholars, who define this duty in positive terms (e.g. 'the duty to act in the best interests of the beneficiary'), but restrict its content to the proscriptive duties.³³⁸ Furthermore, his justification of the existence of the no-conflict duties brings

³³⁵ See e.g. Denis Mazeaud, "Loyauté, solidarité, fraternité: La nouvelle devise contractuelle?" in *L'avenir du droit: Mélanges en l'honneur de François Terre* (Paris: Dalloz, 1999) 603-634.

³³⁶ "L'obligation de loyauté conduit donc son débiteur à agir intentionnellement pour le bien du créancier lorsque l'intérêt de celui-ci entre en conflit avec le sien ou celui d'un tiers. Dans la première situation, il doit sacrifier son propre intérêt ; dans la seconde, il doit agir avec impartialité." (Bonfils, *supra* note 327 at 91).

³³⁷ Bonfils, *supra* note 327 at 88.

³³⁸ See Chapter 2 above.

to mind the idea of ‘temptation of self-interest’ that is so popular in the common law theory of fiduciary duties. In his view, the law imposes on the interpreter a strict duty to forego his personal interests due to a “presumed duplicity” that characterizes each person that has power over another’s interests.³³⁹

Bonfils’ theory has the merit of attempting to unify all relations where one party has discretion over the other’s interests under a common set of concepts and rules. Similarly to Didier, and to other French and common law commentators, however, Bonfils equated the notion of conflict of interest to that of conflicting interests, and did not explain why the law is concerned with the opposition of interests only in fiduciary contracts and not in other types of private law relations.

3.4 The systematization of the various instances of conflicts of interest

Another theory aims to understand the circumstances in which one person is bound to act exclusively for another starting from the recognized instances of conflicts of interest. The importance of an accurate understanding the concept of ‘conflict of interest’ was underlined by Guy Canivet, the president of the French *Cour de cassation*, in the opening statement of a recent workshop dedicated to the problem of conflict of interest.³⁴⁰ Canivet opened his presentation by observing that the concept of ‘conflict of interest’ is increasingly important in the French law, and requires systematic analysis.

In the first part of his discourse, Canivet drew a distinction between conflicting interests and conflict of interest in a technical sense. The first situation refers to the opposition of interests that exists between parties at the stage of negotiation and formation of a contract. ‘Conflict of interest’ in the

³³⁹ See supra note 333.

³⁴⁰ Guy Canivet, “Propos introductifs”, at *Les conflits d’intérêts: Une question majeure pour le droit des affaires du XXI^e siècle*, Colloque organisé par l’Association Droit et Commerce, Deauville, 1-2 avril 2006, online at http://www.courdecassation.fr/institution_1/autres_publications_discours_2039/discours_2202/2_avril_8453.html.

technical sense envisaged by the law refers to the opposition between interest and duty. More precisely, Canivet observed, it designates the conflict between one party's personal interests and his duty to act in the interests of another.³⁴¹ This observation is very important: it is one of the rare instances where French legal scholars recognize that the technical sense of 'conflict of interest' is that of opposition between interest and duty to act for another, rather than the plain, lay meaning of divergence of interests between two persons.

Until recently, Canivet observed, conflicts of interest have been regulated only in specific cases, by the recognition of a specific duty of loyalty. However, many instances in which one person should not be allowed to take into account his personal interests are yet to be acknowledged by law. An independent legal regime of conflicts of interest, Canivet observed, would have certain practical benefits. First, it would make possible the treatment of conflicts of interest separately from the law of contracts. Secondly, it would give general scope to rules which *de lege lata* are limited to certain positions, such as that of mandatary or professional adviser. A unifying principle, however, will have to address the difficult issue of potential overlaps between conflicts of interest and existing similar legal principles, such as fraud on power or abuse of right.

Canivet's discourse is based on a unifying theory of conflicts of interest proposed in 2005 by Pierre-François Cuif.³⁴² Cuif started his analysis by observing that, in broad terms, a conflict of interest denotes a situation where the personal interests of someone are in conflict with the interests of another, which he is bound to look after.³⁴³ Cuif's definition of conflict of

³⁴¹ "Il ne saurait s'agir de l'opposition classique et naturelle des intérêts divergents qui apparaissent dans la *formation* d'un contrat, mais seulement de la situation particulière que révèle l'*exécution* d'un contrat aux termes duquel l'une des parties a pris en charge les intérêts de son cocontractant. Par où il convient de revenir au propos d'ouverture : en dépit de l'absence de définition dans la loi, ou même dans les dictionnaires juridiques les plus autorisés, l'on peut rapidement s'accorder à définir le conflit d'intérêt comme une situation dans laquelle les intérêts personnels d'une personne sont en opposition avec ses devoirs, lesquels tendent justement à la protection des intérêts dont elle a la charge..." (*ibid.*)

³⁴² Pierre-François Cuif, "Le conflit d'intérêts: Essai sur la détermination d'un principe juridique en droit privé" (2005) 1 R.T.D. Com. 1.

³⁴³ *Ibid.* at 1, emphasis added: "[Dans le conflit d'intérêts] il s'agit de la situation dans laquelle une personne voit ses intérêts personnels entrer en conflit avec des intérêts *dont elle a la charge*."

interest is ambiguous. It appears to refer both to conflicting interests and to conflict between interest and duty. Throughout his article, unfortunately, he maintains this ambivalent position. Although he justifies the rules against conflict of interest by referring to an underlying duty of loyalty, Cuif's analysis does not explain in sufficient depth the incompatibility between this duty and self-interest. Ultimately, his theory can be summarized as follows: a person who has a duty to act in the interests of another must not be in a position where his personal interests may jeopardize the proper performance of his duties to another. This understanding of conflicts of interest, shared by many prominent common law scholars, is insufficiently detailed. Its main shortcoming is that it does not explain why the law is concerned with proper performance of duties (in the sense of freedom from self-interest) only in certain relations and not in others.

This notion, Cuif observed, is prominent in the common law tradition, where persons who owe fiduciary duties are prohibited from being in a conflict of interest situation. The idea that certain persons are not allowed to be in a conflict of interest is not alien to civil law. The Civil code provides for several instances where persons in whom confidence has been reposed, such as tutors or mandataries, are prohibited from pursuing their self-interests. The contemporary rules against conflict of interest are not new additions to French civil law. Their roots go back to Roman law and natural law philosophy, which prohibited certain persons to be *auctores in rem suam*.³⁴⁴

A methodical understanding of the multiple instances of conflicts of interest, Cuif noted, must start with the elucidation of the notion of 'interest'. 'Interest' is a concept susceptible of a plurality of definitions. It is a notion that permeates the idea of right, of legal claim and even the idea of law in general. At a very basic level, however, 'interest' refers to a material or moral

³⁴⁴ *Ibid.* at 2, footnotes omitted: "Que l'on emploie le terme anglais ou français, les locutions conflit d'intérêts et opposition d'intérêts doivent être considérées comme synonymes. L'observation ne doit pas surprendre : les règles traitant des conflits d'intérêts ne sont pas exemptes de considérations de droit naturel, jusqu'aux Évangiles stigmatisant le gérant infidèle qui abuse de sa situation à des fins personnelles... Surtout, ces règles puissent une inspiration commune dans l'adage latin *nemo in rem suam auctor esse potest*. Ce précepte, selon lequel « nul ne peut officier en sa propre cause » recouvre un domaine étendu en raison de la notion extensive d'*auctor*: est *auctor* celui qui est titulaire d'un office ou d'une charge, qui ne soit pas nécessairement publics."

utility that one searches for oneself or for another.³⁴⁵ As a rule, every person is entitled to act in his best interests, as long as it does not harm another. In exceptional situations, some persons are held to act in an interest different than their own (*‘l’intérêt supérieur’*). In these circumstances the person must not be distracted by considerations of self-interest (*‘l’intérêt personnel’*) while discharging his duties.³⁴⁶ Relative to the ‘superior’ interest, the ‘personal’ interest acts as the motive that diverts the person in charge of a superior interest from his duties.³⁴⁷

The situations in which such conflicts of interest arise cannot be satisfactorily explained by the existing civilian legal concepts. The ‘legal power’ (in the sense proposed by Emanuel Gaillard, i.e. a legal prerogative oriented towards another’s interests) is one of the most pertinent existing concepts that could justify the prohibition of conflicts of interest. This concept, while relevant, is not sufficient. Not all situations in which reprehensible conflicts of interests arise involve the existence of legal powers. The duties to provide advice binding on certain professionals, Cuif noted, may generate conflicts of interest, although the professional advisors may not have a power in the strict sense.³⁴⁸ Abuse of rights may appear as another potential concept that could illuminate the reason for the prohibition of conflicts of interests. At a closer look, however, it becomes evident that the right in itself, without more, cannot generate a conflict of interest. The concept of subjective right is *a priori* oriented towards the satisfaction of its holder’s interests. Consequently, a conflict of interest cannot exist whenever a person exercises his right within its objective limits. Whenever a right holder causes harm to another by exercising his right in a reprehensible

³⁴⁵ *Ibid.* at 4, citing Andre Gervais, “Quelques réflexions a propos de la distinction des droits et intérêts” in *Mélanges en l’honneur de Paul Roubier* t.1 (Paris: Librairies Dalloz & Sirey 1961) 241.

³⁴⁶ Cuif, *supra* note 342 at 4.

³⁴⁷ *Ibid.* at 11: “L’intérêt doit ici être entendu comme une considération susceptible de motiver un acte; la notion évoque les motifs ou les mobiles du droit des contrats. L’intérêt personnel éloigne de l’intérêt supérieur en ramenant celui qui en a la charge à ses propres préoccupations – directes ou indirectes - ; il est subversif en ce qu’il détourne le sujet de ses devoirs.”

³⁴⁸ *Ibid.* at 15.

manner, he is bound to make good the damage thus caused. But he is under no pre-existing duty to use the right in the interests of another.³⁴⁹

Cuif's analysis points towards a different source for the conflicts of interest. The starting point for understanding why the law prohibits conflicts of interests is the position that a person holds (*'fonction'*). An obligation to abstain from acting self-interestedly arises because the position holder undertook to provide a service to another. Such offices are not limited to those created contractually or regulated by law (such as tutors, corporate directors or providers of financial services). In general terms, an office exists whenever a person makes available his activity in a specific task for the profit of a determined or undetermined number of beneficiaries.³⁵⁰

Cuif attempted to explain the prohibition of conflicts of interest for office-holders by referring to a duty of loyalty that binds them, similar to the common law fiduciary duty.³⁵¹ Loyalty appears as a duty, or, more accurately as a standard, through which the law ensures that the office-holder acts in the 'superior' interests.³⁵² As a standard rather than a duty, loyalty neither prescribes nor proscribes a particular action, but indicates "the path to be followed".³⁵³ Unfortunately Cuif did not explain how self-interest can affect the proper identification of 'the path to be followed' by the office holder. If

³⁴⁹ *Ibid.* at 15-16.

³⁵⁰ *Ibid.* at 17 : "Il est possible de poser de manière générale la règle selon laquelle celui qui est en charge d'un intérêt supérieur ne peut pas le contrarier en poursuivant un intérêt qui l'en détourne. Le domaine d'application des règles relatives aux conflits recouvre des lors un domaine d'application précis: sont concernés tous ceux qui assurent une fonction, c'est-à-dire un service dans un but supérieur. La fonction consiste en la mise a disposition par une personne de son activité au profit du public ou de certaines personnes pour une tâche déterminée... Surtout, la fonction implique la prise en charge par celui qui l'assume d'un intérêt distinct du sien."

³⁵¹ *Ibid.* at 16-17: "D'un point de vue strictement juridique, le conflit d'intérêts peut être considéré comme un manquement à une obligation de loyauté... Cette loyauté rappelle alors les devoirs fiduciaires des droits anglo-américains dont les applications débordent largement le droit des contrats."

³⁵² This view is similar to Peter Birks' theory of fiduciary obligations. In Birks' view, fiduciary obligations are the highest degree of obligatory altruism, which impose a duty to act disinterestedly in another's interest. See Peter Birks, "The Content of Fiduciary Obligation" (2000) 34 *Israel Law Review* 3.

³⁵³ Cuif borrowed the idea of legal standard from Patrick Morvan. Morvan argued that the standard is a *technique juridique* that does not enunciate a legal norm, but has a procedural role. See Patrick Morvan, *Le principe de droit privé* (Paris: Editions Panthéon-Assas, 1999) 65: "[L]e standard en soi, ne prescrit, ne proscriit, ni n'autorise aucune conduite... [Le standard] n'exprime jamais la règle, [mais] la route à suivre." Blandine Mallet-Bricout also endorsed the idea of loyalty as a standard. See Blandine Mallet-Bricout, *La substitution de mandataire* (Paris: Editions Panthéon-Assas, 2000) 133-136

he had done so, he would have provided a solid justification for the rules against conflicts of interest applicable to office holders. Instead of pursuing in more detail the link between prohibition of conflict of interest and duty (or standard) of loyalty, Cuif summarized his theory by invoking the idea of conflicting interests. At the end of his article, Cuif enunciated the principle underlying all situations of conflicts of interest as follows: “no one is allowed to create a conflict between self-interest and the interests which he is bound to promote.”³⁵⁴

3.5 Fraud on power and breach of duty of loyalty by corporate directors

The duty of loyalty of corporate directors is another field where the civil law scholars have analyzed the duty to act in the interests of another.

The French law on commercial companies does not provide expressly for a duty of loyalty for corporate directors. This duty is a recent judicial creation of the *Cour de cassation*. In a first landmark case, *l'affaire Vilgrain* (1996), the Commercial Chamber of the Court asserted that corporate directors owe a duty of loyalty to shareholders.³⁵⁵ Without enunciating the content of the duty of loyalty, the Court held that the defendant director breached this duty by deliberately withholding relevant information from a shareholder while mediating the sale of the latter's shares.³⁵⁶

³⁵⁴ Cuif, *supra* note 342 at 18: “Nul ne peut faire entrer en conflit ses intérêts personnels avec ceux dont il a la charge.”

³⁵⁵ Cass. com., 27.2.1996, JCP ed. E 1996, II, 838. Bernard Vilgrain, director of a joint-stock company, was engaged in confidential negotiations with a potential buyer of the company's shares. One minority shareholder approached Vilgrain in his personal capacity and asked him to intermediate the sale of her shares. Vilgrain purchased the shares in personal capacity, and sold them to the interested purchaser for a substantial profit. Upon discovering the secret commission, the shareholder sued Vilgrain, claiming the annulment of the sale of shares for fraud (*dol*). The Commercial Chamber of the *Cour de cassation* held that Vilgrain, in his personal capacity, acted fraudulently (*manœuvres dolosives*) towards the shareholder. At the same time, in his capacity of director he breached the duty of loyalty that he owed to the shareholder, by failing to disclose the parallel negotiations. Consequently, the Court ordered Vilgrain to pay to the minority shareholder the profit he obtained from the re-sale of shares.

³⁵⁶ “[E]n intervenant dans la cession des actions... tout en s’abstenant d’informer le cédant des négociations qu’il avait engagées... [le dirigeant] a manqué au devoir de loyauté qui s’impose au dirigeant à l’égard de tout associé, en particulier lorsqu’il est intermédiaire pour le reclassement de sa participation.” (*Ibid.*)

The particularity of the *Vilgrain* case resides in the fact that the director acted in personal capacity, rather than *qua* director when he accepted to mediate the sale of shares. Nevertheless, the Court attached the duty of loyalty to the position of director. Le Nabasque explained this anomaly by the fact that, either as director or as intermediary, Vilgrain had assumed an office (*'mission'*) that required him to provide a service to another. Because the office of intermediary was made possible by the confidence that Vilgrain enjoyed as director, the Court attached the duty of loyalty to both offices. In his view, the major premise of the court decision is that corporate directors have a duty of loyalty towards shareholders; the minor premise is that, directors continue to owe a duty of loyalty when they accept the office of intermediary of sale and purchase of shares.³⁵⁷

In its annual report for 1996, the Court offered some clarifications concerning directors' duty of loyalty established in *Vilgrain*. The enunciation of this duty, the Court explained, should not be surprising. Although not provided for by statute, the recognition of a duty of loyalty for directors of closed corporations is a consequence of the evolution of corporate law and is based on their primary mission to act in the corporation's interest while treating shareholders impartially.³⁵⁸

This decision has been extensively interpreted by courts and commentators. It is largely agreed that *l'affaire Vilgrain* has established two main principles regarding directors' duty of loyalty. First, this duty binds all directors, irrespective of the form in which the corporation is constituted. Second, fraudulent nondisclosure of material facts (*'reticence dolosive'*) amounts to a breach of the duty of loyalty.³⁵⁹

³⁵⁷ Hervé Le Nabasque, "Le développement du devoir de loyauté en droit des sociétés" (1995) 2 R.T.D. com. 273 at 280.

³⁵⁸ Marie-Charlotte Piniot, "La *corporate governance* à l'épreuve de la jurisprudence de la chambre commerciale de la Cour de cassation" in Jean-Pierre Mattout et Hubert de Vauplane, eds, *Droit bancaire et financier: Mélanges AEDBF-France II*, (Paris: Ed. Banque, 1999) 369: "La référence au devoir de loyauté des mandataires sociaux envers l'ensemble des associés ne doit pas surprendre. Bien que non inscrit dans les textes, ce principe découle de ce que les mandataires sociaux sont tenus d'agir conformément à l'intérêt social et dans le respect de l'égalité de traitement entre associés."

³⁵⁹ Jean-Jacques Caussain, "Le devoir de loyauté des dirigeants sociaux en droit français" (2000) 340 Gazette du Palais 66.

Several commentators have regarded *l'affaire Vilgrain* as introducing in the French law the Anglo-American theory of fiduciary duties. In a case note on *Vilgrain*, Nathalie Dion and Dominique Schmidt contended that this decision introduces in the French law the American concept of fiduciary duties, consisting in a duty of loyalty and a duty of diligence. The duty of loyalty, these authors added, forbids corporate directors to create a conflict between their personal interest and the interests of the company.³⁶⁰

Two years later, the Court established that, in addition to the duty owed to shareholders, corporate directors owe a duty of loyalty to the corporation itself.³⁶¹ In *l'affaire Kopcio* (1998) the Court held that a director who uses for his own benefit the power to release employees from their non-competition obligations stipulated in their employment agreements breaches the duty of loyalty that he owes to the corporation. Similarly to the *Vilgrain* case, the Court established this duty of loyalty by mentioning it only briefly.³⁶² The particularity of this decision resides not in the prohibition of a director to act in his own interests, but in the fact that the Court has justified

³⁶⁰ Nathalie Dion and Dominique Schmidt, “Devoir de loyauté du dirigeant social à l’égard de tout associé” (1996) 27 *La Semaine Juridique* 838 at 842: “[La Chambre Commerciale] intègre ainsi dans notre droit l’un des concepts les plus importants du droit américain des sociétés : les *fiduciary duties*.. [Le] devoir de loyauté... interdit principalement aux dirigeants d’être à la source d’un conflit d’intérêts entre leur intérêts personnels, directs ou indirects, et ceux de la société ou des associés.” Similarly, Daille-Duclos wrote that: “[L]e devoir de loyauté du dirigeant apparaît directement issu des ‘principles of corporate governance’ définis aux États-Unis par l’American Law Institute en 1993.” (Brigitte Daille-Duclos, “Le devoir de loyauté du dirigeant” (1998) 39 *La Semaine Juridique* 1486 at 1486). See also Laurent Gordon, “Précisions quant au fondement juridique du devoir de loyauté du dirigeant social envers les associés” (2005) 1 *Revue des sociétés* 140 at 144: “Il ne fait en effet plus de doute que la fonction de direction d’une société met automatiquement à la charge de celui qui l’occupe certains devoirs fiduciaires, dictés par la confiance des associés et empreints d’une coloration morale. Ces devoirs sont bien connus du droit anglais et le droit américain qui consacrent l’existence de fiduciary duties parmi lesquels figure un devoir de loyauté... Nul doute qu’en France, la reconnaissance expresse d’un tel devoir a été encouragée par la réflexion sur le « gouvernement d’entreprise » et sur le renforcement en droit français des devoirs des dirigeants de sociétés, à l’instar des dirigeants anglo-saxons.”

³⁶¹ Cass. com., 24.2.1998, Bull. Joly 1998, 813. Kopcio was the director of PIC, a joint-stock company. Kopcio resigned, set up a competing company and persuaded key employees of PIC to join him. Before resigning his position of director, Kopcio had released the key employees from the non-competition clauses provided for in their employment agreements. PIC sued Kopcio for the breach of the non-competition clause comprised in a previous employment agreement that he had with the company, and for unfair competition. The *Cour de cassation* held that Kopcio breached the duty of loyalty that he owed to PIC when releasing the employees from their non-competition duties.

³⁶² “M. Kopcio avait exercé successivement les fonctions de gérant, puis après sa transformation en société anonyme, de directeur général de la société PIC, ce dont il découlait qu’il était tenu à une obligation de loyauté à l’égard de cette entreprise...” (*supra* note 361).

for the first time this prohibition based on a duty of loyalty owed to the corporation.³⁶³

Commenting on the effects of *Vilgrain* and *Kopcio* on the French law, Jean-Jacques Daigre asserted that the courts are gradually introducing the common law fiduciary duties in the French law.³⁶⁴ The growing recognition of these duties has prompted legal scholars to search for their conceptual foundation. Some commentators have justified the existence of the duty of loyalty by referring to the notions of legal power or office.

Hervé Le Nabasque, for instance, argued that, from the perspective of the general theory of obligations, the source of the duty of loyalty is in the concept of power, existing independently from contract (*'pouvoir détaché du contrat'*).³⁶⁵ This duty expresses the requirement that the holder of a legal power must exercise it in an interest which is totally or partially distinct from his own. Based on this premise, Le Nabasque defined the duty of loyalty binding on corporate directors as the obligation “not to use their powers... or the information that they hold for a strictly personal interest and... contrary to the corporation’s or to the shareholders’ interests.”³⁶⁶

Concerning the content of the duty of loyalty, Le Nabasque asserted that the role of this duty is to palliate the generality of the law. Its content is

³⁶³ Marie Lathelize-Bonnemaizon, “Bilan et perspective du devoir de loyauté en droit des sociétés” (2000) 125 *Les Petites Affiches* 7 at 13. The *Cour de cassation* has reaffirmed recently the duty of loyalty that directors owe to the corporation. In a decision of February 2002, the Court ruled that a director who had resigned his position breached his duty of loyalty toward the corporation by setting up a competing company before the expiration of the termination notice (Cass. com., 12.2.2002; JCP G, 2002, IV, 1535).

³⁶⁴ Jean-Jacques Daigre, “Le petit air anglais du devoir de loyauté des dirigeants” in Marie-Charlotte Piniot *et al*, eds, *Mélanges P. Bézard* (Paris: Montchrestien, 2002) 79 at 85 : “La jurisprudence française introduit peu à peu les obligations fiduciaires en droit français... [C]e rapprochement démontre que si les modèles de société anglais et français sont très différents et si la conception anglaise des devoirs des dirigeants sociaux, conception exigeante par son ampleur et sa profondeur, est encore loin de se retrouver en droit français, les zones de convergence n’en existent pas moins. Il est vrai qu’il ne faut pas exagérer les différences entre la *Common law* et la *Civil law*, qui tendent à s’estomper.”

³⁶⁵ Le Nabasque *supra* note 357 at 282. Daigre expressed a similar view: “[L]e fondement de l’obligation de loyauté du dirigeant envers les associés réside dans le pouvoir qui est reconnu à celui-ci, pouvoir détachée de toute base contractuelle... [L]e fondement du devoir de loyauté du dirigeant social réside dans sa qualité même de dirigeant.” (Daigre, *supra* note at 360 at 84).

³⁶⁶ Le Nabasque *supra* note 357 at 283: “[L]e devoir de loyauté en droit des sociétés... peut se définir comme l’obligation, pour les dirigeants de sociétés... de ne pas utiliser leurs pouvoirs (c’est l’affaire *K.*) ou les informations dont ils sont titulaires (c’est l’affaire *V.*) dans un intérêt strictement personnel et, préjudice oblige, contrairement à l’intérêt de la société ou à celui des associés.”

not pre-determined: it comprises a multitude of implicit duties which have not been expressly stipulated by law.³⁶⁷ This view appears to be confirmed by the *Cour de cassation*, which has fleshed out several specific duties binding on corporate directors, based on the general duty of loyalty: a duty not to compete with the corporation, a duty to disclose the direct or indirect personal interests that directors may have in a transaction, or a duty not to usurp corporate opportunities.³⁶⁸

Laurent Gordon proposed a similar view on the source of the duty of loyalty binding corporate directors. This duty springs “not from contract, but from ‘office’ [*fonction*].”³⁶⁹ The ‘office’ generates specific duties for the office-holder, and is, therefore, an autonomous source of duties. The duty of loyalty, therefore, is imposed by law on persons by virtue of their office or profession.³⁷⁰

The developing literature on the fiduciary duties of French corporate directors shows that French scholars tend to follow the Anglo-American understanding of the content of these duties. Although some commentators have pointed out that fiduciary duties are binding on holders of offices or of powers, they did not pursue their analysis further. They seem to rely, instead, on the traditional common law view, which holds that fiduciary duties mitigate the opposition of interests between the parties to a fiduciary relation. This approach could lead civilians to face the same conceptual difficulties that the common law scholar encounter when trying to understand the content

³⁶⁷ *Ibid.* at 284 : “[L]e devoir de loyauté est principalement un remède à la spécialité de la loi. Il est utile, comme en droit commun, parce qu’il génère des devoirs implicites, dont la sanction n’a pas été expressément prévue par le législateur.”

³⁶⁸ See Dominique Schmidt, *Les conflits d’intérêts dans la société anonyme* (Paris: Joly, 2004); Marco Corradi, “Les opportunités d’affaires saisies par les administrateurs de la société en violation du devoir de loyauté” (2011) 2 *Bulletin Joly Sociétés* 157.

³⁶⁹ Laurent Gordon, “Précisions quant au fondement juridique du devoir de loyauté du dirigeant social envers les associés” (2005) 1 *Revue des sociétés* 140: “La spécificité du devoir de loyauté du dirigeant social est alors de puiser sa source, non dans un contrat, mais dans une « fonction ».”

³⁷⁰ *Ibid.* at 149-150: “[La fonction] implique en effet de la part de celui qui l’assume certaines règles de conduite et constitue, par voie de conséquence, une source autonome de responsabilité... L’affirmation que le dirigeant de société est soumis à une responsabilité particulière de sa fonction correspond aussi au sens du mot « devoir » employé par la Cour de cassation pour désigner la loyauté qu’elle requiert expressément. Le terme « devoir » s’entend des obligations « que la loi impose... à une personne en raison de ses fonctions ou de sa profession. » Le « devoir » de loyauté du dirigeant pourrait donc légitimement être fondé sur la « fonction » elle-même.” (citing Gérard Cornu, ed., *Vocabulaire juridique*, 8e ed. (Paris: PUF 2007), s.v. devoir).

and the purpose of these duties. Consequently, an accurate understanding of what is a ‘conflict of interest’ and why the law prevents actual and potential conflicts will contribute to a better integration of fiduciary duties in both civil law and common law tradition.

3.6 Conclusion

Loyalty is a very dynamic concept in the French private law. Two main aspects of loyalty have emerged from recent doctrinal and jurisprudential developments: loyalty as a duty of fair dealing between equal parties pursuing their several or joint interests (the ‘contractual loyalty’), and loyalty of a person who has undertaken to act in the interests of another (the ‘fiduciary loyalty’). The general doctrinal tendency is to regard these two instances of loyalty as manifestations of varying intensity of a more fundamental principle, such as good faith, or predictability of jural relations.

Beyond this common foundation, contractual loyalty and fiduciary loyalty appear to evolve along different paths, given the particularities of the premises in which each of them arises. The doctrinal concerns with the fiduciary duty of loyalty appear to be fairly new in French law. Recent innovations, such as the recognition of a duty of loyalty binding on corporate directors or the introduction of *fiducie* opened up a window of dialogue between common law and civil law concerning fiduciary duties.

The aim of this chapter was to provide evidence that the concerns that fiduciary duties raise in the common law are not unique to this legal tradition. This survey of French law has shown that the problems and the lines of thought surrounding fiduciary duties are remarkably similar in both legal traditions. The general starting point of the discussions appears to be the situation where one person ‘takes charge’ of the interests of another in an open-ended relation. Both traditions struggle to articulate in a legally relevant manner the premise and the consequences of this *prise en charge*. A common view that emerges is that the proper starting point of the comprehension efforts should be the peculiar ‘position’ in which a person finds oneself

towards a determined or determinable second party. Both traditions recognize that such positions are not limited to those already established.

In general terms, a 'position' signifies that its holder undertook to offer a 'service' to another, which involves a certain discretion or leeway for decision-making. Both legal traditions have attempted to find a suitable framework for the decision-making process that would protect the other party to the relation, while not obstructing unnecessarily the first party's freedom of decision. Two common themes emerged with respect to the conduct of the first party: the requirement to act with due prudence and the requirement to act 'in the interests' of the second party. Both traditions struggle with identifying the dividing line between these two themes.

Concerning the requirement to act in the interests of the second party, a growing current of thought in both traditions tends to interpret it as a procedural, rather than substantial theme. The requirement to act for another is not a requirement to accomplish an act that could be put alongside the other obligations that the first party has. It is, instead, a requirement to observe a certain standard, or to follow a certain path when adopting a decision within the scope of the office. These similarities may be regarded with surprise or suspicion by jurists who believe that the equitable jurisdiction of the Court of Chancery created fundamental incompatibilities between the common law and the civil law of obligations. For those who believe that legal systems evolve along similar lines, these converging themes are indicators of a trans-systemic model of fiduciary duties that awaits to be revealed.

CHAPTER IV: CONFLICT OF INTEREST AND THE DUTY TO EXERCISE PROPER JUDGMENT

“Just as no one may be judge in his own cause, so a trustee can not be expected to utilize his best, most objective and disinterested judgment in situations where that judgment may run counter to his own interest. This observation... seems to be something of a constant in human affairs.” (Robert Hallgring, 1966)

4.1 Introduction

As explained in Chapter 2, the dominant fiduciary law theory (with which this dissertation disagrees) justifies the severity of the proscriptive duties based on the imbalance existing between parties to a fiduciary relation. This imbalance creates numerous opportunities for abuse by the dominant party, the fiduciary, and puts the weaker party ‘at the mercy of the other’s discretion.’ Because such abuses are difficult to discover, it is argued, the law must discourage firmly fiduciaries who may be tempted to abuse their superior power. The deterrence effect is ensured by strict standards of liability and far-reaching remedies. A specific aspect of the strictness of fiduciary liability is that courts have proven willing to solve questions of doubt against the fiduciary, with the aim to prevent sophisticated, undetectable abuses from remaining unpunished.

In contrast, several theories of fiduciary duties, insufficiently credited so far, point to a different explanation of the strictness of these duties. This explanation starts from a fundamental feature of a fiduciary position: the fiduciary’s discretion to decide where the best interests of the other party lie and how to advance them. The strict prohibitions to which the law subjects a fiduciary are not ends in themselves - they aim to protect a core duty. Although the formulation of this core duty varies across theories, its gist is that persons occupying a fiduciary position must exercise discretion or judgment according to certain standards (as opposed to deciding based solely on one’s free arbiter, within the limits of prudence and diligence). Consequently, it is argued that the law imposes strict prohibitions on fiduciaries to protect the performance of this core duty.

The connection between self-interest and proper exercise of discretion that this sub-set of theories of fiduciary duties advocates is a theme explored in detail by the emerging philosophical literature on conflicts of interest.³⁷¹ Building on empirical psychological and economic research, the recent works of philosophers (such as Michael Davis, John Boatright or Neil Luebke) and political theorists (such as Andrew Stark) contributed to the emergence of an interdisciplinary ‘standard view’ of the meaning of conflict of interest.

The philosophical ‘standard view’ is centred on the idea that the personal interests or preferences of a person in a position to exercise judgment in the service of another may affect the *reliability* and *credibility* of this person’s judgment, by interfering, consciously or subconsciously, with the person’s ability to give fair and genuine consideration to factors that are relevant in adopting a decision. When a decision requires judgment, extraneous interests could influence the decision process by tending to make the decision-maker’s judgment less reliable than it would normally be, without rendering it incompetent.

This philosophical view of conflict of interest is not completely novel to the legal approach to conflicts of interest. Although ‘conflict of interest’ has become a term of art only recently, the idea that self-interest interferes with the proper exercise of judgment has been present in the legal literature and court opinions since the earliest developments of the rules governing fiduciaries. The early references to the prohibition of being both decision-maker and interested party in the same matter (principle known as *nemo iudex in causa sua*), and the occasional mentioning of the weakness of the human mind, heart or conscience to resist the influence of self-interest, which occur in early fiduciary case law, convey the idea that self-interest impairs genuine judgment. Natural law philosophy recognized many centuries ago that one’s self-oriented feelings, such as greed, vanity or pecuniary interest can render that person’s judgment of conscience erroneous. Early in the development of rules concerning fiduciary law, however, the connection between a fiduciary’s personal interests and his exercise of judgment in

³⁷¹ ‘Philosophy’ is used here in a broad sense, to refer to the theoretical approaches to the notion of conflict of interest developed by researchers from various fields pertaining to humanities or social sciences.

another's service was overshadowed by 'deterrence' and 'evidentiary difficulties' as principal justifications of the existence and strictness of fiduciary duties.

The philosophical view of conflict of interest brings significant clarifications into the mechanism of adopting decisions on another's behalf and offers valuable tools for the advancement of the legal theory of fiduciary duties. Building on consistent empirical evidence, it demonstrates that personal interest tends to affect professional judgment in ways that are beyond the decider's control, and indeed beyond any form of objective assessment. This insight has far-reaching consequences as concerns the content and the purpose of fiduciary duties.

From a theoretical perspective, the 'standard view' could contribute in several ways to the creation of a solid conceptual foundation of fiduciary duties. First, it draws a firm line between, on the one hand, general situations where a person has the possibility to act opportunistically at another's expense, and, on the other hand, situations where self-interest (or other extraneous interest) is detrimental to the fulfilment of a core role or duty. The first situation is nothing more than a form of misappropriation, and is not, in itself, pertinent to the notion of conflict of interest. Only the second scenario represents a situation of conflict of interest, in a restrictive and technical sense. The implication for the theory of fiduciary duties is twofold: (i) the proscriptive duties exist and should apply only in connection with a core duty or role, involving exercise of judgment in the service of another; (ii) the *main* reason for proscribing *actual* conflicts of interest is the protection of the beneficiary's right to the fiduciary's best judgment. Its aim is not, as the contemporary dominant theory of fiduciary duties holds, to protect vulnerable beneficiaries against abuse.

Second, the standard view explains the reprehensibility of *potential* conflicts of interest with arguments that are compatible with private law theory. Potential conflicts must be strictly prohibited not because private law should aim to discipline potentially errant fiduciaries, but because it is impossible to determine if, and to what extent, the existence of a potential interest for a fiduciary in relation to the outcome of his judgment, will affect the reliability of such judgment. The prohibition of potential conflicts aims to

prevent the risk of impaired judgment, rather than to discipline fiduciaries by the threat of severe liability. The same rationale applies to concurrent duties to exercise proper judgment that a fiduciary owes pursuant to different fiduciary relations. The prohibition of a duty-duty conflict is justified by the same idea: the need to protect beneficiaries against the risk of undermined judgment.³⁷²

The theoretical model of fiduciary duties built on the standard view of conflicts of interest has important practical consequences. First, the focus on proper exercise of judgment shows that there is more to the duties specific to a fiduciary than avoiding or managing conflicts. Even in the absence of actual or potential conflicts of interest, fiduciaries are still under a duty to exercise appropriate judgment on behalf of another. This duty requires them to take into consideration relevant factors and to discard irrelevant factors in exercising judgment.

Second, the new theoretical approach offers a more sophisticated response to actual or potential situations of conflict. The proposition that *having* a conflict of interest is always wrong is inaccurate. A fiduciary can have a conflict situation without being in the wrong. How he *responds* to the situation of conflict determines if he should be subjected to legal liability or not. The proscriptive duties should be reformulated as including a *duty not to place oneself* in a situation of conflict, and a *duty to manage* a conflict of interest (by eliminating it, disclosing it, or addressing it in other ways). A plain requirement to *avoid* situations of conflict of interest is insufficient.

Another practical consequence of a profound understanding of the essential elements of a conflict of interest concerns the appearance of a conflict. In contrast with *potential* conflict situations, *apparent* conflicts do

³⁷² In *R v Neil* Binnie J. of the Supreme Court of Canada defined conflict of interest in the legal profession by referring to the *risk* that the lawyer's self-interest or a duty of loyalty that he owes to another client pose to the proper exercise of the lawyer's core duty. Lawyers, as fiduciaries, must avoid conflicts that generate a "substantial risk that the lawyer's representation of the client would be materially and adversely affected by the lawyer's own interests or by the lawyer's duties to another current client, a former client, or a third person" *R v Neil*, [2002] 3 SCR 631 at para 31, adopting the definition of conflict of interest elaborated by the American Law Institute. See American Law Institute, *Restatement Third, The Law Governing Lawyers*, vol. 2. (St. Paul, Minn.: American Law Institute Publishers, 2000). The same definition was applied by Rothstein J in *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd.*, [2011] 2 SCR 175 at [151].

not involve circumstances in which fiduciary's judgment can reasonably be presumed to be distorted (consciously or subconsciously) by extraneous interests. Apparent conflicts are situations that may be perceived by beneficiaries or third parties as creating an actual or potential conflict, without reasonable grounds. While maintaining the public confidence in the decision-making process of professional fiduciaries is an important matter, avoidance of *appearances* cannot be a requirement imposed by fiduciary duties. Since no actual or potential threat to the reliability of fiduciary's judgment is at stake, appearances of impropriety cannot receive the same legal treatment as potential or actual conflict situations.

Regulating the way in which persons adopt decisions on behalf of another in private law relations has proven to be a very difficult exercise, both in terms of conceptual clarity and practical legal prescriptions. Approaches such as correcting one's conscience, requiring altruism, penalizing mere temptations or disciplining through severe remedies failed to create a cogent theory of fiduciary duties. Modern psychological and philosophical research on the mechanism of adopting decisions sheds new light on the direct and indirect ways in which personal interests can affect the reliability and credibility of one's judgment. These new insights represent a solid foundation on which a private law theory can be built. A new theory of fiduciary duties based on the philosophical view of conflict of interest not only brings clarity into common law traditions, but also opens a new avenue of research in comparative fiduciary obligations. With roots in natural law philosophy, and supported by modern social sciences research, fiduciary duties should no longer be regarded as a product of Equity that is alien to civilian traditions. Properly understood, fiduciary duties belong to the universal *fonds commun* of legal concepts.

4.2 Conflict of interest and proper exercise of judgment: a philosophical approach

4.2.1 'Conflict of interest' as term of art in contemporary philosophy

The imprecise understanding of what a situation of conflict of interest involves is one of the foremost problems of fiduciary law theory. As Chapter 2 amply illustrates, the contemporary legal literature on fiduciary duties is premised on the dual assumption that, on the one hand, humans are inclined to act self-interestedly and, on the other hand, they are too weak to resist the urge of acting opportunistically while administering another's affairs. Throughout the past two centuries, these assumptions have been perpetuated by courts and commentators, without any relevant attempt to question their relevance for the justification of fiduciary duties. Although these assumptions may be true in many cases of breach of fiduciary duties, they do not suffice to explain why fiduciary duties are imposed in situations where the fiduciary's honesty cannot be questioned. A deeper investigation of the insidious effects that personal interests have on the objectivity of a person's judgment appears to be essential for an accurate legal theory of deciding on behalf of another.

Academic lawyers and legal practitioners may be reluctant, and indeed ill-equipped, to incorporate specialized knowledge concerning patterns of deviation in judgment or to use technical concepts of cognitive sciences. Such a detailed enquiry, fortunately, is not necessary. Fiduciary law is concerned only with a very specific scenario in which a legal actor's behaviour is at risk of being affected by perceptual distortion or inaccurate judgment. This scenario requires a legal duty to exercise discretion over another's interests. The law's concern with factors that may impair a decision maker's judgment is circumscribed by the need to protect the right that the person on whose behalf the decision is adopted has to a reliable judgment. Even in this strictly defined context, the law's regulatory power is limited. Not all decisions that a fiduciary adopts and not all interests that may influence judgment can be subject to fiduciary duties.

Delineating the precise boundaries of 'conflict of interest' as a legal concept is a challenging task. How can 'judgment' be defined? What kind of

interest can be regarded as interfering with judgment in a legally relevant way? In order to answer these questions, legal theorists can draw inspiration from the recent philosophical theories on conflict of interest.

In the latter half of the twentieth century, a “minor revolution” took place in the philosophical understanding of conflict of interest and the most appropriate strategies to manage it.³⁷³ Breaking off with the traditional view, which advocates the resolution of conflicts between interest and duty by resisting the temptation of selfish acts, the new theory reveals that ‘interests’ can affect the judgment of even the most honourable and disciplined persons. Consequently, management of conflict situations, rather than abstention, is the desirable course of action:

[The] traditional ethical schools of thought were inclined to think that the only morally relevant prescriptive advice in what we are now calling ‘conflict-of-interest situations’ would be to instruct the ‘conflicted’ individual to resist temptation, maintain objectivity and carry out his or her duty. *What we now recognize is that this response is naïve*: conflicted individuals can have their judgment interfered with even when they try their best to ‘correct’ for the influence of the conflicting interest... In many cases they may not even be aware of the influence some source of bias may have over them...³⁷⁴

In other words, the traditional ethical view of conflict situations adopted a virtue-centric approach. A person faced with a choice between interest and duty was expected to do the right and honourable thing and to resist the temptations of selfishness. As long as this person has remained virtuous and fulfilled his primary duties, nothing morally wrong occurred.³⁷⁵ The main flaw of this view is that it overestimates the ability of conflicted individuals to know if their judgment has been affected by the interfering interest. The modern view overcomes this flaw by recognizing that a person is in a conflict of interest on the basis of being in a conflicted situation, irrespective of the person’s belief that he is capable of resisting the

³⁷³ Wayne Norman and Chris MacDonald, “Conflicts of Interest” in George Brenkert and Tom Beauchamp, eds., *The Oxford Handbook of Business Ethics* (Oxford: Oxford University Press, 2010) 441 at 459 (hereinafter ‘Norman and MacDonald’).

³⁷⁴ *Ibid.* at 461.

³⁷⁵ *Ibid.* at 447.

temptation or corrupting influence of the interest that could interfere with his judgment.³⁷⁶

The traditional ethical view of conflict situations coincides with the dominant legal justification of fiduciary duties. In both fields, how a person responds to a situation of conflict tends to be regarded exclusively as a matter of incentives and conscious choice: the rightful course of action is to resist temptation, while the wrongful option is to act opportunistically. Similar recent developments can be observed in the two fields addressing conflicts of interest. In both law and philosophy, modern theorists propose a more sophisticated view of the dangers that a conflict situation creates and of the appropriate course of action for responding to such a situation.³⁷⁷

The contemporary philosophical theories of conflict of interest are built on recent developments concerning decision-making processes made in cognitive sciences. It has been demonstrated that interests affect the way in which a person evaluates the seriousness of various risks, the desirability of certain outcomes, or the perception of connections between cause and effect. Consequently, conflicts of interest are reprehensible not because they create a *measurable* bias, but because they create an “unusual *risk* of error,”³⁷⁸ thus rendering one’s judgment less reliable. Convincing empirical evidence of the insidious ways in which interests can affect the reliability of judgment has been obtained only very recently:

We now realize much more clearly, however, that conflict of interest situations pose a problem even when they are not exploited in corrupt ways. This is in part because conflicting personal and even professional interests can impair the judgment of even the most

³⁷⁶ *Ibid.* at 461.

³⁷⁷ See Don A. Moore, Lloyd Tanlu and Max H. Bazerman “Conflict of Interest and the Intrusion of Bias” (2010) 5 *Judgment and Decision Making* 37 at 46-47, emphasis added: “In analyzing the problem of conflict of interest in business, both the mass media and the academic literatures in business, accounting, and law routinely assume that bias is a matter of deliberate choice... Bias, to the extent that it exists, must, in this view, be a deliberate response to incentives. *This ‘economic’ account of conflict of interest is challenged by psychological research which suggests that biased information processing is not only pervasive, but is typically unconscious and unintentional* - i.e., seldom a matter of deliberate intentional choice... [P]rofessionals who face conflicts of interest may find it difficult, if not impossible, to simply choose objectivity.”

³⁷⁸ Michael Davis, “Conflict of Interest” in Ruth Chadwick, ed., *Encyclopedia of Applied Ethics*, vol. 1 (London: Academic Press, 1998) 589 at 589, emphasis added.

dedicated and conscientious expert. We have had *solid empirical evidence* of this only in the past decade or two.³⁷⁹

The literature on cognitive and motivational biases provides detailed theoretical and empirical information on the ways in which personal interest can interfere with the judgment or motivation of a person. The philosophical understanding of the ways in which interest affects judgment is based on a long-standing distinction drawn by psychologists between two different modes of information processing that characterize human cognition. On the one hand there are ‘automatic’ processes that are relatively effortless and unconscious. On the other hand, there are ‘controlled’ processes, more analytical and more effortful. Automatic and controlled processes often act in concert to produce judgments and decisions, but in certain predictable situations they can come into conflict. In the case of professionals, the two different modes of thinking are illustrated by two different sets of ‘motives’: professional responsibilities and personal interests. As is the case of automatic and controlled processes, these motives often coincide and reinforce each-other. When professional responsibilities and self-interest point in opposite directions, however, self-interest exerts a more automatic influence than professional responsibilities, which are more likely to be governed by controlled processing. Since automatic processing tends to occur outside of conscious awareness, its influence on judgment and decision making is difficult to eliminate or correct entirely. Consequently, self-interest often prevails, even when decision-makers consciously attempt to comply with the rules regulating their role or profession.³⁸⁰

³⁷⁹ Norman and MacDonald, *supra* note 373 at 464, emphasis added. See also Don A. Moore and George Loewenstein, *infra* note 380 at 189, emphasis added: “The role played by cognitive factors has been largely ignored in the academic literature on conflict of interest, which has been dominated by academics who adhere, more or less closely, to a rational choice perspective... [S]uccumbing to a conflict of interest - putting one’s own interests above professional responsibilities - has been viewed, in the media, by the public, and by academics, as a matter of deliberate corruption. The evidence reviewed here, however, is consistent with the conclusion... that the violations of professionalism induced by conflicts of interest often occur automatically and without conscious awareness.” Therefore, “[d]eterrence of misbehaviour using the threat of legal punishments is a clumsy public policy tool for achieving the goal of strengthening professional norms.”

³⁸⁰ See Don A. Moore and George Loewenstein, “Self-Interest, Automaticity, and the Psychology of Conflict of Interest” (2004) 17 Social Justice Research 189 at 190-199; Daniel Kahneman, and Amos Tversky, “Judgment under Uncertainty: Heuristics and Biases” (1974) 185 Science 1124-1131, reprinted in Daniel Kahneman *et al.*, eds, *Judgment under*

Although the empirical research and the philosophical approaches to cognitive and motivational biases are very recent,³⁸¹ a core body of knowledge has been accumulated. These developments are extremely useful for understanding the phenomenon that fiduciary law aims to address, and on shaping rules that are likely to be effective in dealing with it.

4.2.2 The ‘standard view’ on conflicts of interest

The contemporary philosophical preoccupation with the appropriate understanding of a conflict of interest situation was triggered in early 1980s by the innovative work of Michael Davis.³⁸² The most relevant subsequent attempts to clarify this concept were framed explicitly in reaction to Davis’ theory. As a result of these debates, several features of a conflict of interest situation have emerged as largely accepted, forming the basis of a ‘standard view’ of conflict of interest.³⁸³ It is important to note from the beginning that the main purpose of the ‘standard view’ is to determine the moral or ethical consequences of a conflict of interest. Fiduciary law theory, instead, is concerned with understanding the existing legal rules regulating conflicts of interest in private law. Despite its specific objective, the philosophical standard view can help legal scholars acquire an in-depth understanding of the ways in which a situation of conflict of interest affects the conflicted person.

The standard view rejects as superficial the identification of a conflict of interest situation with the principal-agent problem, which has dominated the philosophical and legal literature of conflicts of interest of the past

Uncertainty: Heuristics and Biases (Cambridge: Cambridge University Press, 1982) 3-20; Bernard Lo and Marilyn J. Field, eds., *Conflict of Interest in Medical Research, Education, and Practice* (Washington, D.C.: National Academies Press, 2009).

³⁸¹ Norman and MacDonald, *supra* note 373 at 459: “We cannot stress enough the fact that these are still very early days for this cognitive-bias research, and especially for its application to problems of conflict of interest and institutional design. All we hope to have provided here is a hint and a sketch of how potentially useful this kind of research could be for our understanding of conflicts of interest and their management.”

³⁸² Michael Davis, “Conflict of Interest” (1982) 1 *Business and Professional Ethics Journal* 17.

³⁸³ The ‘standard view’ on conflict of interest was articulated by Michael Davis based on the work of scholars from various fields (philosophy, political theory, ethics, law). See Michael Davis, “Introduction”, in Michael Davis and Andrew Stark, eds., *Conflict of Interest in the Professions* (Oxford: Oxford University Press, 2001) 3-19.

decades.³⁸⁴ The principal-agent problem (or agency problem) arises when the goals of the principal and those of the agent diverge, and it is costly or impracticable for the principal to monitor the agent's actions.³⁸⁵

In the standard view, a person has a conflict of interest if:

- (a) he is in a relationship with another requiring him to *exercise judgment* in that other's service and
- (b) he has an interest *tending to interfere* with the proper exercise of judgment in that relationship.³⁸⁶

Based on this generally-accepted definition, three elements emerge as essential for a situation of conflict of interest: relationship, judgment and interest. The following part of this section will outline the interpretation of

³⁸⁴ "[T]here is generally assumed to be a difference between a true 'conflict of interest situation' and a generic 'principal-agent' problem. It may be that most conflicts of interest can be conceived of as involving at least one agent... and at least one principal. But nobody who takes the concept of 'conflict of interest' seriously will want to conflate the conflicts of interest and generic principal-agent problems..." (MacDonald and Norman, *supra* note 373 at 446).

³⁸⁵ See generally Michael C. Jensen, "Organization Theory and Methodology" (1983) 58 Accounting Review 319-339; Neil R. Luebke, "Conflict of Interest as a Moral Category" (1987) 6 Business and Professional Ethics Journal 66 at 77). Although the standard view of conflict of interest has become established, some ethics theorists continue to use conflict of interest to refer to situations of *conflicting interests*, rather than conflict between interest and judgment. See e.g. Archie B. Carroll, "Ethics in Management" in Robert Frederick, ed., *A Companion to Business Ethics* (Oxford: Blackwell Publishers, 1999) 141 at 145: "Virtually all ethical issues managers face may be characterized as a conflict of interest. The conflict usually arises between the manager's own values or ethics and those of his employer, employees or some other stakeholder group which has an interest in the decision."; O. C. Ferrell et al., *Business Ethics: Ethical Decision Making and Cases*, 7th ed. (Boston: Houghton Mifflin, 2008) 67: "A conflict of interest exists when an individual must choose whether to advance his or her own interests, those of the organization, or those of some other group."

³⁸⁶ Michael Davis, "Conflict of Interest", *supra* note 382 at 21, emphasis added. Davis formulated this definition based on the approach to conflicts of interest developed in legal ethics: "[T]o generalize the analysis... we need to replace being-someone's-lawyer with the appropriate category of which being-someone's-lawyer is a special case... [B]eing-someone's-lawyer [is]... a special case of relationships-between-persons-requiring-one-to-exercise-judgment-in-the-other's-service." (*ibid.* at 21).

John Boatright defined a conflict of interest as a situation in which "a personal interest interferes with a person's acting so as to promote the interest of another when the person has an obligation to act in that other person's interest." (John R. Boatright, "Conflict of Interest: An Agency Analysis" in Norman E. Bowie and R. Edward Freeman, eds., *Ethics and Agency Theory: An Introduction* (New York: Oxford University Press, 1992) 187 at 191). In contrast with the definition adopted by the standard view, Boatright's approach does not focus on judgment, but on the person's *ability to act* in another's interest.

these elements proposed by the standard view theorists and by several other philosophers holding diverging views. The purpose of this outline is to show that the philosophical discussions concerning the circumstances in which a conflict of interest situation arises are very similar to the legal theory debates on fiduciary relations. First, both philosophy and legal theory recognize that the situations of conflict of interest are not restricted to a pre-defined list of ‘established’ relations of positions. The category of persons to which the rules on conflict of interest apply is defined not by a certain role (such as that of member of a profession), but by a central feature that characterizes the person’s situation (‘undertaking’ and ‘power’ in fiduciary law theory and ‘authority to exercise judgment’ in philosophy). Second, both law and philosophy emphasize that ‘judgment’ or ‘discretion’ is essential in order for conflict of interest rules to apply. Both ‘judgment’ and ‘discretion’ are used to refer to the scope that one person has for deciding how to affect another person’s interests. Finally, in both law and philosophy ‘interest’ is an open-ended concept. At its core we find the decision-maker’s financial or material interests – whenever he has such interests in the outcome of his judgment, a situation of conflict of interest occurs. Furthermore, both fields recognize that duties to exercise proper judgment arising from different fiduciary relations (or conflicting loyalties) may generate a situation of conflict. Beside these core interests that affect the proper exercise of judgment, determining what amounts to a conflicting interest is a question to be answered based on the context in which the specific decision will be taken.

A. ‘Relationship’

In the standard view, the relations that can create a situation of conflict of interest are not limited to positions with respect to which there are established rules against conflicts, such as members of professions or public officials.³⁸⁷ The rules against conflicts of interest applicable to these roles are

³⁸⁷ Norman and MacDonald, *supra* note 373 at 448: “It is worth making clear that although we typically discuss the concept of conflict of interest with examples involving professionals, one does not have to be a bona fide professional to have a conflict of interest. The ideas of professionalism and conflict of interest are linked primarily because... all professions explicitly make the management of conflict of interest a central feature of their professional codes of ethics... [M]odern corporations routinely place individual managers in

more visible because, on the one hand, such roles involve exercise of professional judgment or official discretion and, on the other hand, the maintenance of a good public image of such office holders is essential. Despite the close association between ‘conflict of interest’, on the one hand, and ‘public officials’ or ‘members of a profession’, on the other hand, the standard philosophical view applies to all persons who have a duty to exercise judgment or discretion in another’s service: “‘Judgment’, not ‘role’ is the crucial term.”³⁸⁸

Although the ambit of the standard view is broad, the proponents of this view recognize that determining the existence of a duty or authority to exercise judgment on another’s behalf outside the traditional roles may be a difficult exercise. Relations that are well-defined by rules, express agreement or custom do not raise significant difficulties. Relations that are ill-defined, however, are closer to the borderline, and a very close examination of factual elements is required in order to determine the existence of authority to exercise judgment on another’s behalf.³⁸⁹

Fiduciary law theory has a similar understanding of relations where fiduciary duties are imposed. In the ‘established’ or *per se* fiduciary relations the rules against conflict of interest are presumed to apply. In new circumstances, or *ad hoc* relations, the no-conflict duties become applicable if the required central elements are proven to exist.³⁹⁰

B. ‘Judgment’

‘Judgment’ is a central notion in the standard view of conflict of interest. Fundamental to the notion of conflict of interest is that someone’s

situations where they are expected to exercise judgment in matters that require considerable expertise, including expertise that both their superiors and clients may find difficult to evaluate. Such managers will typically not be members of a bona fide profession (like law or accounting) with its own code of ethics, but their employers will be just as concerned as a professional association would be about ways the private interests of these managers might compromise their expert judgment or expose the firm to accusations of corruption, favouritism or unprofessionalism.”

³⁸⁸ Michael Davis, “Conflict of Interest”, *supra* note 382 at 22.

³⁸⁹ *Ibid.* at 23.

³⁹⁰ For more details on the necessary and sufficient elements see Chapter 1 above.

ability to exercise proper judgment is at risk of being affected by a personal interest or by a competing duty to exercise proper judgment.³⁹¹

The concept of ‘judgment’ denotes the existence of discretion, in the sense of absence of a pre-defined script or algorithm based on which a decision can be modelled. In a situation requiring the exercise of judgment, the specification of the *problem* to be solved or the *ends* to be achieved are contested, or open to interpretation.³⁹² In contrast, decisions that do not require judgment are routine, mechanical or ministerial - “they have (something like) an algorithm.”³⁹³ Ministerial decisions require only ‘technical’ rationality. Specific theories or techniques are available to determine the most appropriate way to achieve, pre-defined unambiguous goals.

Given the absence of a pre-defined pattern regarding the ends to be attained and the means to achieve them, exercise of judgment goes beyond mechanical rule-following and entails “the ability to make certain kinds of

³⁹¹ Norman and MacDonald, *supra* note 373 at 455. See also W. Bradley Wendel, “The Deep Structure of Conflicts of Interest” (2003) 16 Georgetown Journal of Legal Ethics 473 at 477, emphasis added: “A conflict of interest arises when a person (the agent) stands in a relationship of trust with another person (the principal) that requires the agent *to exercise judgment* on behalf of the principal, and where the *agent’s judgment is impaired* because of another interest of the agent.”; William H. Shaw, *Business Ethics: A Textbook with Cases*, 7th ed. (Boston, MA: Cengage Learning, 2010) 388, emphasis added: “When in a certain situation an employee’s private interests... are likely to interfere with the employee’s *ability to exercise proper judgment* on behalf of the organization, a conflict of interest exists.”; Manuel G. Velasquez, *Business Ethics: Concepts and Cases*, 5th ed. (Upper Saddle River, NJ: Prentice Hall, 2002) 448, emphasis added: “Conflicts of interest in business arise when an employee or officer of a company is engaged in carrying out a task on behalf of the company and the employee has a private interest in the outcome of the task that is... substantial enough that it does or reasonably might affect the *independent judgment* the company expects the employee to exercise on its behalf.”; Dennis F. Thompson “Understanding Financial Conflicts of Interest (1993) 329 New England Journal of Medicine 573 at 573, emphasis added: “A conflict of interest is a set of conditions in which *professional judgment* concerning a primary interest (such as patient’s welfare or the validity of research) tends to be unduly influenced by secondary interest (such as financial gain)””; Patricia Werhane and Jeffrey Doering, “Conflicts of Interest and Conflicts of Commitment” (1995) 4 Professional Ethics 47 at 51, emphasis added: “What distinguishes conflict of interest situations is that the conflict is between what one is trusted or expected to do in one’s role (with its duties)... and financial or personal influences or interests that will or could *compromise one’s professional judgment* and behaviour in that role.”

³⁹² W. Bradley Wendel, *supra* note 391 at 479-480.

³⁹³ Michael Davis, “Conflict of Interest”, *supra* note 378 at 590.

decisions correctly more often than would a simple clerk with a book of rules... and only the same information.”³⁹⁴

Judgment entails knowledge, skill and insight, and the interactions of these factors can produce unpredictable results. When a decision requires judgment, different decision-makers may disagree on the ends to be pursued and on the optimal course of action, without anyone being wrong in an objective, measurable sense.³⁹⁵ In this scenario, a situation of conflict of interest impairs the decider’s capacity to evaluate the possible ends and other matters of judgment, but it does not affect his overall level of competence.

Extraneous interests interfere with judgment not as ends that a decision-maker has in view, but as factors that tend to influence the ends in view (i.e. promoting another’s interests).³⁹⁶ In other words, the standard view does not start from the premise that a person who must exercise judgment for another yields to temptation and decides to pursue his own interests. It is based, instead, on the idea that the presence of such interests puts at risk the decision-maker’s ability to evaluate the weight to be given to the relevant considerations on which the decision is based.

Not all theorists share the view that impairment of judgment is the central element of a conflict of interest. John Boatright contended that the notion of ‘conflict of interest’ should not focus on exercising judgment, but on the ability to fulfil a general duty that one has to act in another’s interest.³⁹⁷ In another view, proposed by Neil Luebke, the trust that one party

³⁹⁴ Michael Davis, “Introduction”, *supra* note 383 at 8; see also Michael Davies, “Conflict of Interest Revisited”, Michael Davies, “Conflict of Interest Revisited” (1993) 12 Business & Professional Ethics Journal 21 at 21.

³⁹⁵ Michael Davis, “Introduction”, *supra* note 383 at 8: “Where judgment is necessary, different decision-makers, however skilled, may disagree without either being clearly wrong.” See also Michael Davis, “Conflict of Interest”, *supra* note 382 at 22: “Judgment implies discretion... A bank president does not need judgment to decide whether she (as president) should embezzle the bank’s money... In contrast, a critic needs judgment to decide how good a play or actor is.”

³⁹⁶ Michael Davis, “Introduction” *supra* note 383 at 9-10: “On the standard view, interests are not ends in view as much as factors tending to shape the ends that one has in view... What conflict of interest affects are the ends in view, the evaluation of this or that means, and other matters of judgment within the bounds of competence.”

³⁹⁷ See John R. Boatright, “Financial Services” in Michael Davis and Andrew Stark, eds., *Conflict of Interest in the Professions* (Oxford: Oxford University Press, 2001) 217 at 219, emphasis added, footnotes omitted: “A conflict of interest occurs when a personal or institutional interest *interferes with the ability* of an individual or institution *to act in the interests of another party*, when the individual or institution has an ethical or legal obligation to act in that other party’s interest.” In another recent work, however, Boatright appears to

reposes in another is the central element that the rules concerning conflicts of interest aim to protect.³⁹⁸ Another philosopher, Thomas Carson, argued that a situation of conflict involves an opposition between the duties that one person has by virtue of holding an office or a position, and that person's individual interests.³⁹⁹

The divergence of philosophical views on the notion of conflict of interest mirrors the legal theory debates on the purpose of fiduciary duties.⁴⁰⁰ Although the philosophical definitions differ with respect to the relevance of 'exercise of judgment' or 'fulfilment of duty to act in another's interest', at a very general level they share the core idea that a 'conflict of interest' opposes interest and proper fulfilment of a role. None of these definitions appears to regard conflict of interest as conflicting interests.

At minimum, the philosophical understanding of conflict of interest could assist fiduciary law theory by clarifying that concerns with misappropriation or abuse of position are not specific to conflict of interest situations. More importantly, however, the standard view of conflict of interest, which is the predominant philosophical approach, provides an essential clarification of the issues at stake in a conflict of interest: the interests that create a risk to proper judgment are not ends that the decision-maker has in view, *but factors that tend to influence his evaluation of the*

endorse indirectly the primacy of judgment for the existence of a conflict situation, by linking the ability to act in another's interests with the proper exercise of judgment. See John R. Boatright, "Finance Ethics" in Robert Frederick, *ed.*, *A Companion to Business Ethics* (Oxford: Blackwell Publishers, 1999) 153 at 156: "A major source of unethical conduct by fiduciaries and agents is conflict of interest, in which a personal interest of the fiduciary or agent interferes with the ability of the person to act in the interest of the other person. Fiduciaries and agents are called upon to exercise judgment on behalf of others, and *their judgment can be compromised* if they stand to gain personally by a decision."

³⁹⁸ See Neil R. Luebke, "Conflict of Interest as a Moral Category" (1987) 6 *Business and Professional Ethics Journal* 66 at 74: "Davis sees the interest as merely one possible cause of incorrect judgment. To my mind, the moral issue is trust, not correctness. The appropriate question a client might raise is 'Can I *trust* X to give me good advice?' not 'Can I trust X to give me *good* advice?' ... A client concerned with correctness might seek several opinions; a client concerned with trust examines reputation and commitments."

³⁹⁹ Thomas L. Carson, "Conflicts of Interest and Self-Dealing in the Professions: A Review Essay" (2004) 14:1 *Business Ethics Quarterly* 161 at 164-16: "In order for there to be a conflict of interest, the following conditions must be met: 1. There must be an individual (I) who has duties to another party (P) in virtue of holding an office or a position, 2. I must be impeded or compromised in fulfilling her duties to P, 3. the reason for I's being impeded or compromised in fulfilling her duties to P must be that she has interests that are incompatible (or seem to her to be incompatible) with fulfilling her duties to P."

⁴⁰⁰ See Chapter 2 above.

ends in view. Personal material interest is the clearest example. The possibility of obtaining a personal unauthorized material gain as a result of a decision creates a situation of conflict, although the decision-maker does not consciously pursue his own material interests. The mere presence of the possibility of such a benefit affects the reliability of the decider's evaluation of the relevant factors on which he bases his decision. If a decision-maker consciously acts with a view to obtaining an unauthorized benefit, not only he exercises judgment inappropriately, but he also steals or misappropriates.

The distinction between ends in view and factors that tend to influence the ends in view is essential for understanding the relation between the no-conflict duties and the duty to exercise proper judgment proposed by this dissertation. The no-conflict duties aim to prevent the core duty to exercise proper judgment by keeping at bay factors that may distort fiduciary's exercise of judgment unconsciously. The core 'proper judgment' duty requires the fiduciary to base his decision only on relevant factors. The list of such factors excludes *ab initio* his personal interest (including the interests of another person to whom he owes a duty to exercise proper judgment). If personal interest is consciously pursued, the fiduciary is in breach of both the proscriptive duties and the core duty.

C. Interest

'Interest' is the third essential concept for the standard view of conflicts of interest. Since perturbing interests affect the decision-making process as factors that tend to influence the ends in view, the extent of the effect of such interests on one's judgment cannot be assessed based on the actual decision taken. Because the decision-maker is the person who is charged with deciding the appropriate course of action, one cannot simply measure the deviations from a 'right' decision, which the interfering interest had caused.⁴⁰¹ A decision adopted in a situation of conflict is inherently

⁴⁰¹ To illustrate how interests affect judgment, Davis compared a conflict situation to dirt in a sensitive gauge. The dirt causes the gauge to work unpredictably, thus affecting its reliability (Michael Davis, "Conflict of Interest", *supra* note 378 at 591). Because interests affect judgment in unpredictable ways, "courts are incapable of measuring the extent to which [the

flawed, despite the conflicted person's willingness to put aside personal interests and ideological commitments. Since the effect of a conflict of interest cannot be assessed based on results, the theories of conflict of interest focus on certain kinds of identifiable interests that are particularly threatening to the exercise of judgment, such as material interests or family ties. The categories of interfering interests, however, should not be considered closed:

On the standard view, an interest is any influence, loyalty, concern, emotion, or other feature of a situation tending to make [the decision maker's] judgment (in that situation) less reliable than it would normally be, without rendering [it] incompetent... What in fact constitutes a conflict of interest is an empirical question... It is therefore a mistake (on the standard view) to make a list of what constitutes relevant interests.⁴⁰²

Although in the standard view 'interest' is an open-ended concept, it does not include just any factor that might compromise one's judgment. First, it excludes factors that may impinge upon one's level of professional competence. Second, not all personal preferences can be set aside. Decision-makers cannot be required or expected to transcend all aspects of their

decision-maker's] decisions deviate from the true public interest, and then [use] that deviation as an indicator -a proxy- of the extent to which [the decision maker's] judgment may have been impaired." (Andrew Stark, *Conflicts of Interest in American Public Life* (Cambridge, MA: Harvard University Press, 2000) 21, referring to judicial review of administrative decisions). Consequently, the law must intervene to prevent disturbances of judgment that cannot be assessed: "[B]ecause we do not have an ex ante perspective from which to reach judgments about what the right decision would be... the law is forced to reach 'tainted' mental states anterior to the affected decision...; the law instead regulates visible, objective bad acts that are thought to create corrupt mental states or temptation to corruption. There is a subtle irony at work here because the law governing conflicts first looks to mental states, instead of to concrete decisions, because of the impossibility of specifying the [beneficiary's] interest in advance, and then moves back to concrete phenomena such as financial transactions with interested parties, because of the impossibility or undesirability of regulating mental states." (W. Bradley Wendel, *supra* note 391 at 481-482 footnotes omitted).

⁴⁰² Michael Davis, "Introduction", *supra* note 383 at 9-10. Andrew Stark adopted a similarly broad interpretation of the notion of interest. The set of factors that can affect the judgment of public officials stretches beyond the material (or financial) interest, to include "influences, loyalties, concerns, emotions, predispositions, prejudgments, animuses, biases, affiliations, experiences, relationships, attachments, moral constraints, [and] ideological agendas." (Andrew Stark, *supra* note 401 at 119). All these factors "at one time or another have been viewed as every bit as encumbering on official judgment as pecuniary interest itself." (*ibid.*). Luebke contended that a broad interpretation of 'interest' makes the concept of 'conflict of interest' overly vague. In Luebke's view 'conflict of interest' should refer solely to material or objective interests (such as financial gains or family relations), rather than including subjective interests, such as personal desires, affections or preferences (Neil R. Luebke, *supra* note 398 at 67-74).

subjectivity and act like de-humanized, deciding machines. It is not psychologically feasible to divest oneself entirely of interests that are constitutive of one's personhood. Some subjective preferences may be harmless: not every decision that a person makes on another's behalf is influenced by every interest, and not every interest renders judgment unreliable.⁴⁰³

A prohibition of *all* subjective beliefs, commitments, and loyalties is not only unfeasible, but it goes against the core idea of exercise of discretion. The combination of personal characteristics that is specific for each decision-maker accounts for the diversity of equally-valid results that can occur in a situation involving discretion.⁴⁰⁴ Consequently, a line needs to be drawn between legitimate factors that influence the decider's judgment and factors that have the ability to create a conflict of interest. In Stark's terms, the interests that should be encompassed by the notion of conflict of interest are those which create a normatively significant influence on the decider's judgment.⁴⁰⁵

Although what amounts to 'normatively significant' interest is open to debate, the standard view seems to limit 'interest' to factors that are able to affect the reliability of a decision-maker's judgment by their simple existence as potentiality. This idea is known to public law legal theorists as bias (or risk of bias).⁴⁰⁶ From the perspective of fiduciary law theory, the interests that conflict with the proper exercise of judgment include any interest (or conflicting core fiduciary duty) that has the potential to affect unconsciously the proper exercise of judgment. If an irrelevant factor is consciously taken into account in the decision-making process, then the fiduciary is in breach of the core duty to exercise proper judgment. The two sets of factors or interests ('biasing' factors and irrelevant factors) overlap, but are not identical. Some factors (such as personal interest) are both biasing and irrelevant. Other factors (such as the interests of a third person to whom the fiduciary does not owe a core fiduciary duty, or fiduciary's political or moral views) that are

⁴⁰³ Michael Davis, "Introduction" *supra* note 383 at 10.

⁴⁰⁴ Andrew Stark, *supra* note 402 at 241; W. Bradley Wendel, *supra* note 391 at 486-487.

⁴⁰⁵ Andrew Stark, *supra* note 402 at 119-120.

⁴⁰⁶ See *infra*, Section 4.3.

consciously taken into account vitiate the decision-making process in a different way. Rather than creating a risk of unreliability, they are a proof that discretion has not been exercised within the objective boundaries imposed by law. Another consequence of this distinction concerns the notion of potential conflicts of interest. Only factors that are known to create a risk of distorted or biased judgment can create a potential conflict of interest.

D. *Actual v. potential conflict of interest*

The standard view recognizes two main types of conflicts of interest, according to the imminence of the risk of impaired judgment. A conflict of interest is *actual* if the decision-maker has a conflict of interest with respect to a certain judgment that he must make. A conflict of interest is *potential* if the decision-maker has a conflict of interest with respect to a certain judgment, but is not yet in a situation where he must make that particular judgment.⁴⁰⁷ Actual or potential conflicts of interest should be distinguished from situations that only give the *appearance* of a conflict of interest. Such situations are mere appearances, and should not be included in the category of conflict of interest:

A conflict of interest is (merely) *apparent* if and only if [a person] does not have the conflict of interest (actual or potential), but someone other than [that person] would be justified in concluding (however tentatively) that that person does. Apparent conflicts of interests... are no more conflicts of interest than counterfeit money is money.⁴⁰⁸

Appearances of conflict cannot, by themselves, indicate the existence of a conflict. The outward impressions or indications that a person's actions

⁴⁰⁷ Michael Davis, "Conflict of Interest", *supra* note 378 at 593. The fiduciary law's interpretation of a potential conflict of interest is slightly different. See *Boardman v Phipps* [1966] 3 All ER 721 at 756, per Lord Upjohn: "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." See also *supra* Chapter 2.

⁴⁰⁸ *Ibid.*

produce are often a matter of the beholder's subjective perception. In the absence of actual or potential wrongdoing, it is very difficult to draw a line between conduct that appears proper to relatively uninformed outsiders and that which may create an appearance of impropriety.⁴⁰⁹

The standard view of conflicts of interest recognizes, nevertheless, that the distinction between apparent conflicts, on the one hand, and actual and potential conflicts of interest, on the other, is important as concerns the actions that decision-makers must take when faced with these situations. Apparent conflicts, although posing no actual or potential threat to the decision-maker's judgment, should nevertheless be clarified, for the same reasons for which any apparent wrongdoing is objectionable. If the decision-maker becomes aware of appearances of conflict of interest relating to his activity, he must resolve them by making available enough information to show that there is no actual or potential conflict. If he cannot make such clarifications, the conflict of interest is actual or potential, not merely apparent.⁴¹⁰ In the case of professionals, the obligation to dissipate appearances of conflict is justified by the damage that such appearances cause to public confidence in the profession as a whole.⁴¹¹

Both fiduciary law and the standard view of conflicts of interest distinguish between appearances of conflict, on the one hand, and actual or potential conflicts, on the other hand. While apparent conflicts must be dissipated, actual and potential conflicts, in contrast, require a different response – they must be avoided or managed.

⁴⁰⁹ See W. Bradley Wendel, *supra* note 391 at 484-485.

⁴¹⁰ See Michael Davis, "Introduction", *supra* note 383 at 18.

⁴¹¹ Luebke adopted a slightly different view on the importance of appearances. Luebke believed that the most important element that is at stake in a conflict of interest situation is the *trust* that one party places in another. The appearances of conflict can have damaging effects on a given relation of trust as well as on "the milieu of other current and future fiduciary relationships. Especially for those officials and professionals whose successful performance depends on maintaining the trust of others, failing to avoid the appearance of a conflict of interest can have far-reaching effects on the work environment." (Neil R. Luebke, *supra* note 398 at 72).

E. *Managing conflicts of interest*

The standard view of conflicts of interest offers several strategies to deal with such conflicts: avoid, disclose or escape. Avoidance is one way of addressing conflict situations. Persons having a duty to exercise judgment in the interest of another must avoid situations in which their interests pose an actual or potential threat to the reliability of their judgment. Although avoidance of conflict situations is an important duty of decision-makers, a flat prescription to ‘avoid all conflicts of interest’ is not only mistaken, but also unworkable. On the one hand, not all conflicts of interest are avoidable. Some conflict situations are embedded in the relation, while others occur independently of decision-maker’s will.⁴¹² On the other hand, the mere fact of being in a situation of conflict is not always wrong from a moral or ethical point of view. Failure to address the conflict situation, however, may be reprehensible:

Having a conflict of interest is not like stealing money or taking a bribe. One can have a conflict of interest without doing anything wrong. To have a conflict of interest is to have a moral problem. What will be morally right or wrong, or at least morally good or bad, is how one resolves that problem.⁴¹³

Another strategy to handle conflicts of interest is to disclose the conflict to those relying on one’s judgment. Complete disclosure gives the beneficiaries the opportunity to give informed consent to the situation of conflict, to adjust reliance accordingly, or to replace the decision-maker.

⁴¹² For instance, a lawyer may be placed in a conflict of interest situation if one of his clients decides to sue another of his clients. In this example (more accurately referred to as a duty-duty conflict), the lawyer’s exercise of professional judgment for one of the litigating clients may be impaired by the other litigating client’s interests covered by the lawyer’s core fiduciary duty to the later client.

⁴¹³ Michael Davis, “Conflict of Interest”, *supra* note 378 at 592. See also John R. Boatright, “Conflict of Interest: A Response to Michael Davis” (1993) 12:4 Business and Professional Ethics Journal 47 at 49: “We must remember that paradigmatically there is nothing wrong with *being* in a conflict of interest; what is wrong is failing to avoid, acting, or failing to remove oneself from a conflict-of-interest situation or the appearance of one.”; Neil R. Luecke, *supra* note 398 at 70: “Although some conflicts of interest may also be moral dilemmas, conflicts of interest are not a subclass of moral dilemmas... [T]here is nothing wrong with *having*, *being in*, or *finding oneself* in them... Although being in a conflict of interest is itself not a wrong... remaining in a conflict of interest without attempting to alter the situation merits moral suspicion.”

When the decision-maker is not replaced, disclosure does not end the conflict of interest – it merely allows beneficiaries to re-adjust their reliance to the decreased reliability of the decision-maker’s judgment.⁴¹⁴

Another response to the problem posed by a conflict of interest is escape. The decision-maker can escape the conflict by re-defining the scope of the relationship, so that the scope of the judgment is restricted; by divesting himself of the interest creating the conflict; or, where possible, by withdrawal from the relationship.⁴¹⁵

Fiduciary law already recognizes ‘avoid’, ‘escape’ and ‘disclose’ (followed by informed consent) as strategies to deal with conflicts of interest. What fiduciary law theory must emphasize is that a sweeping requirement to avoid all conflicts of interest is misguided.

F. *The ‘standard view’ of conflicts of interest: a summary*

The essence of the standard view of conflicts of interest can be articulated as follows. When a person has a duty to exercise judgment in another’s service, the idea of simply resisting the temptation of self-interest is a misguided solution to the conflict. On the one hand, it has been demonstrated that interests encumber judgment in unpredictable ways, and despite the decision-maker’s honest efforts to keep them aside. On the other hand, from the point of view of the beneficiaries of judgment, ethical self-restraint may appear as an insufficient response to a situation of conflict. More specific prophylactic rules are required, in order to compel the decision-maker to take active steps to steer clear of situations of conflict, to manage unavoidable ones, or to dissipate the mere appearances of conflict.

⁴¹⁴ Michael Davis, “Introduction”, *supra* note 383 at 11-12: “[I]f those justifiably relying on [a person, P] for a certain judgment do not know of P’s conflict of interest but P knows (or should know) that they do not, P is allowing them to believe that her judgment is more reliable than it is. She is, in effect, deceiving them. Insofar as she is deceiving them, she is betraying their (properly-placed) trust.”

⁴¹⁵ Michael Davis, “Conflict of Interest”, *supra* note 378 at 592.

4.3 Conflict of interest and proper exercise of judgment: A comparison with administrative law

The contemporary philosophical ‘standard view’ of conflicts of interest shows that at the centre of this notion lies the concern with the proper exercise of judgment on another’s behalf. Based on recent cognitive research, the standard view shows that self-regarding interests can encumber a person’s judgment in ways that are often difficult to determine or rectify.

Public law theory is the traditional forum where the issue of unencumbered and fair judgment is discussed. More recently, commentators from various fields of professional ethics have developed a body of scholarship advocating the need to understand and regulate conflicts of interest from the perspective of freedom from bias.⁴¹⁶ The law of fiduciary obligations has yet to incorporate these new developments. Both civil law and common law traditions struggle to identify a general set of coherent legal rules and principles that could unify all instances of discretion over another’s interests (or ‘*situations ouvertes*’ as some civil law scholars have put it) in private law relations. The entrenched explanations of the strictness of the no-conflict rules (the need to discipline and remove temptations of abuse, or the impossibility to prove fiduciary’s motives) are unconvincing because they fail to identify the core characteristic of a fiduciary position that justifies such strict rules. A short comparison with the rule against bias developed in administrative law shows that in public law theory the connection between prohibition of self-interest in the outcome of a decision and the need to ensure unencumbered, fair and impartial judgment is well established.

As Section 4.2 shows, the ‘standard view’ of conflict of interest connects personal interests with the undermined judgment within a role. In legal theory, the issue of freedom of a person’s judgment from compromising influences is analyzed mostly in relation to administrative or quasi-administrative office holders. Although, as will be shown below, the central issue in regulating conflicts of interest in public law and in private law should be the same (i.e. the concern with the decider’s unencumbered judgment),

⁴¹⁶ Michael Davis and Andrew Stark, eds., *Conflict of Interest in the Professions*, *supra* note 383.

these two scenarios of conflict of interest differ in two important issues. First, eliminating appearances of improper judgment is vital in public law, since it affects the general confidence in the public service provided. The main purpose of the private law rules on fiduciary obligations is to protect the beneficiary's right to fiduciary's best judgment. Preserving the public confidence in professional fiduciaries is only a consequence, and not the main goal, of fiduciary law rules. Second, public officials are bound to act in the public interest, which may be different from the specific interests of a beneficiary of a public service. Fiduciaries must act in what they have determined to be the best interests of the beneficiaries of the fiduciary relation.

Notwithstanding these differences, several courts and commentators have suggested that the exercise of discretion or judgment in fiduciary law and public law are governed by the same principles. Therefore, before analysing the importance of judgment in fiduciary law, a brief look at the regulation of discretion in administrative law is opportune.

The authorities underlining the parallels between the fiduciary and the administrative exercise of discretion are numerous. The analogies between the two legal fields have been approached from both sides: from the perspective of fiduciary law and from the perspective of public law. Both approaches emphasize that the exercise of discretion in both fields should be governed by analogous rules and principles.

In his treatise on private law powers, Geraint Thomas observed that the principles governing the exercise of powers or discretions by trustees are similar to the public law principles applicable to the exercise of discretion by public authorities. Thus, a public authority must exercise discretion within its objective limits, in good faith, having regard to all relevant considerations and without being swayed by irrelevant considerations.⁴¹⁷ Thomas further asserted that

⁴¹⁷ Geraint W. Thomas, *Thomas on Powers* (London: Sweet & Maxwell, 1998) 36, emphasis added: "[T]he decision-making process may be examined and reviewed in order to ascertain whether the relevant power or discretion can be said to have been exercised properly or at all; and if there is a fundamental flaw in the process by which the trustees arrived at a particular decision they have not, in substance, exercised that power or discretion at all. *Similar well-recognized principles operate in public law...*"

[t]here is no reason why the same principles [i.e. the principles of judicial review of discretion in public law] should not govern the exercise of fiduciary powers and discretions generally. Clearly, their application must take account of, and will vary in effect according to, the particular context. The judicial review of the actions and decision of public bodies involves considerations and is subject to safeguards which do not apply to [private law]... Nevertheless, the underlying principle of review remains common to all cases, *namely that it is some flaw in the decision-making process itself that may be open to challenge and not the merits of the decision itself*.⁴¹⁸

Similarly, Paul Finn, another authoritative fiduciary law scholar, concluded that the legal regime of the exercise of powers attached to a fiduciary office is similar to that of powers attached to public administrative offices: “This resemblance is not an inconsequential one... [T]he actual obligations imposed on a fiduciary in the exercise of his discretions mirror to a large degree the obligations imposed on the public officer in exercising his.”⁴¹⁹

Several judges have observed that the exercise of discretion in private law and in public law is governed by similar rules. In *Edge v Pensions Ombudsman*, Chadwick LJ, writing the unanimous decision, argued that all instances of exercise of judgment in another’s interest should be governed by similar principles.

It seems to us no coincidence that courts, considering the exercise of discretionary powers by those to whom such powers have been entrusted (albeit in different contexts), should reach similar and consistent conclusions; and should express those conclusions in much the same language.⁴²⁰

⁴¹⁸ *Ibid.* at 367, emphasis added.

⁴¹⁹ Paul D. Finn, *Fiduciary Obligations* (Sydney: Law Book Co., 1977) 14.

⁴²⁰ *Edge v Pensions Ombudsman* [2000] Ch 602 at 628. However, the Court of Appeal declined to consider the analogy further: “[It is] unnecessary to consider, in the present case, how far an analogy between the principles applicable in public law cases can or should be pressed in the different context of a private pension scheme.” (*ibid.* at 630).

Sir Robert Walker, writing extra-judicially, expressed the same idea: the review of trustee's exercise of discretion and the judicial review of administrative decisions share the same grounds.⁴²¹

Authors investigating the similarities between the two fields starting from public law observed that the fiduciary model can be used to understand the law's approach to the exercise of discretion by public officials. Sir Anthony Mason, the former Chief Justice of the High Court of Australia wrote that administrative law "from its earliest days, has mirrored the way in which equity has regulated the exercise of fiduciary powers."⁴²² Similarly, Paul Finn observed that

[T]he fiduciary principle in private law began its uninterrupted march to prominence from the middle of the last century... Yet much more so than in the private sector, it was – and is – in the realms of government that fiduciary power is the most pervasive, the most intense...⁴²³

Commenting on Finn's article, K. Ryan underlined that "there can be little room for controversy [regarding] the close analogy between the role of the modern public official and of a fiduciary."⁴²⁴ Evan Fox-Decent expressed a similar view. In the two fields, he explained, the law regulates the exercise of power over another's interests:

[T]he fiduciary theory helps us understand and justify the most important doctrines and practices constitutive of administrative law... Perhaps the most obvious similarity between private law fiduciary

⁴²¹ Sir Robert Walker, "The Limits of the Principle in *Re Hastings-Bass*" (2002) 22 King's Law Journal 173 at 174: "There is an obvious and unsurprising similarity between the grounds on which a decision by trustees may be attacked and the grounds on which official decision-making is subject to control by judicial review." In a similar vein, Tipping J of the Supreme Court of New Zealand asserted that the courts should be able to control the exercise of discretionary powers by trustees in a similar way to the judicial control of exercise of discretion in public law: "[A]n ostensibly intra vires exercise of a discretionary power can, in my judgment, be impugned on a basis somewhat wider than what is conventionally understood by bad faith in this field. If the trustees exercise their discretionary powers in a manner which although formally intra vires is unreasonable the court should be able to intervene... *It is, in my view, time for private law to catch up with public law in this respect.*" (*Craddock v. Crowhen* (1995) 1 NZSC 40331 at 40337).

⁴²² Sir Anthony Mason, "The Place of Equity and Equitable Doctrines in the Contemporary Common Law World" (1994) 110 Law Quarterly Review 238 at 247.

⁴²³ Paul D. Finn, "The Forgotten 'Trust': The People and the State" in *Equity: Issues and Trends* (Annandale, NSW: Federation Press, 1995) 131 at 132.

⁴²⁴ K. W. Ryan, "Commentary" in *Equity: Issues and Trends* (Annandale, NSW: Federation Press, 1995) 152 at 152.

relationships and decision-making contexts of administrative law is that in both cases one party holds administrative power which is to be used exclusively for the sake of someone else.⁴²⁵

Fox-Decent pointed out that an important difference between the two fields consists in the beneficiary of the fiduciary duties: while in private law fiduciaries must act for the benefit of discrete beneficiaries the beneficiaries of public law fiduciary duties range from the public at large to an individual who appeals to an administrative tribunal.⁴²⁶ Nevertheless, in both legal fields fiduciary duties serve the same purpose: controlling discretionary power capable of affecting the interests of others.⁴²⁷

The same idea has been expressed in judicial decisions. In *Equitable Life Assurance Society v. Hyman* Lord Woolf MR compared public officials to fiduciary power holders:

Local authorities have wide discretionary powers conferred upon them so that they can be used in the interest of the locality and those who reside there... The recipients of the powers, whether national or local, are in very much the same position as they would be if they had fiduciary powers conferred upon them.⁴²⁸

Despite these strong endorsements, analogies between private law and public law rules on exercise of discretion are often met with circumspection. The arguments put forth against such a parallel, however, are contradictory. On the one hand, scholars fear that private law will be contaminated with public law principles. The leading treatise on trust law, *Underhill and Hayton Law Relating to Trusts and Trustees* warns that allowing an analogy between review of trustees' of powers and review of administrative discretion will open the gates of introducing other administrative law principles into trust law.⁴²⁹ On the other hand, it has been argued that judicial review of exercise

⁴²⁵ Evan Fox-Decent, *Sovereignty's Promise: The State as Fiduciary* (Oxford: Oxford University Press, 2012) 151-152.

⁴²⁶ *Ibid.* at 152.

⁴²⁷ *Ibid.* at 158.

⁴²⁸ [2000] EWCA 4 at [18]. In the same vein, see Roderick Macdonald, "On the Administration of Statutes" (1987) 12 Queen's Law Journal 488 at 493, observing that the administrative decision-maker "acts no differently than a trustee administering a trust indenture."

⁴²⁹ David Hayton, ed., *Underhill and Hayton Law Relating to Trusts and Trustees*, 18th ed. (London: LexisNexis, 2010) 904: "Once one public law principle is held to apply there is

of discretion by public officials and the private law liability for breach of fiduciary duties are driven by different underlying principles and should not be conflated.⁴³⁰ Similarly, Raymond Davern warned that the mere coincidence of terminology is an insufficient basis on which to draw substantive similarities between public law and trust law:

Trustees are not to be equated with public authorities. They decide things in very different ways and in a context that bears little similarity to that in which public authorities make decisions.⁴³¹

Davern's strict view does not seem to be shared by many courts and commentators comparing the two fields. In a recent article, Matthew Conaglen showed that the two fields share common features with regard to methodology, underlying rationales and remedial considerations.⁴³²

The warnings against close parallels between reviews of discretion in the two fields are only partially justified. First, accepting one analogy does not automatically legitimize other potential overlaps between the two areas. Any dialogues between the two legal areas will have to be justified by common underlying features and not by the pre-existing analogies. Second, the existence of similarities between control of discretion in private law and public law does not mean that the hard law rules or public policies pursued by these fields should be identical. It cannot be contested that the relevant

a danger that judges not steeped in trust law will begin to apply other public law principles, for example, concerned with natural justice and due process, as to the way in which decisions are arrived at." *R v Charity Commissioners, ex p Baldwin* [2001] WTLR 137 at 148-149: "The difference between the public law and the trust approach is that the former focuses on the individual's opportunity to be heard before a decision, whereas the trust concept focuses on the information available to the person making the decision."

⁴³⁰ *Pitt & Anor v Holt & Anor* [2011] EWCA Civ 197 (leave for appeal granted) at para. 235, per Lord Mummery L.J.: "[A]nalogies with judicial review in public law are unhelpful and unnecessary. There is an elementary distinction between, on the one hand, the liability in private law of a fiduciary for breach of duty and, on the other hand, the availability of judicial review for the control of abuses of public power... Judicial review in public law is concerned with the lawfulness of decisions and acts of public authorities to ensure that they are acting within the limits of a power usually set by statute... The discretion of the fiduciary is not controlled by the court, which will not interfere with matters of judgment by the fiduciary."

⁴³¹ Raymond Davern, "Impeaching the Exercise of Trustee's Distributive Discretions: 'Wrong Grounds' and Procedural Unfairness" in David J. Hayton, ed., *Extending the Boundaries of Trusts and Similar Ring-Fenced Funds* (Kluwer Law International, 2002) 437 at 454.

⁴³² Matthew Conaglen, "Public-Private Intersection: Comparing Fiduciary Conflict Doctrine and Bias" (2008) Public Law 58.

factors to be taken into account by a public official are different from those to be considered by a private law fiduciary when exercising their powers. Beyond these specific aspects, however, fiduciary law theory can benefit from the investigation of the public law literature on exercise of discretion.

Public law theory can inform fiduciary law in the following aspects: (i) the distinction between ministerial acts and discretionary acts; (ii) the idea that personal interests can affect judgment despite the decision-maker's good faith; and (iii) in addition to freedom from extraneous interests, a proper decision-making process requires the decision-maker to take into account relevant factors and discard irrelevant ones.

4.3.1 Ministerial and discretionary acts

One aspect in which a parallel between the two legal areas is informative for fiduciary law concerns the identification of the acts which are governed by the rules regulating exercise of judgment. Fiduciary law scholars generally recognize that not all actions by a fiduciary are governed by fiduciary duties, but do not provide a clear delineation of the sphere of acts that fall under the scope of these duties. In administrative law, however, there is a clear distinction between discretionary acts, which require exercise of judgment, and ministerial acts, which are routine.

A discretionary act calls for the exercise of personal deliberation or judgment, which involves examining facts, reaching reasoned conclusions, and acting on them in a way not specifically directed. Discretionary acts have no preconceived course of conduct that one must or must not take, thereby requiring the deliberation and choice of the person performing the act. A ministerial act, in contrast, is commonly one that is simple, absolute, and definite, requiring merely the execution of a specific duty. Where there is an established policy requiring an official to take a specific action in a specific situation, the policy creates a ministerial act. A ministerial act is performed according to explicit directions, usually embodied in a statute rather than directed by judicial order; a purely ministerial act is one which a person

performs on a given state of facts in a prescribed manner, without exercise of his own judgment concerning the propriety of the act being done.⁴³³

The distinction between discretionary and ministerial acts highlights the meaning of ‘discretion’ and casts light on the need to regulate the decision process, through the rule against bias and the duty to decide based on relevant considerations. The same rationale applies in fiduciary law: where discretion is absent, fiduciary duties do not apply. A private law legal actor’s decision to seek or to keep an unauthorized benefit, *in itself*, is never a discretionary act, whether such actor occupies a fiduciary office or not. Such a decision lacks the central elements of authority to decide over another’s interests, and does not generate a ‘conflict of interest’ situation. While it is true that seeking or keeping an unauthorized benefit may not be in the best interests of the other party to the legal relation, this is a situation of conflicting interests rather than conflict between interest and judgment. A mere situation of conflicting interests is reprehensible not as a breach of fiduciary duty, but under other causes of actions, such as breach of contract, unsonscionability or unjustified enrichment.

4.3.2 The effects of bias

Public law legal theory and case law have recognized that judicial or administrative decisions that require judgment may be invalidated if the decision-maker was biased or prejudiced in a way that precluded fair and genuine consideration to be given to factors that ought to guide the decision.⁴³⁴ The rule that invalidates the decision-making process whenever

⁴³³Steven H Gifis, *Dictionary of Legal Terms* (Hauppauge, N.Y.: Barron’s Educational Series, 1998) *s.v.* ministerial act. See also Edwin W. Patterson, “Ministerial and Discretionary Official Acts” (1922) 20 Mich. L. Rev. 848; The Rt. Hon. The Lord Woolf *et al.*, eds, *De Smith’s Judicial Review*, 6th ed. (London: Sweet & Maxwell, 2007) (hereinafter ‘*De Smith’s Judicial Review*’) 978: A ministerial duty is a duty “the discharge of which involves no element of discretion or independent judgment.”

⁴³⁴*De Smith’s Judicial Review*, *supra* note 433 at 499-500. Bias has been defined as “an operative prejudice, whether conscious or unconscious” (*R. v. Queen’s County Justices* [1908] 1 I.R. 285 at 294, per Lord O’Brien C.J.; See also *Flaherty v. National Greyhound Racing Club Ltd* [2005] EWCA Civ 1117 at para. 28 per Bowen J: Bias is “a predisposition or prejudice against one party’s case or evidence on an issue for reasons unconcerned with the merits of the issue.” *R. v. Bertram*, [1989] O.J. No. 2123 (QL) (H.C.), quoted by Cory J. in *R. v. S. (R.D.)*, [1997] 3 S.C.R. 484, at para. 106: Bias is “a leaning, inclination, bent or

there is a real risk that the decision be predetermined towards a specific result is known as the rule against bias. The rule against bias is traditionally expressed as the maxim *nemo iudex in causa sua* (no person should be a judge in his own cause).⁴³⁵

As shown in the previous chapter, the dominant fiduciary law theory explains the prohibition of self-interest mostly as a means to discipline fiduciaries who are tempted to abuse their position for their own benefit. In public law theory, in contrast, the prohibition of having a personal interest in the outcome of a decision is linked to the need to ensure that judicial or administrative decision-makers do not stray, consciously or unconsciously, from their core duty to exercise impartial and independent judgment. Although impartiality of judgment is not the main concern of fiduciary law, the essence of the two instances of conflict of interest is the same: when a duty to decide over the interests of another based on pre-defined standards exists, the interference of personal interests and preferences can alter the decision-making process and cause a breach of this duty.

The *nemo iudex* maxim encompasses two prohibitions: (i) no one can be both decision-maker and party in the same case; and (ii) no one should exercise judgment in a matter in which he has an interest that may affect the impartiality or independence of the decision-making process.⁴³⁶ The application of the rule against bias is not limited to courts and judges. It applies equally to the decisions of administrative and domestic tribunals and of any authority exercising an administrative power that affects a person's status, rights, or liabilities.⁴³⁷ Several authors have recognized that the

predisposition towards one side or another, or a particular result... Bias is a condition or state of mind which sways judgment and renders a judicial officer unable to exercise his or her functions impartially in a particular case.”

⁴³⁵ For a historical review of this maxim see Chapter 5 below.

⁴³⁶ See *In re Pinochet (No. 2)* [2000] 1 AC 119 at 130, per Lord Browne - Wilkinson: “The fundamental principle... that a man may not be a judge in his own cause... has two very similar but not identical implications. First it may be applied literally: if a judge is in fact a party to the litigation or has a financial or proprietary interest in its outcome then he is indeed sitting as a judge in his own cause... The second application of the principle is where a judge is not a party to the suit and does not have a financial interest in its outcome, *but in some other way his conduct or behavior may give rise to a suspicion that he is not impartial*, for example because of his friendship with a party...”

⁴³⁷ The vast range of decision-makers to which the rule against bias applies includes tribunals, statutory authorities, court officials, government ministers, local councils, bureaucrats, or private arbitrators. See Matthew Groves, “The Rule against Bias” (2009) 35

essence of the *nemo iudex* rule applies to all conflict of interest situations, whether occurring in public or in private law:

[T]he English legal system is famously rigorous in controlling conflicts of interest which might be seen to affect what should be a neutral decision making process. The rule, which applies across the board to trustees, company directors and other fiduciaries as well as judges, is so strict that the mere possibility of a conflict of interest is sufficient to invalidate any decision so made, even if in reality the individual concerned was completely unaffected by their own interest in coming to the decision.⁴³⁸

Not all interests or predispositions of a decision-maker have the potential to distort his judgment. Some interests have been held to be so threatening for the impartiality of the decision-process and for the public confidence in this process, that they cause the automatic disqualification of the decision-maker. A decision-maker is automatically disqualified if he has a direct pecuniary or proprietary interest in the outcome of the proceedings,⁴³⁹ or if he is involved in the 'promotion of a cause' to which one party is connected.⁴⁴⁰ Other personal interests, connections or preferences (such as friendship, animosity, kinship, professional relations, or the expression of partisan views on a particular issue) may raise a presumption of bias.⁴⁴¹ Finally, factors such as religion, national origin, service or employment background or previous political associations are considered not to create a real danger of bias.⁴⁴²

Monash University Law Review 315 at 315 and the cases cited therein; Jonathan Law and Elizabeth A. Martin, eds., *A Dictionary of Law* (Oxford: Oxford University Press 2009), s.v. *natural justice*.

⁴³⁸ Gary Slapper and David Kelly, *The English Legal System*, 10th ed. (Oxford: Routledge-Cavendish, 2009) 207.

⁴³⁹ *R. v Rand* (1866) L.R. 1 Q.B. 230 at 232, per Blackburn J (holding that the smallest pecuniary interest is sufficient to disqualify); *Locabail (UK) Ltd v Bayfield Properties Ltd* [2000] Q.B. 451 at [10] (holding that the rule of automatic disqualification for financial interest will not apply if the falls under a *de minimis* threshold).

⁴⁴⁰ See *In Re Pinochet (No. 2)* [2000] 1 AC 119 at 132-133.

⁴⁴¹ *De Smith's Judicial Review*, *supra* note 433 at 516-525.

⁴⁴² *Locabail (UK) Ltd v Bayfield Properties Ltd* [2000] Q.B. 451 at para. 25; *De Smith's Judicial Review*, *supra* note 433 at 516.

A decision may always be invalidated if actual bias on the part of the decision-maker is proved.⁴⁴³ Proof of actual bias, however, is not always necessary or possible. A decision where a sufficiently serious possibility of bias has been established may be quashed without the need to investigate further the existence of actual bias. Various tests have been developed to establish the limits beyond which the appearances of bias become reprehensible.⁴⁴⁴ At the one end of the spectrum, the courts invalidated official decisions if there has been a “reasonable suspicion of bias”.⁴⁴⁵ At the other end, a decision-maker is disqualified only where there is a “real likelihood” of bias.⁴⁴⁶ Between the two extremes, the courts invoked the “real danger of bias”⁴⁴⁷ and “real possibility of bias”.⁴⁴⁸ The last test appears to have settled the matter. An official decision-maker is disqualified whenever “the fair-minded and informed observer, having considered the facts, would conclude that there was a real possibility of bias.”⁴⁴⁹ This test is remarkably similar to the fiduciary law test for determining the possibility of a conflict of interest, which holds that the test is met if “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.”⁴⁵⁰ As Matthew Conaglen observed, the similarity between the two tests goes beyond mere language. The common language reflects a similar methodology in determining possible conflicts of interest and, respectively, situations of bias.⁴⁵¹

The scope of the rule against bias in public law is defined by two guiding principles: the maintenance of public confidence in official authorities⁴⁵² and the need to ensure a reliable exercise of discretion.

⁴⁴³ See e.g. *R. v. Burton ex p. Young* [1897] 2 Q.B. 468 at 471; *De Smith’s Judicial Review*, *supra* note 433 at 504; Andrew P. Le Sueur *et al.*, *Principles of Public Law*, 2nd ed. (London: Cavendish Publishing, 1999) 279.

⁴⁴⁴ *De Smith’s Judicial Review*, *supra* note 433 at 504-508.

⁴⁴⁵ See *R. v. Sussex Justices Ex p. McCarthy* [1924] 1 K.B. 526 at 529, per Hewart C.J.

⁴⁴⁶ See *R. v. Barnsley Licensing Justices Ex p. Barnsley* [1960] 2 Q.B. 167 at 187, per Devlin L.J.

⁴⁴⁷ See *R. v. Gough* [1993] A.C. 646 at 670, per Lord Goff.

⁴⁴⁸ See *Porter v Magill* [2002] 2 A.C. 357 at [103], per Lord Hope.

⁴⁴⁹ *Ibid.*

⁴⁵⁰ *Boardman v Phipps* [1966] 3 All ER 721 at 756, per Lord Upjohn.

⁴⁵¹ Matthew Conaglen, “Public-Private Intersection: Comparing Fiduciary Conflict Doctrine and Bias”, *supra* note 432 at 69.

⁴⁵² According to an often quoted phrase, “justice should not only be done, but should manifestly and undoubtedly be seen to be done.” (*Rex v. Sussex Justices, Ex parte*

Fiduciary law mirrors the same underlying concerns, but to a different extent. Only the second concern, i.e. the need to ensure unencumbered exercise of discretion is a guiding principle of private law fiduciary duties. As indicated before, appearances of conflict of interest are (or should be) approached differently in private law.⁴⁵³

The prohibition of actual or potential bias (and, respectively, of conflict of interest) is a central concern in both legal fields. The rules share the same rationale: to ensure accuracy in decision-making. As Dawn Oliver remarked, “the rule that a trustee must not benefit from the trust provides a parallel with the rule against bias in judicial review.”⁴⁵⁴

The way in which personal interests or prejudices distort decision-maker’s judgment cannot be easily observed or measured. Bias can affect the decision-maker subconsciously, and despite his good faith and desire to keep aside personal interests.⁴⁵⁵ As Devlin L.J. observed, “[b]ias is or may be an unconscious thing and a man may honestly say that he was not actually biased and did not allow his interest to affect his mind, although, nevertheless, he may have allowed it unconsciously to do so.”⁴⁵⁶

If the decision-maker is influenced by his private interests or personal predilections, he will be less likely to follow the required standard and considerations which ought to guide the decision, and to give appropriate weight to relevant matters.⁴⁵⁷ According to Lord Bingham C.J., a presumption of bias occurs whenever there is “real ground for doubting *the*

McCarthy [1924] 1 K.B. 256 at 259, per Lord Hewart CJ). See also *Dimes v. The Proprietors of the Grand Junction Canal* (1852) 3 H.L. Cas. 759 at 793-794, per Lord Campbell, C.J

⁴⁵³ See *supra*, Section 4.2.

⁴⁵⁴ Dawn Oliver, “Review of (Non-Statutory) Discretions in Christopher Forsyth, ed., *Judicial Review and the Constitution* (Oxford: Hart Publishing, 2000) 307 at 310.

⁴⁵⁵ *De Smith’s Judicial Review*, *supra* note 433 at 505: “Nor it would be useful to do so [i.e. to investigate evidence of actual bias] because in many cases bias may be unconscious (as it is said – subconscious may be a more accurate description) in its effect.”; Andrew P. Le Sueur *et al.*, *supra* note 443 at 278: “[B]ias can operate even though the individual concerned is unaware of its effect.”

⁴⁵⁶ *R. v Barnsley Licensing Justices, Ex p Barnsley and District Licensed Victuallers’ Association* [1960] 2 QB 167 at 187. See also *R v Gough* [1993] AC 646 at 659, per Lord Goff: “[B]ias is such an insidious thing that even though a person may in good faith believe that he was acting impartially, his mind may unconsciously be affected by bias.”

⁴⁵⁷ See *R v Inner West London Coroner, Ex p Dallaglio* [1994] 4 All ER 139 at 152, per Sir Thomas Bingham, arguing that bias law is concerned with the question whether there is “a real danger of bias having affected the decision in the sense of having caused the decision-maker, albeit unconsciously, to weigh the competing considerations, and so to decide the merits, unfairly.”

ability of the judge to ignore extraneous considerations, prejudices and predilections and bring an objective judgment to bear on the issues before him.”⁴⁵⁸ In other words, disqualification for bias aims to protect the decision-maker’s ability to identify and weigh the relevant considerations on which to base his judgment. More than two centuries ago, Jeremy Bentham expressed this insight as follows:

He who has a bias in his mind, a determined prejudice, applies himself entirely to consider in a fact only that which flatters his own likings; he does not see what is, but what he desires to see; every thing that would operate the other way escapes him.⁴⁵⁹

In addition to the independence and impartiality requirements imposed by the rule against bias, judicial and administrative decision-makers have a duty to exercise judgment based on relevant considerations. In order to identify the range of relevant and irrelevant factors, decision-makers must refer to the relevant statutory provisions setting forth the matters to which regard may, or may not, be had in exercising a specific discretionary power. Besides the factors specified in statutes (or when there is no such specification) the decision-maker can found his judgment on factors that he considers to be relevant. The decision-maker’s assessment of what constitutes a relevant factor can be subject to review on ground of unreasonableness.⁴⁶⁰ Moreover, if a non-specified consideration that the decision-maker judges relevant is extraneous to the purpose of the discretionary power, the exercise of judgment can be reviewed for illegality.⁴⁶¹

The decision-making process is not automatically flawed if some of the factors that the decision-maker has considered are irrelevant. As a general rule, an irrelevant factor flaws the decision process only if such factor had a material or substantial influence on the outcome of the decision process.

⁴⁵⁸ *Locabail (UK) Ltd v Bayfield Properties Ltd* [2000] Q.B. 451 at para. 25. See also *Ebner v. Official Trustee* (2000) 205 CLR 337 at 361: “[T]he application of the apprehension of bias principle requires identification of what it is *said* might lead a judge to decide a case other than on its *legal* and factual merits.”

⁴⁵⁹ Jeremy Bentham, *A Treatise on Judicial Evidence* (London: J.W. Paget, 1825) 21-22.

⁴⁶⁰ *R. v Secretary of State for Transport Ex p. Richmond LBC* [1994] 1 W.L.R. 74 at 95, per Laws J.

⁴⁶¹ *De Smith’s Judicial Review*, *supra* note 433 at 282.

Conversely, if a relevant consideration has not been taken into account, it is for the court to evaluate the actual or potential importance of the omitted consideration for the decision process.

The duty to exercise discretion based on relevant considerations adds an extra ring of protection on decision-makers' exercise of judgment. Not only must the decision-maker be free from the distorting effects of bias, but he must also reach a decision based on relevant considerations.

This brief survey of the rules governing exercise of discretion in administrative law demonstrates that public law's approach to the concept of conflict of interest and proper exercise of judgment is similar to the philosophical 'standard view' of conflicts of interest. The two fields of thought have developed along two central ideas: first, personal interests can affect the reliability or objectivity of a person's assessment of the relevant factors when deciding how to promote another's interests (or the public interest); and second, an exercise of discretion is valid only if it is driven by relevant considerations. As the next section will show, some of these insights have already been articulated in fiduciary law. What the theory of fiduciary obligations lacks is a unifying approach that could piece together the rules governing conflict of interest and exercise of discretionary powers based on relevant considerations.

4.4 Conflict of interest and proper exercise of judgment in private law

Fiduciary law scholars largely agree that the existence of a discretion (or discretionary power, or scope to affect the interests of another in a legal or practical sense) is a *sine qua non* feature of a fiduciary position. Ernest Weinrib, one of the first authors to engage in a general analysis of fiduciary obligations, underscored the centrality of discretion:

[F]iduciary obligation is the law's blunt tool for the control of... discretion... Two elements thus form the core of the fiduciary concept and these elements can also serve to delineate its frontiers. First, the fiduciary must have scope for the exercise of discretion, and second,

this discretion must be capable of affecting the legal position of the principal.⁴⁶²

Although most scholars accept that fiduciaries have discretion, they interpret differently the way in which fiduciary duties control the exercise of this discretion. Some scholars equate discretion with opportunities to cheat,⁴⁶³ to exploit other people's vulnerability⁴⁶⁴ or with enlarged scope for breach of non-fiduciary duties by fiduciaries.⁴⁶⁵ Therefore, in their view, fiduciary duties (equated with the no-conflict duties) control discretion in the sense of removing temptations to gain unauthorized benefits. As this section shows, neither the contemporary 'standard view' of conflicts of interest nor the administrative law theory approach the concept of discretion from the perspective of temptations or scope for obtaining unauthorized benefits. A decision whether to misappropriate or not is not an exercise of discretion in any meaningful sense of this concept. Both contemporary philosophy and public law theory point out that exercising discretion over another's interests means being in a position to adopt a decision in another person's interests (or in the public interest), where there is no pre-determined course of action. Consequently, discretion in this technical sense, and not in the sense of opportunity for self-benefit, is the central element of a fiduciary position.

It is important to underline that fiduciary law aims to control the *process* of exercising discretion and not the substantial merits of the ensuing

⁴⁶² Ernest Weinrib, "The Fiduciary Obligation" (1975) 25 University of Toronto Law Journal 1 at 4. See also Matthew Conaglen, *Fiduciary Loyalty: Protecting the Due Performance of Non-Fiduciary Duties* (Oxford: Hart Publishing, 2010) 247: "It is difficult to imagine fiduciary relationships that do not involve some element of discretion on the fiduciary's part, and that discretion will inevitably be capable of affecting the legal position of the fiduciary's principal."; Paul D. Finn, *supra* note 419 at 24: "[T]he fiduciary's personal responsibility as fiduciary ends at the point where he is expressly obliged to act under dictation in some matter... In such cases, when executing the directions given, the fiduciary is acting solely in a ministerial capacity."

⁴⁶³ This view is prevalent in the Law and Economics analysis of fiduciary relations. See *supra* note 184 and the accompanying text.

⁴⁶⁴ See e.g. *Lac Minerals Ltd. v. International Corona Resources Ltd* [1989] 2 S.C.R. 574 at 599, per Sopinka J.; *Hodgkinson v. Simms* [1994] 3 S.C.R. 377 at para. 130, per Sopinka and McLachlin JJ.

⁴⁶⁵ See e.g. Matthew Conaglen, *supra* note 462 at 248: "[W]hen there is discretion that affects the interests of others, the discretion is generally regulated by duties that control its exercise, and the presence of inconsistent interests or duties carries with it a heightened risk of breach of those non-fiduciary duties... [W]hen there is discretion fiduciary duties may also exist in order to eliminate temptations that are inconsistent with the proper exercise of the discretion, so as to increase the chance of the discretion being exercised in accordance with those non-fiduciary duties."

decision. The judicial review of the exercise of powers or discretions by fiduciaries is based on the long-standing distinction between the decision-making process and the result of the decision itself. It is firmly established that, generally, the Court's supervision of trustees' exercise of power concerns the decision process rather than its results:

It is to the discretion of the trustees that the execution of the trust is confided, that discretion being exercised with an entire absence of indirect motive, with honesty of intention, and with a fair consideration of the subject. The duty of supervision on the part of this court will thus be confined to the question of the honesty, integrity, and fairness with which the deliberation has been conducted, and will not be extended to the accuracy of the conclusion arrived at.⁴⁶⁶

More specifically, the law's supervision of a fiduciary's exercise of discretion concerns the factors based on which the fiduciary reaches a decision regarding the most appropriate course of action. In this sense, fiduciary law aims to "channel the direction of [a fiduciary's] activities,"⁴⁶⁷ by ensuring that "[t]he only constraining influence upon his discretion [is] his own conscientious appreciation of his beneficiary's interests."⁴⁶⁸

Similar to public law theory, fiduciary law courts and commentators recognize that not all acts that a fiduciary performs require exercise of discretion. The distinction between acts or legal prerogatives that require exercise of discretion and 'ministerial acts' is frequently invoked in relation to delegation of powers or tasks by fiduciaries.

The distinction between ministerial and discretionary acts is well known in trust law. Only discretionary acts, which involve exercise of judgment, are specific to the office of trustee. While trustees cannot delegate the exercise of judgment or discretion, unless expressly authorized, they can entrust the performance of routine or 'ministerial' acts to other persons. The duty not to delegate powers involving exercise of judgment is an established rule, supported by ample judicial authority. The standard nineteenth century treatise on powers, *Sugden on Powers*, clearly states this distinction:

⁴⁶⁶ See *In re Beloved Wilkes's Charity* (1851) 42 ER 330 at 333-334, per Lord Truro L.C.

⁴⁶⁷ Paul D. Finn, *supra* note 419 at 13.

⁴⁶⁸ *Ibid.* at 25, footnotes omitted.

[I]f the power repose a personal trust and confidence in the donee of it, *to exercise his own judgment and discretion*, he cannot refer the power to the execution of another... Where the power... does not involve any confidence or personal judgment, it may be executed by attorney in the same manner as a fee-simple may be conveyed by attorney...”⁴⁶⁹

Likewise, referring to the common law rules of delegation of administrative or dispositive powers (as contrasted with the more recent statutory provisions on delegations of powers), Geraint Thomas and Alastair Hudson remarked:

The crucial question is whether the exercise of the particular power requires the exercise of a personal discretion... [T]rustees could delegate tasks which were mainly ministerial and involved no personal discretion or confidence. Trustees were themselves required to exercise discretions... but, once they had done so, the mere ‘mechanical’ task of implementing their decision could then be delegated to another.⁴⁷⁰

Despite substantial statutory regulation of the authority to delegate,⁴⁷¹ the principle remains that a power involving exercise of trustee’s personal discretion cannot be delegated, unless there is express authority to do so.⁴⁷² Although the distinction between discretionary and ministerial acts is blurred

⁴⁶⁹ Edward B. Sugden, *A Practical Treatise of Powers*, 3rd ed. (London: J.&W. Clarke, 1821) 175-179. Furthermore, “where the power is inseparably annexed to the person or mind of the donee, it will not be forfeited to the crown by his attainer; but where the thing to be done is a mere ministerial or formal act, not inseparably annexed to the person or mind of the donee, but which may be performed by one person as well as another, the power will go to the crown.” (*Ibid.* at 179). See also George Farwell, *A Concise Treatise on Powers*, 2nd ed. (London: Stevens & Sons, 1893) 441-445: “A power involving the exercise of personal discretion by the donee cannot be delegated... A power to do an act merely ministerial, and involving no personal discretion, may be delegated;” *Robson v Flight* (1865) 4 De. GJ & S 608 at 613, per Lord Westbury LC: “Such trusts and powers are supposed to have been committed by the testator to the trustees he appoints by reason of his personal confidence in their discretion, and it would be wrong to permit them to be exercised by [another].”; *Speight v Gaunt* (1883) LR 22 Ch D 727 at 756, CA: “A trustee has no business to cast upon brokers or solicitors or anybody else the duty of performing those trusts and exercising that judgment and discretion which he is bound to perform and exercise himself.

⁴⁷⁰ Geraint Thomas and Alastair Hudson, *The Law of Trusts*, 2nd ed. (Oxford: Oxford University Press, 2010) 500. For a comprehensive discussion of the relevance of the distinction between discretionary and ministerial acts prior to Trustee Act 2000, see the *Law Commission Paper on Trustee Duties and Powers*, available online at http://www.justice.gov.uk/lawcommission/docs/cp146_Trustees_Powers_and_Duties_Consultation.pdf

⁴⁷¹ For English trust law see Trustee Act 1925, Trustee Delegation Act 1999, Trustee Act 2000.

⁴⁷² Geraint Thomas and Alastair Hudson, *supra* note 470 at 515.

by the extended statutory authority to delegate granted to certain fiduciaries (such as trustees or corporate directors) from a theoretical perspective this distinction is essential for a proper understanding of the purpose of fiduciary duties. Only acts that require exercise of discretion fall under the no-conflict rules and under the duty to exercise proper judgment.

4.4.1 The distorting influence of extraneous interests on fiduciary's exercise of discretion

As shown Chapter 2, the peculiar strictness of the 'no-conflict' rules is an undisputed feature of fiduciary law, despite the divergence of theoretical views on its justification. It is also largely accepted that scope for exercise of discretion is one of the core features of a fiduciary position. Unlike the contemporary philosophical understanding of 'conflict of interest' and the established public law interpretation of the *nemo iudex* principle, the dominant theory of fiduciary obligations has failed, to a large extent, to connect the two essential elements of fiduciary law. A coherent fiduciary law theory must be constructed around the core insight that dominates the other two fields of 'conflict of interest' analysis: actual or potential personal interests in the outcome of a decision must be prevented or managed because they pose a risk on the reliability and credibility of the decision-maker's judgment.

Although the link between extraneous interests and proper exercise of judgment does not feature prominently in the contemporary fiduciary law theory, this insight is not altogether absent. Several cases and commentaries have recognized, although with insufficient authority, that the strict no-conflict rules are meant to protect fiduciary's judgment.

In *Re Trusteeship of Stone*, Zimmerman J. of the Supreme Court of Ohio observed that the reason why a trustee is in breach of duty of loyalty for self-dealing, although he acted in good faith, is the need to keep aside factors that tend to interfere with the reliability of is judgment:

[The self-dealing rule] may seem a harsh rule when applied to instances where there is no studied or deliberate design to do wrong

and when the [investment activity] is conceived and executed in good faith. However, the rule corresponds with most of the judicial pronouncements and with the best legal thought on the subject, and has been adopted by this court. Since a trustee is a fiduciary of the highest order... he must refrain from... doing those things which would *tend to interfere with the exercise of a wholly disinterested and independent judgment*.⁴⁷³

Writing extra-judicially, Justice Earl R. Hoover explained the rationale of the strict rule against self-dealing by emphasizing the threat that the presence of an actual or potential gain poses on trustee's judgment:

The only reason self-dealing is wrong is because, in self-dealing, there is conflict of interest which *prevents the fiduciary from exercising a disinterested judgment*. Necessarily, any other situation, though not self-dealing, which... destroys disinterested judgment is, by the same reasoning... a breach of loyalty.⁴⁷⁴

Fiduciary law is concerned with the adequacy of fiduciary's decision-making process in order to protect the beneficiary's right to the fiduciary's best judgment. As Chapter 2 amply illustrates, the dominant fiduciary law theory explains the existence and strictness of fiduciary duties based on two ideas: the impossibility of demonstrating fiduciary's actual state of mind and the need to send a strong signal to persons in a fiduciary position that the law will not tolerate even appearances of impropriety. These explanations have been rightfully criticized as being at odds with private law's approach to legal relations. Several courts and commentators have highlighted that the main reason why the law imposes the proscriptive duties is to protect beneficiary's right to obtain an unbiased judgment. In *Re Gee*, for instance, Harman J. expressed this view:

The beneficiaries are entitled to the advantage of the unfettered use by the trustee of his judgment as to the government of the company in which they are interested. This they do not get if *his judgment is clouded by the prospect of the pecuniary advantage* he may acquire if

⁴⁷³ *Re Trusteeship of Stone* (1941) 138 Ohio St 293 at 302, emphasis added.

⁴⁷⁴ Earl R. Hoover, "Basic Principles Underlying Duty of Loyalty" (1956) 5 Clev. Marshall L. Rev. 7 at 9-10.

he makes use of the trust shares to obtain or keep for himself a directorship carrying remuneration.⁴⁷⁵

Several courts and commentators have explained the irrelevance of fiduciary's good faith and desire to resist temptation in a situation of conflict of interest by underlining the insidious ways in which the possibility of self-interest affects the fiduciary's judgment. Similarly to the proponents of the contemporary philosophical view of conflicts of interest, these jurists recognize that a situation of conflict creates a risk on the fiduciary's judgment that cannot be measured or controlled. *Re Skeats's Settlement* is one of the rare cases acknowledging this idea. In this case, the donees of a fiduciary power granting them authority to appoint "any other person" as trustee exercised the power to appoint themselves. Since the power was fiduciary in character, Kay J. held that the exercise of discretion was invalid:

The universal rule is that a man should not be judge in his own cause; that he should not decide that he is the best possible person, and say that he ought to be the trustee. Naturally *no human being can be imagined who would not have some bias one way or the other as to his own personal fitness*, and to appoint himself among other people, or excluding them to appoint himself would certainly be an improper exercise of any power of selection of a fiduciary character such as this is.⁴⁷⁶

Judge Earl Hoover expressed a similar view: "Even assuming that a trustee with an adverse interest does not mean to do wrong, *his judgment is so warped that he cannot be fair*, and the taking of some undiscoverable advantage is almost certain."⁴⁷⁷

⁴⁷⁵ *Re Gee*, [1948] 1 All ER 498 at 504, emphasis added. See also *Pyle v. Pyle*, 137 App.Div. 568, 572, 122 NYS 256 [1910], affd. 199 NY 538, 92 NE 1099 [1910], emphasis added: "[A trustee] owes an undivided duty to his beneficiary... The purpose... is to require a trustee to assume a position where his every act is above suspicion and the trust estate, and it alone, can receive, *not only his best services, but his unbiased and uninfluenced judgment.*" *Thurston v. Nashville & American Trust Co.*, 32 F. Supp. 929 (MD Tenn. 1940), emphasis added: "these salutary rules of equity... guarantee... that beneficiaries... shall at all times have *the benefit of unbiased and disinterested judgment of the trustee...*"

⁴⁷⁶ *Re Skeats's Settlement* (1889) 42 Ch D 522 at 527, emphasis added.

⁴⁷⁷ Earl R. Hoover, *supra* note 474 at 16. See also George G. Bogert and George T. Bogert, *The Law of Trusts and Trustees, Sections 511-550*, 2nd ed. (St. Paul, Minn: West, 1993) 227: "It is not possible for any person to act fairly in the same transaction on behalf of himself and in the interest of the trust beneficiary. It is only human that he will tend to favor his individual interest, *whether consciously or unconsciously*, over that of the beneficiary."

More recently, Matthew Conaglen underlined the substantive similarities between the public law rule against bias and the fiduciary no-conflict rules:

[If] bias law's fundamental rationale is to provide an instrumentalist form of protection against decisions being made otherwise than on the merits, than the analogy drawn between it and the fiduciary conflict doctrine is viable.⁴⁷⁸

Although this observation is correct, Conaglen's understanding of how these two doctrines relate is questionable. In his view, the purpose of fiduciary no-conflict duties is to remove temptations of breach of non-fiduciary duties.⁴⁷⁹ Accordingly, Conaglen did not grasp the more fundamental similarity that exists between the two fields: the concern with proper exercise of judgment.

As these examples illustrate, a technical understanding of the notion of conflict of interest, in the sense of opposition between the decision maker's personal interests and his judgment (or between duties to exercise proper judgment arising from different fiduciary relations), is not altogether absent from fiduciary law theory. This technical understanding, however, has been obscured by the dominant theory, advocating the need to prevent temptations of unauthorized benefits. Besides failing to acknowledge the biasing effect that extraneous interests have on fiduciary's judgment, the dominant theory of fiduciary obligations focuses insufficiently on the fiduciary's duty to exercise discretion based on relevant considerations. The prevention of risk of bias and the duty to take into account relevant considerations are different facts of a single matter: the protection of beneficiary's right to the fiduciary's best judgment.

⁴⁷⁸ Matthew Conaglen, "Public-Private Intersection: Comparing Fiduciary Conflict Doctrine and Bias", *supra* note 432 at 75.

⁴⁷⁹ *Ibid.* at 82.

4.4.2 The duty to exercise discretion based on relevant considerations

In general terms, a fiduciary is bound to exercise discretion within the objective limits of his powers and in what he believes to be the best interest of the beneficiary or the scope for which the power was granted.⁴⁸⁰ The determination of beneficiaries' best interests or of the purposes for which a power was granted allows the fiduciary a large degree of subjectivity. As illustrated in the previous section, the judicial review of the exercise of fiduciary discretion is focused on fiduciary's decision-making process, rather than on the substantive merits of the result of an exercise. Besides the need to ensure that the decision-making process is not vitiated by the presence of self-interest, the law imposes on fiduciaries another procedural duty: the duty to base the decision-making process on relevant considerations.

Before analyzing this central duty, it is worth mentioning another set of proscriptive duties that are meant to ensure the adequacy of fiduciary's judgment: the duty not to place fetters on discretion and the duty not to act under dictation. A trustee (or other fiduciary) is under a duty not to fetter his discretion by committing irrevocably to exercise his powers or discretions in a particular way.⁴⁸¹ Furthermore, a trustee must not act under the dictation of another person; the exercise of discretion must be the result of his personal consideration and deliberation.⁴⁸² The rules against fettering discretion underline the importance of proper exercise of judgment. According to Moulton L.J., the vice in a constraint on discretion is that it obliges the fiduciary to exercise his discretion "in a specified manner to be decided by considerations other than *his own conscientious judgment at the time* as to what is best in the interests of those for whom he is trustee."⁴⁸³

⁴⁸⁰ See Lionel Smith, "Understanding the Power" in William Swadling, ed., *The Quistclose Trust: Critical Essays* (Oxford: Hart Publishing, 2004) 67-76.

⁴⁸¹ See e.g. *Re Hurst* (1892) 67 LT 96 at 99, per Lindley LJ; Geraint Thomas and Alastair Hudson, *supra* note 470 at 381.

⁴⁸² See e.g. *Selby v. Bowie* (1863) 8 LT 372; Geraint W. Thomas, *supra* note 417 at 299-300. The same requirements apply to company directors. In the parliamentary debates regarding the Company Law Reform Bill, per Lord Goldsmith pointed out that "the exercise of the judgment of a director... must be independent *in the sense of it being his own judgment*. He can even adopt the judgment of another. What matters is that *the judgment becomes his own*."; available online at:

<http://www.publications.parliament.uk/pa/ld200506/ldhansrd/vo060206/text/60206-37.htm>

⁴⁸³ *Osborne v. Amalgamated Society of Railway Servants* [1919] 1 Ch. 163 at 187.

In general terms, an appropriate exercise of discretion imposes on fiduciaries two requirements. First, a fiduciary must exercise active discretion, in the sense of applying his mind and reaching a conscious decision regarding the need for, and the implications, of exercising any power or discretion that he holds in fiduciary capacity.⁴⁸⁴ Second, if a fiduciary decides that it is opportune to exercise a power, he must decide where the best interests of the beneficiary lie (in case of an administrative power) or what is the best way to achieve the purpose for which the power was given (in case of a dispositive power). The two aspects of the exercise of judgment involve a similar decision-making process: fiduciaries must decide based on relevant considerations.⁴⁸⁵

Identifying a complete list of considerations that are relevant for each exercise of discretion is not possible.⁴⁸⁶ The identification of the considerations or factors that should be assessed in the decision-making process, is in general an objective matter. Although factors cannot be exhaustively spelled out *in abstracto*, fiduciaries and courts can determine what factors are relevant for each particular exercise of discretion.

When determining the relevant factors to be taken into account on a particular exercise of discretion, fiduciaries and courts must consider the following issues: the nature and the purpose of the particular power to be exercised; the relationship that the power has to the other powers and duties of the fiduciary; the nature of the transaction in which the fiduciary intends to

⁴⁸⁴ Geraint W. Thomas, *supra* note 417 at 297.

⁴⁸⁵ See Gary Watt, *Trusts and Equity*, 4th ed. (Oxford: Oxford University Press, 2010) 373: “Trustees are obliged to reach their decisions by a sound process... To exercise a sound discretion the trustees should take into account the relevant factors bearing upon their decision and discard all irrelevant considerations.”

⁴⁸⁶ As Geraint Thomas observed, it is not always easy (or possible) to determine objectively all factors that are relevant for a decision: “What ‘considerations’ is [a fiduciary] supposed to consider?... To what extent (if at all) are these matters left to the subjective preferences of the trustee or controlled by the objective criteria which the donor of the power intended should apply; and, in either case, upon what basis is the trustee able to decide? To these questions there is seldom a precise answer. An element (often a substantial element) of subjectivity is unavoidable, particularly where an absolute discretion is conferred upon the trustee. On the other hand, this clearly does not mean that the trustee has a completely free hand in such matters.” (Geraint W. Thomas, *supra* note 417 at 266). Similarly, the editor of *Snell’s Equity* observed, “the old law had been criticized on the grounds that it is often not clear what fiduciaries should or should not take into account when making a decision. This is no clearer under the new law, though there is some broad guidance in *Pitt v Holt*.” See *Snell’s Equity*, 32nd edition *online supplement*), online at <http://www.snellsequity.co.uk/Chapter.aspx?PartID=9&ChapterID=53>, para. 10-033.

perform.⁴⁸⁷ Furthermore, they must have regard to the already recognized relevant factors such as the wishes, circumstances and needs of beneficiaries, or fiscal considerations.⁴⁸⁸ Furthermore, it is possible to determine factors that are not relevant, such as fiduciary's personal interests or ethical views.⁴⁸⁹

Although the relevant factors on which discretion must be exercised are objective or objectively determinable, the *weight* that each of these factors should carry in determining the course of action is a subjective matter.⁴⁹⁰ As long as they have applied their mind to the importance of a relevant consideration for a particular decision, fiduciaries have complied with the duty of real and genuine consideration of relevant factors. As mentioned before, the duty to exercise judgment based on relevant considerations is procedural in nature. If the relevant factors are assessed, the duty is complied with even if, in hindsight, the adopted decision proves to be less than optimal. As Lloyd J. observed in *Pitt v Holt*, the fiduciary duty to take relevant matters into account is complied with when trustees seek advice on a relevant matter from apparently competent advisers, even if it turns out that the advice given to them was materially wrong.⁴⁹¹

The duty to exercise proper judgment is breached if the decision-making process is flawed. A blatant procedural flaw exists when fiduciaries exercise their powers without any exercise of judgment,⁴⁹² or when they base their decision not to exercise a power on a clearly irrelevant consideration.⁴⁹³

⁴⁸⁷ Paul D. Finn, *supra* note 419 at 27.

⁴⁸⁸ *Pitt v. Holt*, *supra* note 430 at [114]-[116].

⁴⁸⁹ See *Cowan v. Scargill*, [1984] 2 All ER 750 at 761, where Megarry VC stated that the trustees were on breach of their fiduciary duties in refusing approval of an investment plan for the pension scheme based on their social and political views.

⁴⁹⁰ *Edge v Pensions Ombudsman* [2000] Ch 602 at 626, per Chadwick LJ: "The essential requirement is that the trustees address themselves to the question what is fair and equitable in all the circumstances. The weight to be given to one factor as against another is for them."

⁴⁹¹ *Pitt v Holt*, *supra* note 430 at [127] per Lloyd LJ. In discussing the duty to take into account relevant considerations, the Court of Appeal revised what had, until then, been known as the rule in *Re Hastings-Bass*. See *Re Hastings-Bass (deceased)*, *Hastings and Others v Inland Revenue Commissioners* [1975] Ch 25 at 41; *Mettoy Pension Trustees Ltd v Evans* [1990] 1 WLR 1587.

⁴⁹² See e.g. *Turner v. Turner* [1984] Ch 100, where trustees with a discretionary power to distribute capital or income of a trust fund executed several deeds placed before them by the settlor without considering their discretion and the consequences of the deeds. Mervin Davies J concluded that "the Court can put aside the purported exercise of a fiduciary power, if satisfied that the trustees never applied their minds at all as to the exercise of the discretion entrusted to them." (*ibid.* at 109-110).

⁴⁹³ See e.g. *Klug v. Klug* [1918] 2 Ch 67, where a trustee refused to exercise a power of appointment because the beneficiary had married without her consent. Neville J stated that

Even when trustees or other fiduciaries are authorized to exercise their powers in their ‘absolute’ or ‘uncontrolled’ discretion, their exercise of powers may be challenged if their decision-making process is flawed. When reviewing the exercise of absolute and unfettered discretions, courts will investigate the decision process in order to determine if the donee of the power exercised it “upon real and genuine consideration and in accordance with the purposes for which the discretion was conferred.”⁴⁹⁴

Although it is habitually discussed in trust law contexts, the duty to exercise powers based on relevant considerations applies to any person in a fiduciary position (holding a fiduciary power).⁴⁹⁵ As the editor of *Snell’s Equity* remarked, the proper judgment duty articulately recently in *Pitt v Holt* binds any holder of a fiduciary power.⁴⁹⁶

Corporate directors, for instance, have a duty to take into account the interests of corporate constituencies when determining the best interests of the corporation. In *Peoples Department Stores Inc. (Trustee of) v. Wise* the Supreme Court of Canada stated that, in order to discharge their fiduciary duty of loyalty, corporate directors may take into account the interests of various stakeholders with a view to determine what course of action is in the

the court interfered because the trustee had refused to exercise the power “not because she has considered whether or not it would be for her daughter’s welfare that the advance should be made, but because her daughter had married without her consent... [The trustee] has not exercised discretion at all.” (*Ibid.* at 71). This case can be considered also as an exercise of discretion for an improper motive or purpose (Geraint Thomas and Alastair Hudson, *supra* note 470 at 377, note 84).

⁴⁹⁴ *Karger v. Paul* [1984] V.R. 161 at 163-164, per McGarvie J. He further added that the Court’s review of the exercise of an unfettered power is limited to assessing the compliance with these procedural safeguards: “As part of the process of, and solely for the purpose of, ascertaining whether there has been any such failure, it is relevant to look at evidence of the inquiries which were made by the trustees, the information they had and the reasons for, and the manner of, their exercising their discretion... The issues which are examinable by the court are limited to whether there has been a failure to exercise discretion in good faith, upon real and genuine consideration and in accordance with the purposes for which the discretion was conferred.” (*ibid.* at 164).

⁴⁹⁵ In *Pitt v Holt*, for instance, the rule was applied to a receiver (*supra* note 430 at [162]).

⁴⁹⁶ See *Snell’s Equity*, 32nd edition *online supplement*, *supra* note 486 at para. 11-009: “Questions have been raised as to whether the rule [of *Pitt v Holt*] applies solely to trustees or solely to trustees and the holders of fiduciary powers or to the holder of any power... In the light of *Pitt v Holt*, which founds the rule squarely on breach of the duty to have regard to material factors when exercising a power, the rule can only apply where such a duty exists. Consequently, the rule would not apply to the holder of a non-fiduciary power who has no such duty.”

best interests of the corporation.⁴⁹⁷ In the light of the evolving fiduciary jurisprudence, the Supreme Court's use of 'may' could be interpreted as referring to the ultimate weight that the interests of different corporate constituencies bear in director's decisions. In other words, the duty to exercise proper judgment requires them to address their mind to the potential effects of a decision on all relevant stakeholders. The weight that such interests are to have is a matter left to the directors' appreciation.

This interpretation of directors' 'duty of loyalty' is consistent with the UK approach. Section 172 of the UK Companies Act 2006 reformulates the common law duty of loyalty of company directors as 'the duty to promote the success of the company'.⁴⁹⁸ This duty requires a director to act "in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole." The Act then sets out a list of non-exhaustive matters to which directors *must* 'have regard' when deciding on the appropriate course of action.⁴⁹⁹

The duty imposed by section 172 is the analogue of trustee's duty to take into account relevant matters.⁵⁰⁰ In determining what actions contribute to the success of the company, directors must exercise judgment based on the relevant factors enumerated by the statute.⁵⁰¹ Although section 172 lists some

⁴⁹⁷ *Peoples Department Stores Inc. (Trustee of) v. Wise* [2004] 3 S.C.R. 461 at 480-482: [I]n determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment."

⁴⁹⁸ Paul L. Davies, *Gower and Davies Principles of Modern Company Law*, 8th ed. (London: Sweet & Maxwell, 2008) 506: "The duty to promote the success of the company is the modern version of the basic loyalty duty of directors."

⁴⁹⁹ Companies Act 2006, Section 172 (1): "A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to: (a) the likely consequences of any decision in the long term; (b) the interests of the company's employees; (c) the need to foster the company's business relationships with suppliers, customers and others; (d) the impact of the company's operations on the community and the environment; (e) the desirability of the company maintaining a reputation for high standards of business conduct; and (f) the need to act fairly as between members of the company."

⁵⁰⁰ *Snell's Equity*, 32nd edition online supplement, *supra* note 486 at para. 10-033: "Trustees have duties to take into account relevant factors and to desist from taking into account irrelevant factors... Company directors have such duties under section 172 of the Companies Act 2006."

⁵⁰¹ As Lord Goldsmith put it, "a director [must] act in a way that he considers in good faith to be most likely to promote the success of the company for the benefit of its members... [I]t is for the directors... to judge and to form a good faith judgment about what is to be regarded

of the most important factors to be considered by directors, thus rendering clarifying what considerations are relevant, the weight that each of these factors carries in a particular judgment is a matter left to the director's subjective appreciation:

[T]he words 'have regard to' - mean 'think about'; they are absolutely not about just ticking boxes... In other words 'have regard to' means 'give proper consideration to'... The clause makes it clear that a director is to have regard to the factors in fulfilling that duty. The decisions taken by a director and *the weight given to the factors will continue to be a matter for his good faith judgment.*⁵⁰²

Although the actual relevance of each factor to be taken into account is a matter governed exclusively by a director's good faith, the failure to assess the weight of a factor enumerated by section 172 amounts to breach of duty of loyalty.⁵⁰³ This provision illustrates the fact that the main focus of the duty of loyalty is the validity of the decision-making *process*, rather than the results of the decision. When such process is flawed by inclusion of irrelevant factors or by exclusion of relevant ones, the exercise of discretion is voidable.

The rules governing the exercise of discretion by trustees and company directors express a fundamental concern with the appropriate decision-making process that permeates all fiduciary relations. The debates surrounding the drafting of the section 172 of UK Companies Act 2006 show that the UK legislator was concerned with the development of a homogenous set of rules governing all fiduciary relations:

as success for the benefit of the members as a whole. It will be for the directors to determine; it is their good faith judgment that will matter, and they will need to look to the company's constitution, shareholder decisions and anything else that they consider relevant in helping them to reach that judgment." See the parliamentary debates regarding the Company Law Reform Bill, 6 February 2006, column 255-256, per Lord Goldsmith, *supra* note 482.

⁵⁰² The parliamentary debates regarding the Company Law Reform Bill, Commons Report, 17 October 2006, column 789, per Margaret Hodge, available online at: <http://www.publications.parliament.uk/pa/cm200506/cmhansrd/vo061017/debtext/61017-0012.htm>.

⁵⁰³ Paul L. Davies, *Gower and Davies Principles of Modern Company Law*, *supra* note 498 at 514: "[A] proper reading of the section [172] does lead to the conclusion that a failure by a director to have regard to each item on the list of factors would constitute a breach of duty [of loyalty] and render the director's decision challengeable, even if the weight to be attached to each factor and the extent to which it is appropriate to consider it in the circumstance of the case remain matters for the director's judgment..."

[T]he common law rules and equitable principles applying to directors did not develop in isolation... [A] lot of [directors'] duties derive... from the fact that directors are acting in some senses as agents, so the law of agency is relevant. Other law relating to trustees is also relevant from time to time... [T]he courts [must] continue to have regard to developments in the common law rules and equitable principles applying to these other types of fiduciary relationships. The advantage of that is that it will enable the statutory duties to develop in line with relevant developments in the law as it applies elsewhere.⁵⁰⁴

4.5 The relevance of the philosophical 'standard view' of conflict of interest for private law

How does a decision-maker select relevant factors, assign their appropriate weights and reach what he believes to be the most adequate decision? An increasingly popular trend in legal scholarship uses theories developed by cognitive and behavioural sciences in order to acquire a better understanding of the existing legal rules regulating the judgment and decision making process of legal actors in various contexts.⁵⁰⁵ The emerging Law and Psychology field improves both the descriptive and the normative legal analysis by offering a more in-depth understanding of existing legal rules regulating judgment and decision-making.⁵⁰⁶ So far, legal scholars have applied psychology theories and insights mostly in public law, in relation to decision-making by juries, judges and administrative decision-makers.⁵⁰⁷

⁵⁰⁴ The parliamentary debates regarding the Company Law Reform Bill, Lords Grand Committee, 6 February 2006, column 243, per Lord Goldsmith, *supra* note 482.

⁵⁰⁵ See Don Langevoort, "Behavioral Theories of Judgment and Decision Making in Legal Scholarship: A Literature Review" (1998) 51 Vanderbilt Law Review 1499; Avishalom Tor, "The Methodology of the Behavioral Analysis of Law" (2008) 4 Haifa Law Review 237.

⁵⁰⁶ Jeffrey J. Rachlinski, "The 'New' Law and Psychology: A Reply to Critics, Skeptics, and Cautious Supporters" (2000) 85 Cornell Law Review 739 at 740-741. Several traditionally-minded legal scholars have expressed concerns vis-à-vis the use of psychology tools in legal analysis. See Robert A. Hillman, "The Limits of Behavioral Decision Theory in Legal Analysis: The Case of Liquidated Damages" (2000) 85 Cornell Law Review 717; Samuel Issacharoff, "Can There Be a Behavioral Law and Economics?" (1998) 51 Vanderbilt Law Review 179. For a rebuttal of some of these critiques see Jeffrey J. Rachlinski, *ibid.* at 743-753.

⁵⁰⁷ See Jeffrey J. Rachlinski, *supra* note 506; Michael J. Saks and Robert F. Kidd, "Human Information Processing and Adjudication: Trial by Heuristics" (1980) 15 Law and Society Review 123; Hal R. Arkes and Cindy A. Schipani, "Medical Malpractice v. the Business Judgment Rule: Differences in Hindsight Bias" (1994) Oregon Law Review 587; Samuel

The application of cognitive sciences insights to fiduciary law is in incipient stages. Gregory Alexander is one of the first scholars to adopt such an approach.⁵⁰⁸ He used several cognitive theory concepts to rebut the traditional Law and Economics view that fiduciary duties are nothing but a species of contractual obligations. Alexander's theory demonstrates the discrete nature of fiduciary relations based on the model of cognitive analysis that the courts use when deciding cases involving breach of fiduciary duty. In breach of fiduciary duty cases, Alexander argued, courts have a tendency to apply top-down cognitive processes, which are theory-driven and therefore more sensitive to the judge's preconceived notions and expectations. In cases of alleged breach of contract, in contrast, courts use a bottom-up cognitive method, which is data-driven and, consequently, largely insulated from the judges preconceived views.⁵⁰⁹

Alexander's theory, while providing important new arguments for the specificity of fiduciary relationships, does not engage with the intrinsic features of legal relations that attract fiduciary duties. This dissertation uses insights from cognitive sciences to further the analysis of fiduciary relations by focusing on their substantive features. If the notion of conflict of interest is properly understood, it becomes clear that fiduciary law rules have already incorporated these insights and have been fashioned to prevent or reduce the unwanted consequences of erroneous decision-making processes.

The 'standard view' of conflicts of interest has a descriptive, rather than normative role in understanding fiduciary law. The philosophical view of conflict of interest helps lawyers understand the proper scope and justification of firmly established rules. It does not aim to dictate how the law should be; rather, it brings scientific, albeit meta-juridical, explanation of the justification of the proscriptive duties. As Section 2.3 has shown, courts have constantly affirmed the very strict nature of the proscriptive duties since the earliest stages of fiduciary law. In very rare occasions, several courts have emphasized that judges are ill-equipped to investigate whether the core

Issacharoff, "Behavioral Decision Theory in the Court of Public Law" (2002) 87 Cornell Law Review 671.

⁵⁰⁸ Gregory S. Alexander, "A Cognitive Theory of Fiduciary Relationships" (2000) 85 Cornell Law Review 767.

⁵⁰⁹ *Ibid.* at 768.

fiduciary duty has been breached. The ‘standard view’ helps lawyers understand why this is so – the effect of self-interest is unpredictable and escapes any measurement.

As Chapter V shows, the essence of the ‘standard view’ was known to philosophers many centuries before modern social sciences articulated it cogently. Lawyers seem to have built the proscriptive duties around this core insight. The proscriptive duties have been developed and applied in relations where the protection of a person’s rights is dependent on another person’s unencumbered exercise of judgment. In public law, proscriptive duties have been developed to protect the administrative or judicial decision-making process. In private law, the proscriptive duties apply to fiduciaries. In contrast to public law, where considerations of public interest have a key role, in private law a fully-informed beneficiary of the proper judgment duty can waive the extra-protection that the prophylactic duties offer.

The possibility to relax or remove the proscriptive duties allows the beneficiary to tailor his relation to the fiduciary and assume the risk derived from the decreased reliability of fiduciary’s judgment. While the fiduciary remains bound by the core duty, the beneficiary assumes the risk that the fiduciary’s appreciation of the relevant factors may be less than optimal, due to the presence of an authorized self-interest.

The special nature of the proscriptive duties and their prophylactic purpose can be understood only in connection with the core duty to exercise proper judgment. In contrast to other legal duties, the core duty needs the extra protection of the prophylactic duties. Situations of conflict of interest must be managed because in certain cases nobody –not even the fiduciary himself- can determine whether the core duty has been breached or not. This peculiar feature of the core duty justifies the protection of the prophylactic duties.

The ‘standard view’ strengthens the connection between the proscriptive duties and the core duty. The proscriptive duties are not ends in themselves, but means to ensure proper exercise of judgment. For this reason, the proscriptive duties are better understood as duties to manage, rather than simply avoid, situations of conflict of interest. The ‘standard view’ helps lawyers understand that the manner in which a fiduciary responds to a

situation of conflict is more important than the occurrence of the situation itself.

Disciplines outside of the law are increasingly aware of the biasing effect that self-interest has on judgment, and have described it in sophisticated ways. If the fundamental fiduciary law concepts are understood properly, it becomes clear that fiduciary law has also been aware of the relation between self-interest and proper exercise of judgment in another's interest. The structure of fiduciary law reflects a fundamental concern to acknowledge the biasing effect and to minimize the possibility that it will affect the decisions of fiduciaries and therefore the interests of beneficiaries.

4.6 Conclusion

The proper exercise of judgment or discretion is the law's main concern in regulating fiduciary relations. Irrespective of the label used (such as fiduciary duty, duty of loyalty, duty to exercise sound discretion, duty of real and genuine consideration), the central duty binding on every person holding a fiduciary power aims to guide the fiduciary's exercise of discretion by regulating the decision-making process. Recent developments in the rules governing the exercise of discretion by trustees and company directors show that the duty to exercise proper discretion by taking into account relevant matters is a combination of objective and subjective standards. While courts and fiduciaries can determine objectively whether a certain factor is relevant or not to a particular exercise of discretion, the ultimate assessment of the weight that a relevant factor should have in the outcome of a decision-process is left at the fiduciary's good faith judgment.

The primacy of the decision-making process explains why fiduciary law comprises stringent proscriptive duties. Adopting a decision in a conflict of interest situation amounts to a flawed decision process, irrespective of the actual outcome of such decision. The presence of an actual or potential personal interest on the fiduciary's part in the outcome of a decision process flaws this process by affecting the fiduciary's ability to evaluate the weight that relevant factors should bear in his decision. Although the biasing effect

that self-interest has on judgment has been known for centuries, contemporary fiduciary law theory has largely lost sight of it. One of the main causes of this oversight is the continuous attempts to find a theoretical foundation for the proscriptive duties independently of the core feature that is specific to a fiduciary position: power to affect the legal or practical interests of another, coupled with a duty to exercise it in the best interest of another or for the purpose for which it was granted. The view that has dominated the fiduciary law theory throughout twentieth century was based on the premise that fiduciaries inevitably exploit to their advantage their superior position, and therefore need to be disciplined. The law's concern with prevention of abuse or misappropriation, however, spreads across various legal fields. Therefore, it cannot be the central feature that sets fiduciary law apart. Recent research in various fields concerned with conflicts of interest has demonstrated that self-interest can affect the proper exercise of judgment in ways that often escape measurement or control. The main reason why fiduciary law is concerned with the management of actual or potential situations of conflict is not prevention of abuse by stifling temptations. It is protection of beneficiary's right to fiduciary's unencumbered and genuine judgment. Disciplining legal actors and reinforcing the general confidence in legal relations are, at best, secondary effects of fiduciary law and, indeed, of any private law rules.

CHAPTER V: SELF-INTEREST AND PROPER EXERCISE OF JUDGMENT: HISTORICAL INSIGHTS

5.1 Introduction

As shown in the previous two chapters, the emerging philosophical understanding of a conflict of interest situation has developed around the central idea that a decision-maker's personal interests may affect the reliability of his professional judgment. The current fiduciary law theory has not yet incorporated this understanding of a conflict of interest situation. Maintaining the conventional view that fiduciary law rules are designed to mitigate the opposing interests of the parties to a fiduciary relation, the dominant contemporary theory of fiduciary duties perpetuates the ambiguity that has affected this legal field for many decades. Nevertheless, the insight, around which the philosophical 'standard view' is built, is not entirely unknown in legal theory. It has been expressed in the legal sphere in various forms since Roman law. This chapter will analyze several legal or philosophical concepts that connect the prohibition of acting self-interestedly with the requirement of exercising proper judgment in the interest of another.

The main aim of this historical excursus is to show that the contemporary standard philosophical view of 'conflict of interest' can be integrated organically in private law. Its core insight has been known in law, under various forms, since very early times. Although the similarities between the concepts analyzed in this chapter and the standard view of conflict of interest are notable, more research is necessary before convincing historical arguments can be adduced to support the claim that the opposition between self-interest and proper exercise of judgment has been the fiduciary law's main concern in the early stages of its development.

5.2 *Bonus vir* as a standard of proper exercise of judgment in Roman law

Roman legal philosophers were familiar with the idea of biased judgment. In *On Benefits* Seneca discussed the bias that self-regarding feelings cause on a person's judgment concerning the value of the favours given and received. Feelings like greed or jealousy, innate in all humans, determine persons to discount the value of the favours received in a way that they do not discount their own services.⁵¹⁰ In contrast, when self-regarding feelings are set aside, a person's judgment functions at its best:

Yet we never give anything with more care, we never take such pains in deciding upon our verdict, as when, without any views of personal advantage, we think only of what is honorable, *for we are bad judges of our duty as long as our view of it is distorted by hope and fear, and that most indolent of vices, pleasure...* [W]e never take more scrupulous care than in deciding what is to be done with what does not concern us...⁵¹¹

The concept of *bonus vir* is another illustration of the Roman's concern with proper exercise of judgment over another's interests. Many persons who had discretion to affect another's interests, such as tutors or fiduciary heirs, were required to exercise judgment as a *bonus vir* would do, by taking into account relevant considerations, while remaining disinterested. *Bonus vir* not only possessed the two virtues that were essential for trustworthiness (*fides*), namely justice (*iustitia*) and prudence (*prudentia* or *sapientia*), but was also endowed with an uncanny ability to resist self-regarding impulses and avoid any suspicion of deceit:

⁵¹⁰ See Lucius Annaeus Seneca, *On Benefits*, transl. by Aubrey Stewart (London: George Bell and Sons, 1905) 2.26.2: "We must now consider what is the main cause of ingratitude. It is caused by excessive self-esteem, by that fault innate in all mortals, of taking a partial view of ourselves and our own acts... *Every one is prejudiced in his own favour (nemo non benignus est sui iudex)* from which it follows that he believes himself to have earned all that he receives, regards it as payment for his services, and does not think that he has been appraised at a valuation sufficiently near his own."

⁵¹¹ *Ibid.* at 4.11.5, emphasis added. See also Brad Inwood, *Reading Seneca: Stoic Philosophy at Rome* (Oxford: Oxford University Press, 2005) 211-212.

Trust reposed in us can be established by two qualities, that is, if people come to believe that we have acquired prudence allied with justice... As for men of justice, in other words good men [*boni viri*] trust in them depends on their *having no suspicion of deceit and injustice* in their make-up. So these are the men to whom we believe our safety, our possessions, and our children are most justifiably entrusted.⁵¹²

In addition to keeping at bay self-regarding interests, *bonus vir* was expected to exercise judgment based on relevant considerations. Due to these two central features (judgment unencumbered by self-interest and based on relevant considerations) the judgment of a *bonus vir* became a standard of decision-making for persons called to exercise discretion over others' interests.

Bonus vir became a standard of proper judgment as a consequence of the arbitration role that he played. Arbitration by *bonus vir* was a purely private and informal method of resolving disputes. In settling a dispute, the *bonus vir* was called to exercise equitable discretion and to decide based on relevant considerations, following the social standards of fairness and common sense. Although the *arbiter bonus vir* was not bound to apply the positive law, as an honourable man, he was expected to take it into consideration. The criterion used by *bonus vir* in rendering his decisions was *bonum et aequum*, 'that which is right and equitable', a standard combining objective elements and principles derived from *aequitas*.⁵¹³

⁵¹² Cicero, *On Obligations*, transl. by P.G. Walsh (Oxford: Oxford University Press, 2000) 2.9.33, emphasis added.

⁵¹³ See Derek Roebuck and Bruno de Loynes de Fumichon, *Roman Arbitration* (Oxford: HOLO Books, 2004) 64; Adele C. Scafuro, *The Forensic Stage: Settling Disputes in Graeco-Roman New Comedy* (Cambridge, UK: Cambridge University Press, 1997) 141-153. One of the oldest extant references to the arbitration of the *bonus vir* comes from Marcus Porcius Cato (commonly surnamed 'the Censor' or 'the Elder') who lived between 234 BCE and 149 BCE. In his chief work, *On Agriculture*, Cato recommended that various kinds of contracts include a clause whereby potentially controversial matters were to be submitted to the judgment of a *bonus vir*. In disputes concerned agricultural leases, for instance, the amount of damages caused to the lessor was to be determined by a *bonus vir*. (See Cato, *On Agriculture* 149.1, in William D. Hooper, trans., *Marcus Porcius Cato, On Agriculture* (London: W. Heinemann, 1934) 135-136: "All damage done to the owner by the renter or his herdsmen or cattle shall be settled for according to the decision of an honest man; and all damage done to the renter by the owner or his servants or cattle shall be settled for according to the decision of good man."). Another instance of the proper judgment of the *bonus vir* concerns the contracts for the harvesting of an olive crop. In such contracts, *bonus vir* was called to determine whether or not the contractor returned the owner's ladders in good condition. See *ibid.* at 127-131: "Ladders are to be returned in as good condition as

Gradually, the ‘judgment of a *bonus vir*’ acquired a more technical meaning. It was no longer associated with a concrete, trustworthy person, but became an abstract standard of judgment, guiding the exercise of discretion by persons in a position to decide for others. In many passages from Justinian’s Digest *bonus vir* appears as a standard of discretion rather than an actual arbiter.

A tutor, for example, was required to decide the amount of dowry for the daughter of a deceased man *ac si viri boni arbitrato* (as a *bonus vir* would judge). The *bonus vir* standard mitigated the tutor’s unfettered discretion by requiring him to take into account objective elements, such as the testator’s wealth or the size of his family:

If a father had directed that a dowry should be given to his daughter at her tutor’s discretion, Tubero says this is to be taken just as if it had been bequeathed at the discretion of an upright man. Labeo asks: How can you tell how much dowry ought to be provided for the daughter of this person or that, at the discretion of an upright man? He says that is not difficult to estimate from the rank, means, and number of children of the person making the will.⁵¹⁴

when they were issued, except those which have been broken because of age; if they are not returned, a fair deduction will be made by arbitration of an honest man. Any damage done to the owner through the fault of the contractor will be deducted on the decision of an honest person.”

⁵¹⁴ Dig. 32.43, translated in Theodor Mommsen and Paul Krueger, eds., *The Digest of Justinian*, vol. 3, trans. by Alan Watson (Philadelphia: University of Pennsylvania Press, 1985) 86-87. Another example where the *bonus vir* as a standard of judgment over another’s interests was applied refers to the institution of *fideicommissum*. Ulpian, for instance, provided several hypothetical examples which demonstrated how the fiduciary heir (*fiduciarius*) was expected to exercise his judgment over the interests of the beneficiary of the *fideicommissum*. If the testator instructed the fiduciary heir to make unequal payments, without specifying the amount of these payments, the fiduciary heir was bound to exercise discretion as a *bonus vir*, based on relevant elements: “those [payments] are owed... which a good man would judge consistent with the resources of the deceased and the situation of the property.” (Dig. 33.1.3 in Mommsen and Krueger, *ibid.* at 102). Moreover, if the testator instructed the fiduciary heir to make a payment to a beneficiary “if you think [the beneficiary] deserves it” then the former was expected to make such determination “following the judgment of a *bonus vir*.” (Dig. 32.11.1 in Mommsen and Krueger, *ibid.* at 73-74). See also Roebuck & Fumichon, *supra* note 513 at 62). If the payment is to be made “if [the beneficiary] does not offend [the fiduciary heir]” the heir will not be able to justify a claim that the beneficiary is undeserving, if a *bonus vir* would admit him as deserving (*ibid.*). Furthermore, a *fideicommissum* whereby the fiduciary heir was instructed to make payments ‘if you judge it good’ or ‘if you think it suitable,’ required the heir to make such determination not according to his complete discretion, but based on relevant matters, as an upright man would do (*ibid.*).

In addition to the duty to exercise judgment as a *bonus vir*, the tutor was bound by a strict duty not to benefit from his position. A tutor was not entitled to buy or to acquire for himself any part of his ward's estate, or to do any act connected with it for his own personal benefit - as, for example, to authorize the pupil to perform an act that would benefit the tutor. Such a situation would render a tutor *auctor in rem suam*, which would be in contradiction to his duty to act in the pupil's interests.⁵¹⁵

The notion of 'judgment of a *bonus vir*' combines two essential features. First, considerations of self-interest are excluded ab initio from the exercise of judgment. As Cicero's work shows, a person is a *bonus vir* only if he can resist acting in his own interests to another's detriment.⁵¹⁶ Second, the judgment is based on relevant objective factors as opposed to being guided only by the decision-maker's free will.

These two features render the concept of 'judgment of a *bonus vir*' similar to the model of proper exercise of judgment developed in this dissertation. The resemblance between the two models may be more than a mere coincidence. The *bonus vir* standard appears in several instances in relation to the early jurisdiction of the English Court of Chancery. The celebrated American jurist Norton Pomeroy described the equitable jurisdiction of early Chancellors as the exercise of a power to do justice according to the requirements of the Roman principle *arbitrium boni viri*.⁵¹⁷ *Bonus vir* was mentioned also in relation to the use, the forerunner of the trust. Lord Bacon defined the use as "the equity and honesty to hold the land

⁵¹⁵ Robert D. Melville, *A Manual of the Principles of Roman Law* (Edinburgh: W. Green & Son, 1921) 182.

⁵¹⁶ Cicero, *On Obligations*, *supra* note 512 at 3.19: "If a good man, then, should have this power, that by snapping his fingers his name could creep by stealth into the wills of the wealthy, he would not use this power, not even if he had it for certain that no one at all would ever suspect it... [T]he just man, and he whom we deem a good man, would take nothing from any man in order to transfer it wrongfully to himself."

⁵¹⁷ John Norton Pomeroy, *A Treatise on Equity Jurisprudence*, vol. 1 (San Francisco: AL Bancroft, 1881) 35-36: "[E]quity is nothing more nor less than the power possessed by judges -and even the duty resting upon them- to decide every case according to a high standard of morality and abstract right, that is, the power and duty of the judge to do justice to the individual parties in each case. This conception of equity was known to the Roman jurists, and was described by the phrase, *arbitrium boni viri*, which may be freely translated as the decision upon the facts and circumstances of a case which would be made by a man of intelligence and of high moral principle."

in *conscientia boni viri*,”⁵¹⁸ i.e. according to the conscience or judgment of a *bonus vir*. The work of Lord Stair offers another example. The celebrated Scottish jurist described the position of a general mandatary as requiring the exercise of discretion as a *bonus vir* would do:

The obligation arising from mandate is chiefly upon the part of the mandatar, to perform his undertaking... Where the mandate is not special, it must be performed *secundum arbitrium boni viri*.⁵¹⁹

The presence of the ‘judgment of a *bonus vir*’ in the writings of early modern legal scholars as a standard of exercise of discretion over another’s interests is remarkable. Just as the contemporary ‘standard view’ of conflicts of interest postulates, ‘judgment of a *bonus vir*’ conveys the idea that persons occupying positions of trust are expected to exercise discretion based on relevant factors, and excluding considerations of self-interest.

5.3 Nemo iudex in causa sua

As shown in the previous chapter, several early fiduciary law cases and commentators linked the concept of fiduciary duties with the maxim stating that no person may be both judge and party in the same cause.⁵²⁰

In modern legal theory the maxim *nemo iudex in causa sua* is regarded as one of the pillars of ‘natural justice’. Until the eighteenth century, ‘natural justice’ lacked a precise meaning – it was often used interchangeably with ‘natural law’, ‘natural equity’, ‘eternal law’ ‘the laws of God’ and other similar expressions, to refer to “the natural sense of what is right and wrong.”⁵²¹ In modern times ‘natural justice’ has acquired a restricted meaning. It has been used as a compendious phrase to describe certain rules

⁵¹⁸ Francis Bacon, *The Works of Lord Bacon: With an Introductory Essay*, vol. 1 (London: William Ball, 1838) 584. See also Edward Hilliard, ed., *Sheppard’s Touchstone of Common Assurances*, 7th ed., vol. 1 (London: J&WT Clarke, 1820) 501 (defining the use as “the [right in equity to have the] profit or benefit of lands and tenements; or, as others define it, the equity and honesty to hold the land in *conscientia boni viri*...”).

⁵¹⁹ James Dalrymple, Viscount of Stair, *The Institutions of the Law of Scotland* (Edinburgh: G. Hamilton, 1759) 115.

⁵²⁰ See e.g. *York Buildings Company v Mackenzie* (1795) 8 Brown PC 42 at 63: “The ground on which the disability or disqualification rests [i.e. the rule against self-dealing], is no other than that principle which dictates that a person cannot be both judge and party.”

⁵²¹ *Voinet v. Barrett* (1885) 55 L.J.Q.B. 39 at 41, per Lord Esher M.R.

of judicial procedure. The main two procedural rules or principles of natural justice are usually expressed in the following form: (a) no man shall be judge in his own cause, or *nemo iudex in causa sua*;⁵²² (b) both sides shall be heard, or *audi alteram partem*. The traditional forum for the application of these rules is public law; they were invoked to guide the exercise of discretion by administrative and domestic tribunals and of any authority exercising an administrative power that affects a person's status, rights or liabilities.⁵²³

Although more frequently used in public law, the *nemo iudex* maxim was regarded as having a universal applicability. It was held to be a general rule of law, founded on nature itself and known to all legal systems. In *Mersey Docks Trustees v. Gibbs*, for example, Lord Blackburn asserted that "it is contrary to the general rule of law, not only in this country [England] but in every other, to make a person judge in his own cause."⁵²⁴

In private law relations, the maxim was often used to express the prohibition of self-help. The interdiction to act as judge in one's cause meant that no person was allowed to take justice in his own hands.⁵²⁵ In other cases

⁵²² According to David Yale, this Latin formulation of the prohibition of being judge in one's own case was coined by Sir Edward Coke. See David E.C. Yale, "Iudex in Propria Causa: An Historical Excursus" (1974) 33 Cambridge Law Journal 80 at 80. Coke laid down this phrase in his comments on section 212 of Littleton, concerning self-help for damages caused by straying cattle. According to this section, an act whereby a lord established his right to impose arbitrary fines for damages caused to him by straying cattle is void because it is against reason. See Sir Edward Coke, *The First Part of the Institutes of the Law of England*, vol. 1, 15th ed. (London: E. and R. Brooke, 1794) 229: "[I]t is against reason, that if wrong be done [to] any man, that he thereof should be his own judge; for by such way, if he had damages but to the value of an halfpenny, he might assesses and have therefore [one hundred pounds], which should be against reason."

⁵²³ Hedley H. Marshall, *Natural Justice* (London: Sweet & Maxwell, 1959) 3-12; Jonathan Law and Elizabeth A. Martin, eds., *A Dictionary of Law* (Oxford: Oxford University Press 2009), s.v. *natural justice*.

⁵²⁴ *Mersey Docks Trustees v. Gibbs*, (1886) L.R. 1 H.L. 93 at 110. See also *Gibbons v. Bishop of Cloyne*, Holt 599 at 600: "Lastly, here the bishop was both judge and party, which is not to be allowed by any law in the world."; Steward Kyd, *A Treatise on the Law of Awards* (Dublin: J. Stockdale, 1791) 42: "It is a general rule of law, founded on the first principles of natural justice, that a man cannot be judge in his own cause."; John Erskine, *An Institute of the Law of Scotland*, vol.1 (Edinburgh: John Bell, 1773) 45, emphasis added: "Declinature is founded, thirdly, *ratione suspecti judicis*, where either the judge himself, or his near kinsman hath an interest in the suit. *It is a rule founded on nature itself*, that no man ought to judge in his own cause; and it holds, though the judge have only a partial interest in the cause..."

⁵²⁵ See Jacob Giles, *A Treatise of Laws: Or, A General Introduction to the Common, Civil, and Canon Law* (London: T. Woodward, 1721) 315: "The person letting to hire may expel his tenant by authority of the judge, before the term is expired. This must be by authority, if the tenant resisteth, for no man ought to judge in his own cause."; Sir Edward Coke, *The*

the principle was used to express the idea that where a decision requires judgment, an interested party is never a competent decision-maker. In *Hall v. Harding*, for instance, it was held that if the number of cattle that a commoner is allowed to pasture is uncertain, another commoner is not a competent judge to determine it:

It is unnecessary to give any opinion as to the commoner's right of distraining where the number is absolutely certain; that is, where the other commoner's claim is for ten, twenty, or thirty, without any relation to the quantity of land... [W]hen the question depends upon a collateral fact, or upon a matter of judgment, *the party interested can never be a competent judge in his own cause.*⁵²⁶

As these examples show, the *nemo iudex* maxim was applied in many different contexts in public and private law. Due to the heterogeneity of the scenarios in which it was invoked, it is difficult to determine the core rationale for the prohibition of being both decision-maker and interested party.⁵²⁷ In purely private law matters, it is possible to argue that the *nemo iudex* prohibition was justified by the need to ensure objective and unbiased judgment. The concern with proper exercise of judgment seems to be one of the main rationales behind the presence of this rule in Roman law.

Section 2.2 of the Theodosian Code may offer an insight into the reason behind the existence of this prohibition in Roman law. This section,

Second Part of the Institutes of the Law of England (London: E. & R. Brooke, 1797) 102-103: "*Aliquis non debet esse iudex in sua propria causa...* [N]o private revenge [should] be taken, nor any man by his owne arme or power revenge himselfe... [A]ll causes ought to be heard, ordered, and determined before the judges of the king's courts..." The axiom that no person should be judge in his own cause was often used to express the prohibition of private vengeance in relation to damage caused by straying cattle. See *supra* note 522. The maxim appears also in *Doctor and Student* several times, as an argument against self-help in case of damages. See Christopher Saint German, *The Doctor and Student: Or, Dialogues between a Doctor of Divinity and a Student in the Laws of England*, 18th ed. (Dublin: James Moore, 1792) 124-125: "I agree that he may not take upon him to be his own judge, and to come to his duty against the order of the law... [H]is assent is not much to be pondered in that case, for all his assessing of him that took the distress, and so hath made himself his own judge, and that is prohibited in all laws..."

⁵²⁶ *Hall v. Harding* (1769) 4 Burr. 2426 at 2431, emphasis added.

⁵²⁷ According to Yale, the typical context in which the principle was applied in medieval times in common law concerned the validity of royal grants of jurisdictional franchise to various grantees, such as religious houses, boroughs, universities or individuals. The main question was whether the king could enable a man to decide a case in which he was concerned because he was lord of the franchise in which the cause of action arose. The main problem was not the proper exercise of judicial powers, but what judicial powers could be properly conferred or claimed. See David E.C. Yale, *supra* note 522 at 84-85.

entitled “No person shall be judge in his own cause” (*Ne in sua causa quis iudicet*) states that this prohibition was established in 376 CE by a joint decree issued by emperors Valens, Gratian and Valentinian:

We decree with sweeping generalization that no person shall act as judge for himself. For since the law has deprived all persons of the right to testify in their own case, it is entirely unfair to grant them the license to pronounce sentences.⁵²⁸

The official interpretation of this text underlines that the reason why a person cannot be judge in a matter in which he is interested is the same reason that prohibits a person to be witness in a case where he has an interest: “Our regulation shall constrain all men that no man may be judge of his own case, because just as no man can testify for himself, so he cannot act as judge for himself.”⁵²⁹ Unfortunately it is very difficult to find a clear explanation of the latter prohibition in a Roman source. One possible explanation for the interdiction is the concern with the reliability of the witness’ judgment.

This explanation of the interdiction to be an interested witness in a case appears in English law, in one of the earliest treatises on the law of evidence. Sir Geoffrey Gilbert pointed out that the prohibition of being witness in one’s own cause is justified by the fact that, due to the shortcomings of human nature, the testimony of a witness that has an interest in the outcome of the case is unreliable:

[T]he general rule is, that no man can be a witness for himself... [F]or men are generally so short-sighted, as to look at their own private benefit which is near to them, rather than to the good of the world, that is more remote; therefore from the nature of human passions and actions, there is more reason to distrust a biased testimony than to believe it.⁵³⁰

⁵²⁸ *The Theodosian Code and Novels and the Sirmondian Constitutions*, trans. by Clyde Pharr (Princeton: Princeton University Press, 1952) 39-40. These provisions were restated in Justinian’s Code 3.5.0: No one shall be judge in his own cause; and Justinian’s Digest 22.5.10: No person is deemed to be a competent witness in his own cause.

⁵²⁹ *The Theodosian Code*, *supra* note 528 at 40.

⁵³⁰ Sir Geoffrey Gilbert, *The Law of Evidence*, 3rd ed. (London: His Majesty’s Law Printers, 1769) 122-123. Blackstone offered a similar justification for the prohibition of being witness in one’s own cause. Referring to the prohibition of a spouse to testify for the other spouse, Blackstone noted that one of the reasons of this rule is that “it is impossible for their testimony [to be] indifferent...; and therefore, if they were admitted to be witnesses for each other, they would contradict one maxim of law, ‘*nemo in propria causa testis esse debet*’.”

These texts show that the need to ensure objective and unbiased judgment was one of the reasons behind the *nemo iudex* rule. As part of ‘natural law’ or ‘natural justice’, the *nemo iudex* maxim has influenced the early jurisprudence of the Court of Chancery. As Joseph Story commented, early Chancellors “acted upon principles of conscience and natural justice, without much restraint of any sort.”⁵³¹ Consequently, it can be contended that, when Chancellors explained that a person in a fiduciary position cannot be in a situation of conflict of interest since no person can be judge in his own cause,⁵³² they were invoking the need to ensure that fiduciaries’ judgment be reliable and unbiased.

5.4 Auctor in rem suam

A current of opinion, especially popular among Scottish jurists, identifies the origins of the fiduciary no-conflict rule in the Roman law rule that prohibited a tutor or curator to be ‘*auctor in rem suam*’. A well-known Scottish work on Latin legal maxims translates this expression as “one who acts for his own behoof”.⁵³³

In Roman law, the expression was used to refer to a procedural incompatibility. If a suit arose between a tutor and his ward, the tutor could not stand in court both in his name and as representative of the ward.⁵³⁴ Until

Sir William Blackstone, *Commentaries on the Laws of England: In Four Books*, vol. 1, 12th ed. (London: A. Strahan and W. Woodfall, 1793) 443.

⁵³¹ Joseph Story, *Commentaries on Equity Jurisprudence*, vol. 1, 14th ed. (Boston: Little, Brown and Co., 1918) 21). See also Sir Duncan Mackenzie Kerly, *An Historical Sketch of the Equitable Jurisdiction of the Court of Chancery* (Cambridge: Cambridge University Press, 1890) at 101: “The Civil Law... was referred to as a repertory of moral principles, and, as such, it was accepted not only in our Court of Chancery, but throughout the Western World. The Law of Nature... was nothing more than the Civil Law denuded of its technicalities, and modified occasionally by contrast with the positive morality of the Christian system.”; Dennis Klinck, *Conscience, Equity and the Court of Chancery in Early Modern England* (Farnham: Ashgate, 2010) 219-263

⁵³² See e.g. *supra* note 520.

⁵³³ John Trayner, *Latin Phrases and Maxims: Collected from the Institutional and Other Writers on Scotch Law* (Edinburgh: W. Paterson, 1861) 32-33.

⁵³⁴ The Institutes of Gaius sets forth this rule as follows: “Formerly, when the *legis actiones* were in use, a new tutor was named every time there was an action between the tutor and the woman, or pupil subjected to his *tutela*. Because the tutor could not be plaintiff in his own suit [*in re suam auctor*] another was appointed under whose authority it was necessary to

the second half of the eighteenth century, the Scottish lawyers applied the *auctor in rem suam* principle solely in the context of the actions of tutors in connection with the estates of their wards.⁵³⁵ Starting with the works of John Erskine, this rule was expanded to any person occupying a fiduciary position. At the same time, the rule was no longer restricted to a procedural incompatibility; it was interpreted as encompassing a general interdiction of using such position for its holder's benefit:

Neither tutors nor curators can be *auctores in rem suam*. They cannot, contrary to the nature of their trust, interpose their authority to any deed of the minor, in which themselves have an interest, or which tends to produce an obligation against him in their own favour, no more than they can be judges or witnesses in their own cause.⁵³⁶

In *Aitken v Hunter* Lord Neaves confirmed that the *auctor in rem suam* principle applies universally to any fiduciary:

It appears to me that from first to last the rule of the law of Scotland has been that any one holding a fiduciary character, whether that of guardian or trustee, cannot lawfully become *auctor in rem suam*... That doctrine is derived from the civil law... It is a sacred rule.⁵³⁷

Contemporary Scots law jurists use the expression '*auctor in rem suam*' interchangeably with breach of fiduciary duties, to denote that trustees and other fiduciaries are bound to exercise their powers so as to further the interests of the beneficiaries and must not use their position to further their own interests.⁵³⁸ The most common explanation for this strict rule is identical to the dominant common law theory of fiduciary duties: such strict rules are necessary in order to prevent abuse.⁵³⁹

carry on the suit." (Gaius 1.184, in Frederick Tomkins and William G. Lemon, *transl.*, *The Commentaries of Gaius* (London: Butterworths, 1869) 183.

⁵³⁵ John Blackie, "Enrichment and Wrongs in Scots Law" (1992) *Acta Juridica* 23 at 43.

⁵³⁶ John Erskine, *An Institute of the Law of Scotland: In the Order of Sir George Mackenzie's Institutions of That Law*, vol. 1 (Edinburgh: John Bell, 1773) 123.

⁵³⁷ *Aitken v Hunter* (1871) 9 M 756 at 762 per Lord Neaves.

⁵³⁸ See Scottish Law Commission, "Discussion Paper on Breach of Trust" (September 2003) 4-5, available online at: www.scotlawcom.gov.uk/download_file/view/111/.

⁵³⁹ See e.g. "Fiduciary Duties of Trustees and Others; *Auctor in Rem Suam*" in Sir Thomas Smith and Robert Black, eds., *Stair Memorial Encyclopaedia*, vol. 24 (Edinburgh: Butterworths, 1989) 116-127.

Several authors have suggested that the *auctor in rem suam* rule has the same rationale as the prohibition to act both as judge and party in the same cause. John Erskine's text mentioned above an eloquent example.⁵⁴⁰ Patrick Fraser made a similar point: a person occupying a fiduciary position is prohibited from engaging in transactions with himself, or be *auctor in rem suam*, just as no person can be judge in his own cause.⁵⁴¹ These associations of *auctor in rem suam* and *nemo iudex* rules suggest that the ultimate reason for which a person having discretion to affect another's interests is not allowed to engage in self-interested acts (or to be *auctor in rem suam*) is the need to ensure that his judgment is not affected by the possibility of personal gains. As in the case of the *nemo iudex* rule, more historical research is required in order to unveil the essential reason behind the prohibition to act *auctor in rem suam*. Engaging in such detailed historical research is beyond the purpose or means of this dissertation. As mentioned before, the aim of this section is to show that the idea of incompatibility between self-interest and proper exercise of judgment on another's behalf was present in the early legal literature relevant to fiduciary duties.

5.5 Error of conscience in moral philosophy

The understanding of the meaning of conflict of interest developed in this dissertation bears notable similarities to the concepts of 'judgment of conscience' and 'erroneous conscience' developed in natural law philosophy. Given the influence of natural law ideas on the early chancellors and the importance of the concept of 'conscience' for the Court of Chancery, it is

⁵⁴⁰ See *supra* note 536 and the associated text.

⁵⁴¹ Patrick Fraser, *A Treatise on the Law of Scotland Relative to Parent and Child and Guardian and Ward*, 2nd ed. (Edinburgh: T. & T. Clark, 1867) 279: "A principle applicable to all offices of trust of this kind, and more especially of guardianship, is this, that the person acting with such deputed power... shall not be *auctor in rem suam*... It is just as incompetent for him to do this as it would be for a person to be judge in his own cause." See also James Avon Clyde, transl., *The Jus Feudale by Sir Thomas Craig of Riccarton*, vol. 1 (Edinburgh: William Hodge, 1934) 292: "[I]f tutors and curators cannot turn their office to their advantage... far less can the friends at whose instance the interdicted person was deprived of the management of his own property, and placed under supervision, be allowed to use their consents for the purpose of acquiring his property for themselves. It is a principle which knows no exception that no man can make the law to suit himself [*nemo sibi jus dicere*] or be the author of his own rights [*nemo sui juris auctor esse potest*]."

possible that the philosophical ideas on ‘error of conscience’ caused by self-interest provided the ideological support for the strict fiduciary rules against conflict of interest.

The concept of conscience as a judgment process susceptible to error appears in the earliest writings of moral philosophers. The writings of Philo of Alexandria, Saint Paul or Thomas Aquinas depict conscience as a judge or as a judgment process.⁵⁴² The basic components in terms of which many philosophers described conscience were *synteresis* (or *synderesis*) and *conscientia*. *Synteresis* is the innate human faculty or disposition that allows humans to apprehend the natural law without reasoning and without a deliberative process.⁵⁴³ *Conscientia* involves the application of knowledge provided by *synteresis* to actual, particular situations.⁵⁴⁴

Moral philosophers described the process through which conscience operates as syllogistic: (i) the major premise is the universal moral precept supplied by *synteresis*; (ii) the minor premise is the factual knowledge provided by the senses (in the case of proposed action) or by memory (in the case of past action); (iii) the conclusion of judgment is obtained by applying the principle of the major premise to the facts of the minor premise.⁵⁴⁵

Starting with the writings of Saint Paul, moral philosophers have recognized that conscience is not an infallible judge; the judgment process

⁵⁴² See Philip Bosman, *Conscience in Philo and Paul: A Conceptual History of the Synoida Word Group* (Tübingen: Mohr Siebeck, 2003); Saint Thomas Aquinas, *The Treatise on Human Nature: Summa Theologiae*, transl. by Robert Pasnau (Indianapolis: Hackett Publishing, 2002); Augustin Fagothey, “Conscience as Principle of Moral Action” in George F. McLean, ed., *Ethics at the Crossroads*, vol. 2: *Personalist Ethics and Human Subjectivity* (Washington, D.C.: Paideia Publisher, 1996) 71.

⁵⁴³ Timothy C. Potts, *Conscience in Medieval Philosophy* (Cambridge: Cambridge University Press, 1980) 32; Timothy C. Potts, “Conscience” in Norman Kretzmann *et al*, eds *The Cambridge History of Later Medieval Philosophy* (Cambridge: Cambridge University Press, 1982) 687-704; Dennis R. Klinck, *Conscience, Equity and the Court of Chancery in Early Modern England* (Farnham: Ashgate, 2010) 32; Richard Janda, “Legal Architecture, Equity and Christopher St. German” in John E. C. Brierley, *Mélanges offerts par ses collègues de McGill à Paul-André Crépeau* (Cowansville, Quebec : Éditions Y. Blais, 1997) 373-416.

⁵⁴⁴ See Timothy C. Potts, *Conscience in Medieval Philosophy*, supra note 543 at 60: “[S]ynderesis consists of rules, whereas conscientia is concerned with their application (including missapplication).”; Clive S. Lewis, *Studies in Words*, 2nd ed, Chapter Eight, “Conscience and Conscious” (Cambridge: Cambridge University Press, 1967) 181 at 190-191 (stating that *synteresis* is the part of conscience that acts as internal lawgiver, while *conscientia* acts as a witness, discerning and assessing facts).

⁵⁴⁵ Michael G. Baylor, *Action and Person: Conscience in the Late Scholasticism and the Young Luther* (Leiden: E.J. Brill, 1977) 47-48.

through which human conscience operates is prone to errors.⁵⁴⁶ Philosophers identified there main causes for errors of conscience: ignorance of the correct moral precept applicable, ignorance of the factual circumstances of the case (the misapprehension of facts by memory, perception or prediction) and faulty reasoning in applying the precept to the facts.⁵⁴⁷

One potential source of factual errors concerns the minor premise of the syllogism. One may have rightfully derived the major premise to guide his conscience, but if the apprehension of facts is deficient (either as a result of an invincible error or as a result of culpable error) the resulting judgment is flawed. An error is invincible when a misapprehension of facts “unavoidably remains after a determined effort to discover the nature of the morally relevant facts in a given case”.⁵⁴⁸ Culpable error is the result of a failure to form one’s conscience correctly through “a careful inquiry as to the factual circumstances of a particular case.”⁵⁴⁹

Self-interest or self-regarding feelings were recognized as a source of invincible error of conscience. This idea appears in Christopher St. German’s *Doctor and Student*, a work that set the tone for almost all English legal reflection on equity in the sixteenth century.⁵⁵⁰ In Chapter 15, ‘Of Conscience’, St. German wrote:

[C]onscience... is nothing else but an applying of any science or knowledge to some particular act of man. And so conscience may sometime err, and sometime not err... Error in conscience cometh in seven manner of ways. First, through ignorance... The second is through negligence... The third is through pride... The fourth is through singularity... The fifth is *through an inordinate affection to himself, whereby he maketh conscience to follow his desire, and so he causeth her to go out of her right course*. The sixth is through pusillanimity... The seventh is through perplexity...⁵⁵¹

⁵⁴⁶ See e.g. Richard Francis, *Maxims of Equity* (Richmond: Shepherd & Pollard, 1828) 6: “[H]uman Nature is too corrupt to be left solely to the Guidance and Directions of Conscience.”

⁵⁴⁷ Michael G. Baylor, *supra* note 545 at 90. See also Dennis R. Klinck, *supra* note 543 at 35.

⁵⁴⁸ Michael G. Baylor, *supra* note 545 at 90.

⁵⁴⁹ *Ibid.*

⁵⁵⁰ Dennis R. Klinck, *supra* note 543 at 1.

⁵⁵¹ Christopher Saint German, *Doctor and Student: Or, Dialogues between a Doctor of Divinity, and a Student in the Laws of England*, 16th ed. (London: S. Richardson and C. Lintot, 1761) 42-43, emphasis added.

Another authoritative text that refers to the error of conscience caused by self-interest is the *Sermons* of John Tillotson, who held the position of Archbishop of Canterbury at the end of the seventeenth century. In Sermon XXXVIII, entitled “A Conscience void of Offence towards God and Man”, Tittloson referred to the “bias of self-interest” as a cause for errors of conscience:

[Conscience] is the principle or faculty whereby we judge of moral good and evil, and do accordingly direct and govern our actions... We should be very careful to inform our conscience aright, that we may not mistake concerning our duty; or if we do, that our error and mistake may not be grossly wilful and faulty... [A]n error which proceeds from want of ordinary human care, and due government of a man’s self, is in a great degree wilful: as when it proceeds from an unreasonable and obstinate prejudice; from great pride and self-conceit, and contempt of counsel and instruction; or from a visible *bias of self-interest*; and when it is accompanied by a furious passion and zeal...⁵⁵²

The philosophical concept of conscience played an important role in the early judicial activity of the English Chancery. As Carleton Allen observed, “[a] philosophical and theological concept of conscience [was] the

⁵⁵² John Tillotson, *Sermons* in T. Birch, ed, *The Works of Dr. John Tillotson, Late Archbishop of Canterbury*, vol. 3 (London: J. F. Dove, 1820) 152-155, emphasis added. See also Johannes Sleidanus, *A Famouse Cronicle of Oure Time, Called Sleidanus Commentaries* (London: Ihon Daye, 1560) 61 (via EEBO - Early English Books Online): “Again not only the laws written, but also the law of nature printed in men’s minds, shows that no man ought to be judge in his own cause. For we be all faulty and blinded with the love of our selves.”; James Dalrymple, Viscount of Stair, *The Institutions of the Law of Scotland*, 3rd ed., Book 1 (Edinburgh: G. Hamilton and J. Balfour, 1759) 11-12, emphasis added: “[G]overnment necessarily implies in the very being thereof a yielding and submitting to the determination of the sovereign authority in the differences of the people... Otherwise they behoved to dissolve authority and society, and return to the sovereignty of their private judgment and their natural force, from which they did flee unto the sanctuary of the government; which, though it may sometimes err, *yet can be nothing like those continual errors, when every one owns himself as sovereign judge in his own cause.*” Lord Stair also evoked the danger that the bias of interest poses to the correct decision of cases in equity: “[T]he law of nature and of reason... can none quarrel, because they do not alter, but declare equity; and that very necessarily, because, though equity be very clear in its principles and its *thesi*, yet the deduction of reason further from the fountain, *through the bias and corruption of interest*, may make it more dubious in *hypothesi*, when it comes to the decision of particular cases in all their circumstances.” (*ibid.* at 9); John Locke, *Of Civil Government: The Second Treatise* (Rockville: Wildside Press, 2008) 76: “[F]or though the law of nature be plain and intelligible to all rational creatures; yet men being biased by their interest, as well as ignorant for want of study of it, are not apt to allow of it as a law binding to them in the application of it to their particular cases.

one general principle which more than any other influenced equity.”⁵⁵³ As judge in a court of conscience, the chancellor’s role was “to correct Men’s consciences for Frauds, Breach of Trusts, Wrongs and oppressions, of what Nature soever they be...”⁵⁵⁴ In other words, the Court of Chancery, as court of conscience, intervened to correct the process through which conscience was known to operate. When the Court of Chancery engaged in correcting defendants’ consciences, it searched for flaws in the three areas where errors of conscience could occur.⁵⁵⁵ In relation to errors occurring at the level of the minor premise of the syllogism (misapprehension or ignorance of the factual circumstances), the Court of Chancery prevented trustees and other fiduciaries from deriving a personal benefit from their office in order to prevent the distorting effect that self-interest has on their judgment of conscience. In the absence of detailed records of the early Chancery decisions, however, it is difficult to find compelling evidence of a connection between the philosophical and theological concept of error of conscience and imposition of fiduciary duties.

5.6 Conclusion

The contemporary philosophical understanding of ‘conflict of interest’ shows that one person’s decision-making process can be vitiated by the presence of a personal interest in the outcome of his decision. This understanding casts a new light on the private law’s concern with exercising discretion over another’s interests. The strict no-conflict duties imposed by fiduciary law can be explained by the need to protect the fiduciary’s judgment process against perturbing factors. This understanding of the purpose of fiduciary duties does not amount to introducing an entirely new

⁵⁵³ Carleton K. Allen, *Law in the Making*, 6th ed. (Oxford: Oxford University Press, 1958) 389. See also A.W.B. Simpson, *A History of the Common Law of Contract: The Rise of the Action of Assumpsit* (Oxford: University Press, 1975) 397: “[T]he primary principle of decision” in the “fifteenth- and early-sixteenth century court of Chancery was Conscience.”

⁵⁵⁴ *Earl of Oxford’s case* (1615) 21 ER 485, per Lord Ellesmere LC. See also Francis Bacon, *Reading on the Statute of Uses* (1600) in J. Spedding et al, eds *The Works of Francis Bacon* vol. 7 (London: Longmans, 1857-1874) 401: Uses were “ordered and guided by conscience, either by the private conscience of the feoffee, or the general conscience of the realm, which is Chancery.”

⁵⁵⁵ Dennis R. Klinck, *supra* note 543 at 35.

idea in legal theory. As the present chapter has shown, this insight has been present in various forms in the philosophical background against which the legal rules governing fiduciary relations have developed.

CHAPTER VI : CONCLUSION

This dissertation provides a theory of fiduciary duties that aims to demystify this nebulous field of private law. The foundation of this research is the emerging consensus among scholars and courts across common law jurisdictions with respect to the key elements that attract the incidence of fiduciary duties: one party's undertaking to do something in the interests of the other, coupled with the first party's discretion over the second party's interests. The element of undertaking shows that a person becomes subject to fiduciary duties only as a result of his manifestation of will. The requirement of undertaking excludes the instrumental approach to fiduciary duties. Courts cannot impose such duties to achieve policy objectives in the absence of a voluntary undertaking. The element of power or discretion points to the central feature of a fiduciary relation: not only has the fiduciary agreed to perform an action or render a service to the beneficiary, but he also has scope with respect to how to promote the beneficiary's interests. The existence of discretion shows that a fiduciary's judgment or decision-making process is essential. Once this central feature is understood, it becomes clear why fiduciaries are subject to strict no-conflict duties. Similar to administrative law, fiduciaries are prohibited from deciding in a situation of conflict of interest because personal or other extraneous interests can affect the reliability of fiduciary's judgment.

A cogent theory of fiduciary duties must be based on a proper understanding of the notion of 'conflict of interest'. 'Conflict of interest' describes a situation that an individual finds himself in, which raises reasonable doubts about the reliability of that person's service as a trusted decision-maker. A conflict of interest situation occurs if there are good reasons to think that the judgment of a fiduciary will be impaired. The question that arises is: will the fiduciary be able to exercise judgment to the best of his abilities, or will his judgment be clouded by other factors that ought to be excluded? This question cannot be answered satisfactorily. In a situation of conflict between self-interest and duty to exercise proper

judgment, it is impossible to determine whether the fiduciary's judgment has been effectively altered by the presence of self-interest.

This understanding of 'conflict of interest' offers a satisfactory explanation of the strict standards to which fiduciaries are held. The peculiar strictness of these standards has many facets: fiduciaries are in breach of duty when deciding in a situation of conflict of interest, even if they act in good faith, in the sense that they are not motivated by a desire to obtain an unauthorized benefit; fiduciaries are in breach of fiduciary duties if they obtain a benefit, even if the beneficiary incurred no loss. These strict rules have been traditionally interpreted as tools to discipline fiduciaries by preventing temptation of exploitative conduct. This explanation does not sit well with private law. Disciplining a general category of legal actors cannot be the main aim of a private law rule – private law will always be concerned with the bipolar relation between two parties. Furthermore, punishing good faith fiduciaries in order 'to send a strong signal' is an unacceptable explanation for any legal norm, not only for fiduciary law. It is an old legal axiom that one is considered innocent until proven guilty: *ei incumbit probatio qui dicit, non qui negat*. The proper explanation of the strict fiduciary rules is centred on the idea of risk of impaired judgment. A fiduciary that fails to avoid or manage a situation of conflict of interest should bear the risk that this situation creates for his exercise of discretion.

Another consequence of a proper understanding of 'conflict of interest' is the primacy of 'managing' situations of conflict of interest, rather than 'not being' in one. Conflicts of interest have often been regarded as an evil to be avoided at any cost, because allowing them to occur for one fiduciary would send the wrong signal to other persons in a similar position. This dissertation has argued that conflicts of interest should not fall under a sweeping prohibition. A proper understanding of this concept shows that management of conflicts is more important than imposing an obligation not to be in a situation of conflict. Although actual or potential conflicts of interest may give rise to a negative public perception of the profession or organization to which the conflicted fiduciary belongs, the main concern of fiduciary law should be mitigating adverse consequences that the interfering interest has for the duty to exercise proper judgment.

Fiduciary law's concern with proper exercise of judgment, as opposed to the public perception of fiduciaries' integrity, explains why the scope of the proscriptive duties does not extend to apparent conflicts of interest. It is very important to understand that the proscriptive duties do not aim to eliminate any form of suspicion. Fiduciaries are under no legal duty to dissipate unreasonable suspicions of impropriety. If the beneficiaries' suspicion of conflict is reasonable, then the conflict is potential or actual, and the fiduciary must manage it. If the appearance of conflict is only a misapprehension, fiduciaries come under a legal or a simply moral obligation to put beneficiaries' minds at ease by showing that there is no conflicting interest.

Another important consequence of a proper understanding of conflict of interest is the insight that fiduciary law is concerned with proper exercise of judgment or discretion. Personal interests or duties to promote other beneficiaries' interests form only one class of factors that render inappropriate an exercise of judgment. Besides the proscriptive duties, fiduciaries are bound by a duty to exercise judgment based on relevant considerations. While identifying the factors that are relevant for a decision is a matter governed by the duty of care, skill and diligence, determining the appropriate weight that a factor should bear in a given exercise of judgment is a matter governed by the core duty to exercise proper judgment.

The association between avoidance of self-interest and proper exercise of judgment is not an entirely new approach to exercise of discretion over another's interests. Similar ideas have been expressed in Roman law and medieval philosophy as well as in contemporary cognitive research.

The Roman legal philosophers described the *bonus vir*, the prototype of trustworthy decision-maker, as a person with an unparalleled ability to rise above his selfish interests and to do what is just in all occasions. When *bonus vir* became an ideal model of decision-maker, the *judgment of a bonus vir* became a legal standard for exercise of discretion based on relevant considerations. The Romans' concern with proper exercise of judgment was also expressed in the maxim that no one who has a judgment to make is allowed to have a benefit in the outcome of the decision as party: *nemo iudex in causa sua*. This requirement has grown into a core principle of natural law,

and later of natural justice. The moral philosophers were aware that factors such as pride or self-interest distort one's judgment of conscience and therefore may lead to a failure to distinguish the good from the bad. Self interest could render the judgment of conscience erroneous, although the person may in good faith believe that his conscience tells him the correct thing to do. Recent research in cognitive sciences and business ethics demonstrate that these ancient intuitions are correct. Persons who must decide for others are prone to cognitive and motivational biases due to self-interest, and their decision may be flawed even if they are not conscious of it.

The new theory of fiduciary duties also exposes the fallacies of the established fiduciary vocabulary. It has become a truism to say that a fiduciary owes both fiduciary and non-fiduciary duties and that the core fiduciary duty is the duty of loyalty. The statement that the duty of loyalty is the core duty is useful insofar as it shows that the fiduciary duties are composed of a core duty and other (non-core) duties. Beyond this limited benefit, this statement is prone to maintain the doctrinal uncertainty. The opinions on what the duty of loyalty is are divergent. As discussed in Chapter 2, some authors interpret the duty of loyalty as the sum of proscriptive duties, while others see it as a central duty that justifies the existence of proscriptive duties. While both currents of opinion appear to agree that fiduciary law is concerned with the imposition of a core duty of loyalty, in substance they propose different views.

Loyalty may also be misleading insofar as it evokes the idea of honesty or selflessness. These terms have contributed to the perpetuation of misconceptions about the content and justification of fiduciary duties. They have created the false impression that fiduciary law is concerned with the imposition of a high moral standard, or that fiduciary duties are at the top of a pyramid of legal duties that protect valuable social attributes. This research aims to eliminate some of these shortcomings by identifying the duties based on their content, rather than using an established label. Thus, the fiduciary duties are composed of the core duty to exercise proper judgment, and of the proscriptive, or no-conflict duties. They aim to guide the fiduciary's exercise of discretion, and to protect the beneficiary's right to the fiduciary's best judgment.

The articulation of the content and rationale of fiduciary duties proposed by this dissertation could contribute to a trans-systemic understanding of this legal institution. Just like the common law trusts, fiduciary duties are a peculiarly English variation of a universal theme: those who acquire discretion over the interests of another must exercise such discretion based on relevant matters and free from conflicts of interest. These insights could contribute to the articulation of a system-neutral theory of fiduciary duties that could guide the developments in this field of law across legal traditions. As the illustrious French jurist Raymond Saleilles observed, “[t]he outcome of a comparative analysis of law should be the creation of a body of *types idéals* towards which national legal systems should evolve, without resorting to assimilations or legal transplants that often lack scientific rigour or political sense.”⁵⁵⁶

⁵⁵⁶ Raymond Saleilles, “Conception et objet de la science du droit comparé” in Société de Législation Comparée, *Congrès International de Droit Comparé Tenu à Paris du 31 Juillet au 4 Août 1900: Procès-Verbaux des Séances et Documents*, t.1 (Paris: Librairie Générale de Droit et de Jurisprudence, 1905) 167 at 180-181, my translation.

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