

The Interface between Contract and Equity
Lehane Memorial Lecture, Sydney
Lord Sales, Justice of the Supreme Court of The United Kingdom
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It is an honour to be invited to give the Lehane lecture for 2019.

I became aware of John Lehane when, as a law student studying Equity, I came across the wonderful book, Meagher, Gummow and Lehane, *Equity: Doctrines and Remedies*. I used it even more as a practising barrister.

In many ways Meagher, Gummow and Lehane was, and I suppose still is, a conservative text. However, I found it refreshingly new. The authors worked from the ground up. They traced the development of equitable doctrine and the way it came to be laid over common law.

Bill Gummow, who I believe is in audience this evening, kindly supplied me with some brief biographical details about John Lehane. He was a Sydney boy through and through. Sydney Grammar then University of Sydney, BA, LLB and LLM. Then to Allen, Allen & Hemsley as it was in those days, making partner in short order. In parallel with this John lectured in Equity at the University of Sydney. He was a partner at Allens before being appointed to the Federal Court bench in 1995. He was a huge figure in the field of Equity. He died tragically young at 59. By all accounts he was a delightful and modest man. It is a privilege for me to be invited to give this lecture in his memory.

For my lecture, I have chosen the topic of the interface between contract and Equity. This is, of course, a very large area. My focus will be on substantive legal obligations rather than remedies. So I will not be attempting to deal with the topics of specific performance and injunctive relief, interesting though they undoubtedly are.

Equity and contract are two of the great intellectual traditions of the common law, using that term in its expansive rather than narrow technical sense. It is important to emphasise that they *are* traditions. They change over time as social conditions and needs change, and as the understandings of lawyers adapt in the light of those changes.

The common law is itself a sort of overarching tradition, in which Equity and contract are nested. The way these traditions hang together is not a simple matter. Equity has one trajectory and contract has its distinct trajectory.

In significant ways they tend to promote different values. For example, in *Norberg v Wynrib*, McLachlin J said:

“In negligence and contract the parties are taken to be independent and equal actors, concerned primarily with their own self-interest. ... The essence of a fiduciary relationship, by contrast, is that one party exercises power on behalf of another and pledges himself or herself to act in the best interests of the other. ... The fiduciary relationship has trust, not self-interest at its core ...”¹

Moreover, the groups of people who developed the two traditions were often in large part self-conscious participants in them as separate streams of thinking about law and legal problems.

Yet these traditions have to be brought into some kind of coherent relationship with each other.

As Martin Krygier writes in his essay, “Law as Tradition”,² tradition is inherent in law. This aspect of law allows for change as the tradition is interpreted in modern times, as an authoritative presence from the past. The past speaks with many voices, so choice is necessary to pick out what is authoritative. As Krygier says,

“Legal traditions provide substance, models, exemplars and a *language* in which to speak about and within law. Participation in such a tradition involves sharing a way of speaking about the world which, like language though more prescriptively and restrictively than natural language, shapes, forms and in part envelops the thought of those who speak it and think through it”.³

¹ [1992] 2 SCR 226, 272-4.

² (1986) 5 Law and Philosophy 237-262

³ p. 244.

He refers to the observation of Maitland, that lawyers use the past as a resource rather than to write accurate history: “Whig interpretations may be unsuccessful history, but they are often very successful law”.⁴ In law and religion, traditions depend on castes of expert interpreters, who have power over past and future; however, as Krygier says, “Such power ... is rarely absolute, but must conform to canons of coherence and plausibility known to and accepted by participants in the tradition.”⁵

This poses problems where one is dealing with more than one tradition and where the participants in the traditions are distinct and at a tangent to each other. For a long time, Equity lawyers have thought about legal problems through a somewhat different lens than common law contract lawyers.

The origins of both traditions lie in the division between the common law in its narrow and more technical sense and Equity. With important qualifications, contract as a body of doctrine is an aspect of the common law. Equity grew up because of the reification and rigidity of the common law, which split apart from social understandings of justice and acceptable conduct. The common law was born out of a formulary system based on the established and time-honoured forms of action. It also tended to favour strict, bright-line rules of property and obligation.⁶

To simplify in a crude and no doubt highly contestable way, Equity as the tradition we know was born in about the fourteenth century and developed out of the jurisdiction of the Lord Chancellors and the judges acting on their behalf to issue specific forms of remedy. This came to be done according to general principles which in turn came to imply certain substantive rights. The Lord Chancellors in the early period operated with considerable freedom to do as they thought was right. This was followed in the nineteenth century by a hardening of the arteries and what is sometimes referred to as the decline of Equity, as it became more an assembly of technical rules.⁷

⁴ p. 249.

⁵ p. 251.

⁶ Irit Samet, *Equity: Conscience Goes to Market* (2018).

⁷ P.S. Atiyah and R.S. Summers, *Form and Substance in Anglo-American Law: A Comparative Study of Legal Reasoning, Legal Theory, and Legal Institutions* (1987), 242, 423-424.

That is an exaggerated view; and in many ways the tightening of doctrine was a valuable thing. It promoted predictability and stability in the law. Equitable doctrine had to escape Selden's quip about the state of the law depending on the length of the Chancellor's foot. I think there are two particular reasons this became a pronounced feature of the law in the nineteenth century.

First, certain generally accepted moral foundations for how people should behave in using their legal rights began to break down. As is often observed, where there are strong and generally accepted moral norms there is less need for strict law to provide guidance. The appeals of the Chancellors to an ill-defined concept of conscience as the guide for their interventions came to feel less certain.

Secondly, there was the rise of a way of thinking about law as a science in the nineteenth century, in light of the prestige of the natural sciences and Benthamite philosophy. The Treatise tradition was born. Law should be capable of being stated in definite formulae and propositions. Propositions of law were felt to be capable of being worked out like mathematics, with intellectual coherence being a criterion in its own right.⁸

These two factors also underlie the rise of contract as one of the great organising principles of our law. No longer could an appeal to the old forms of action be regarded as a satisfactory way of ordering the law. They left too many questions unanswered and applied in what had come to seem a fairly random way. More intellectual coherence was required to provide predictability.

The scientific approach affected contract as well. The law needed to be stated in clear, generalised propositions. Rather than a law of contracts, a unified law of contract was the desirable model. It was constructed by great judges of the common law in the nineteenth and early twentieth centuries. They had to operate within a more fixed tradition than the Equity lawyers. They were remarkably imaginative, fashioning a new understanding of a coherent unified law of contract out of the rather unpromising raw material of the forms

⁸ SFC Milsom, "The Past and the Future of Judge-made Law" (1981-1982) 8 Monash U.L. Rev. 1, 8 ("The appropriation of right and wrong by lawyers led into another process. As enough individual propositions of law became, as it were, explicit, there was the intellectual impulse to fit them together into a system ... the end of that was the exposition of substantive rules of law as an object of study for their own sake in text-books.")

of action and against the background of a rather recalcitrant theory of the common law as the unchanging inheritance given from time out of mind.

Even today, chancery lawyers and common lawyers have a tendency to think about issues in somewhat different ways. That is so even though all lawyers now have to be able to cope with the interaction between the two. In the nineteenth century, this divergence was stronger. The common lawyers and the Chancery lawyers were different personnel and formed different cadres with distinct esoteric knowledge. They litigated in their own distinct courts.

Two projects of conceptual development continued side by side. The common law tradition developed a greater intellectual freedom. If one reads Supreme Court judgments now, they openly debate how the law should be developed and formulated in the light of underlying policy factors, to an extent that would have been unthinkable in the nineteenth or early twentieth centuries.

A milestone is the famous lecture in 1972 by Lord Reid, announcing the end of the fairy tale of the declaratory theory of the common law.⁹ The result is that there is now a freedom in the development of the common law which more nearly resembles the freedom for development of Equity.

This has exacerbated the tension at the interface between Equity and the common law, in particular Equity and contract. If the common law has its own internal powers of adaptation, why does it need a different system of law with distinct rules laid over the top of that? What is it that Equity achieves in the modern law?

Part of the answer to that question lies in the sediment laid down by Equity in the course of its history of interacting with the common law. Equity has established rights, particularly property rights in the field of trust law, which create great flexibility in the management of property and which the legal system cannot do without. These rights presuppose the distinction between common law and Equity for their operation. To mention another example, the equity of redemption is an essential foundation for our market in real property.

⁹ Lord Reid, "The Judge as Law Maker" (1972) 12 JSPTL 25.

Also, Equity has served to obviate the need for an abuse of rights doctrine in the common law. It has thereby allowed the common law freedom to focus on constructing clear, bright-line rules regulating rights between parties, as mapped out in cases such as *Allen v Flood*¹⁰ and *Bradford v Pickles*.¹¹ This has been important for English commercial law, with its emphasis on clear rules applicable to govern relationships between well-resourced and well-advised parties. Equity has operated as a focused safety valve in certain other situations to bridge the tension between such bright line rules and a need for a sense of moral legitimacy in the application of the law; and to curtail opportunistic use of common law rights for abusive ends in the context of certain relationships.¹²

Further, Equity's doctrinal and remedial flexibility has been and remains important. The equitable rules governing the actions of trustees and fiduciaries are well suited to providing legal regulation for relationships which span long periods of time and require adjustment to unanticipated circumstances as they unfold. This feature has also proved valuable for certain commercial relationships: the operation of pension or superannuation funds is an important example. Equity also allows for a more modulated scheme of relief than the common law: Equity is better attuned to coping with interposed interests and changes in circumstances which may affect the rights of affected parties.¹³

The integration of common law and Equity was, for some, belatedly announced in 1977 by Lord Diplock in *United Scientific Holdings v Burnley Council*,¹⁴ in which he said that the two streams of Equity and common law had now mingled and fused together. There is an academic school which presses for the thorough-going fusion of common law and Equity. However, other academics argue for the continued legitimacy of and need for an independent body of equitable doctrine.¹⁵ Different jurisdictions have adjusted their integration of common law and Equity in different ways. It is sometimes said that fusion has been adopted in the USA, rejected in Australia and that England has reached a sort

¹⁰ [1898] AC 1.

¹¹ [1895] AC 587.

¹² See Samet, *op. cit.*, ch 2..

¹³ See e.g. P. Sales, "The Future of Tracing: Practical and Conceptual Issues" [2017] *Restitution Law Review*.

¹⁴ [1978] AC 904, 924-925

¹⁵ The literature is reviewed by Samet, *op. cit.*, 3ff.

of half-way house. These stereotypes are overstated.¹⁶ Certainly I find myself in a half-way house position; but I wonder how very different that is from my judicial colleagues in Australia.

The common law has always had capacity to learn from Equity, and vice versa. The modern openness of common law doctrine to principled development means that its capacity to learn from Equity, to use its techniques and to strive where appropriate for something resembling its flexibility is more pronounced than previously.

Lord Diplock's statement in *United Scientific Holdings* was premature. It is not really possible to understand or state the law without including Equity as a distinct body of doctrine. Nor, in my opinion, would it be desirable to.

Equity served valuable functions in the past and serves valuable functions now, albeit they are somewhat altered functions in a somewhat altered doctrinal environment. There is force in Irit Samet's argument in her book, *Equity: Conscience goes to Market*, that Equity as a distinct body of doctrine laid over the common law serves to narrow the gap between law and morality and thus legitimise the law and secure loyalty to it;¹⁷ that Equity is not as vague or uncertain as its critics allege, but provides comprehensible and valid guides to action; and that helps to keep the underlying values and rationales of law in line with the actual application of the law, by providing relief against opportunistic misuse of the strict rules of the common law.

These are big themes which have been developed by Samet and others. For my lecture, I want to focus in on more specific topics to try to convey a sense in which contract and Equity continue to interact with each other in the modern doctrinal environment I have described.

The flexibility of Equity makes its concepts attractive as potential building blocks for constructing some kinds of reciprocal relationships. Contract is the natural legal category for framing reciprocal relationships, but contracting parties may choose to make use of the resources of Equity, particularly when framing relationships which are to last over

¹⁶ Samet, *op. cit.*, 4.

¹⁷ See also P. Sales, "Common Law: Context and Method" (2019) 135 LQR 47, 53.

extended periods of time and which must be resilient in the face of unforeseen changes of circumstances. Trust concepts and fiduciary relationships may be employed or created by contract. Good examples arise in the context of complex lending structures and pension schemes. Contract and Equity are overlaid.

When contract and Equity are put into operation together in this way, how should they be conceptualised? I suggest that as contract is the natural category for thinking about reciprocal relationships, we should be analysing the content of obligations by reference to the objective interpretation of what the parties have agreed – that is, as per the law of contract. However, this must be done with due sensitivity to the equitable context and concepts which the parties have chosen to create and deploy in framing their relationship.

There are four particular areas which I want to discuss where this process has either taken hold or where I would argue it is appropriate that it should be carried further in a more conscious and analytical way:

- 1) The area of construing powers to identify their objects, which I suggest should be taken now to cover also the area known in equity as the doctrine of “fraud on a power”;
- 2) Fiduciary obligations arising in contractual contexts: when should they be found to arise and what is their substantive content?
- 3) What I will call the *Imperial Group* duty in pension schemes. A duty equivalent to the implied duty of trust and confidence in the contract of employment has been adopted by analogy in relation to the use of powers in pension schemes; and
- 4) In relation to standards of performance to be expected of a contracting party who is also subject to equitable obligations.

(1) Fraud on a power and the objects of powers

Equity has a longer history than the common law of controlling the exercise of powers conferred to allow for the holding and disposition of property over long periods of time. Settlements of land, involving discretionary powers given to the trustees holding the land, were used to maintain family estates through generations. The settlor created these

powers in recognition of the fact that the trust institution would need to respond to unknown and uncertain future events in flexible and effective ways.

This context, of trying to set rules in advance where the particular circumstances in which they might fall to be applied could not be predicted with confidence is one of the prime factors underlying the development of equitable doctrine.

If the settlor stated that a power of disposition could be used for the benefit of particular objects, say to give money to A, B or C, the donee of the power could not use it to give money to Z. So far so good. The misuse of the power in such a case could be seen to be unauthorised; that much would be patent from the face of the power and the facts of the case.

But what if the donee of the power used it for a purpose which was improper, but where the impropriety was not immediately apparent from the way in which the power was exercised? In *Cloutte v Storey*,¹⁸ for example, an appointment of property was made by a father to one of his children pursuant to a power conferred upon him in a trust instrument, but subject to a covert arrangement that fruits of the appointment would be returned to the father. This looks more fraud-like. Cases of this kind gave the equitable doctrine of “fraud on a power” its name. The common law was thought to be powerless to address these cases of latent impropriety.

As Lord St Leonards put it in *Sugden on Powers* in 1861¹⁹:

“There are some cases which a court of law cannot reach. This happens where the power is duly executed according to the terms of it; but there is some bargain behind, or some ill motive, which renders the execution fraudulent, and will enable equity to relieve.”

So the conception of the fraud on a power rule involved laying an equitable doctrine on top of a rigidly conceived rule taking effect at common law. However, the idea that the common law is unable to reach these kinds of cases has come under increasing strain. It

¹⁸ [1911] 1 Ch 18 (CA)

¹⁹ 8th ed., 606.

may be asked, why is the common law not able to take account of latent impropriety just as it takes account of patent impropriety?

There has been a gradual shift to consolidate the fraud on a power doctrine with the ordinary construction of express powers as to their objects. As Lord Nicholls of Birkenhead has suggested, writing extra-judicially, a trustee's duty to act in the best interests of his beneficiary may best be analysed as an obligation to act for the proper purposes for which the trustee has agreed to act.²⁰

In 1915 in *Vatcher v Paul*²¹ Lord Parker of Waddington stated the fraud on a power rule in a way which covers both patent and latent improper purposes:

“The term fraud in connection with fraud on a power does not necessarily denote any conduct on the part of the appointor amounting to fraud in the common law meaning of the term or any conduct which could be properly termed dishonest or immoral. It merely means that the power has been exercised for a purpose, or with an intention, beyond the scope of or not justified by the instrument creating the power.”

The equitable doctrine continues to be applied. In the recent *Eclairs Group* case Lord Sumption was at pains to say that the proper purpose rule inherent in the doctrine of fraud on a power and replicated in section 171(b) of the Companies Act 2006 “is not concerned with excess of power by doing an act which is beyond the scope of the instrument creating it as a matter of construction or implication”, but rather with “abuse of power, by doing acts which are within its scope but done for an improper reason”.²² However, I respectfully suggest that it is difficult to see why the propriety of the reasons for using the power is not itself a matter of interpretation of the contract which has created the power.

The case concerned the exercise of powers conferred on the directors of a public limited company by its articles of association. The directors were concerned to stop what they

²⁰ D. Nicholls, "Trustees and Their Broader Community: Where Duty, Morality and Ethics Converge" (1995) 9 *Trust Law International* 71, 74.

²¹ [1915] AC 372, 378.

²² *Eclairs Group Ltd v JKK Oil and Gas Plc* [2015] UKSC 71 at [15].

saw as a possible attempt by minority shareholders to take control of the company, and used a discretionary power which allowed them to block a shareholder from exercising voting rights in particular circumstances.

The Supreme Court held that the directors acted for an improper purpose and that the restriction imposed on the voting rights of the shareholders was invalid. Lord Sumption said:

“... I do not doubt that a term limiting the exercise of powers conferred on the directors to their proper purpose may sometimes be implied on the ordinary principles of the law of contract governing the implication of terms. But that is not the basis of the proper purpose rule. The rule is not a term of the contract and does not necessarily depend on any limitation on the scope of the power as a matter of construction. The proper purpose rule is a principle by which equity controls the exercise of a fiduciary's powers in respects which are not, or not necessarily, determined by the instrument. Ascertaining the purpose of a power where the instrument is silent depends on an inference from the mischief of the provision conferring it, which is itself deduced from its express terms, from an analysis of their effect, and from the court's understanding of the business context.”²³

Lord Sumption was concerned to reject the idea that the only constraints on the exercise of the power had to be derived, if at all, from the very restrictive test for implication of terms in a contract or other instrument. That is an important point and I respectfully think it is correct.

But in my opinion it is open to question whether Lord Sumption is right to say that an analysis of the purpose of the power is a matter to be determined as something distinct from its proper interpretation. Might it not be said that the matters referred to by Lord Sumption as relevant to the identification of the proper purposes for which the power might be exercised are precisely the matters to which one would have regard when interpreting the limits inherent in the power in the contractual setting in which it appears?

²³ At [30].

Parties to a contract create discretionary powers to allow for reasonable adjustment to future events, not to place themselves completely at the mercy of the other party or any person such as the directors in this case. If the parties have not stipulated that a power must be used reasonably, it is nonetheless the case that the parties intend that *some* limitations on the power should be inherent in the power itself, having regard to the purposes for which the parties contemplated it might legitimately be used.

That inference cannot be excluded by reference to the restrictive test for implication of terms into a contract. Lord Sumption was rightly concerned to reject that as the relevant test. But it is arguable that in seeking to achieve this, he did not need to reject the idea that identifying the proper purposes for which the power might be used was a function of interpretation of the contract.

By contrast, the House of Lords in *Hole v Garnsey* in 1932 addressed a similar problem by means of interpretation of the relevant contract power.²⁴ The case concerned exercise of a general discretionary power allowing the rules of association of an industrial society to be amended upon a vote by a super-majority of its members. The power was exercised to alter the rules so as to require members of the society to subscribe for additional shares, as a way of raising funds for the society. The amendment to the rules was struck down as unlawful as being outwith the power of amendment, according to its proper interpretation. The result was arrived at without reference to Equity or any distinct doctrine of fraud on a power.

Lord Atkin said:²⁵

“I should have thought on principle that the matter was fairly plain. If a man enters into association with others for a business venture he commits himself to be bound by the decision of the majority of his associates on matters within the contemplated scope of the venture. But outside that scope he remains dominus and cannot be bound against his will.”

²⁴ *Hole v Garnsey* [1930] A.C. 472.

²⁵ [1930] A.C. 472, 493-494.

As Dixon J put it in a similar case in 1939:²⁶

“The chief reason for denying an unlimited effect to widely expressed powers such as that of altering a company’s articles is the fear or knowledge that an apparently regular exercise of the power may in truth be but a means of securing some personal or particular gain, whether pecuniary or otherwise, which does not fairly arise out of the subjects dealt with by the power and is outside and even inconsistent with the contemplated objects of the power.”

On this approach to analysing how to construe the ambit of a contractual power, one has to stand back from the mere language of the power-conferring provision, which may be entirely general. It is necessary instead to form a broad view of the purposes of the venture to which the contract gives effect, and of what loyalty to that venture might involve for a party to it, and to take those broad purposes as providing the inherent limits for the exercise of the power. Those limits will constrain the due exercise of the power whether the illegitimate purpose for which it is exercised is patent at the time of the exercise or is latent.

It might be said that this seems a rather vague test for the limits of a discretionary power. But the vagueness does not mean that the limits are contentless; nor that there is an absence of a methodology for working out in a particular case where the limits lie. That can be done having regard to the nature of the venture, the other contractual terms and what is sought to be achieved by the exercise of the power.

In fact, the vagueness is just a reflection of the situation the parties find themselves in when they contract, in which they cannot predict future circumstances but wish to make provision for their relationship to be capable of continuance into the future, including by adjustment to future events via the exercise of discretionary powers created for that very purpose. If the court can discern the broad outlines of what the parties contemplated such powers could or should be used for and can tell when a purported exercise lies outside such contemplation, it is difficult to see why as a matter of contractual interpretation the court cannot say that the use of the power exceeds those contractual powers.

²⁶ *Peters’ American Delicacy Co Ltd v Heath* (1939) 61 C.L.R. 457, 511.

On this approach, there is no need to overlay a distinct equitable principle called ‘fraud on a power’. Moreover, if exercise of a power is within the contemplation of the parties to the contract, what business has Equity in intervening to defeat their expectations? Perhaps, instead, we should now say that the principles for the interpretation of the ambit of a power are really in substance the same as would have governed the old rules delimiting the operation of the fraud on a power doctrine; and that for this purpose contract doctrine should draw on the intellectual resources provided by the equitable doctrine of “fraud on a power”.²⁷

(2) *Fiduciary obligations in reciprocal arrangements and their substantive content*

In contexts governed by a contract, equitable principles have to take account of and fall to be moulded around the rights and obligations set out in the contract, as properly construed. In the *Hospital Products* case in 1984 Justice Mason made this influential statement:²⁸

“ ... it is the contractual foundation which is all important because it is the contract that regulates the basic rights and liabilities of the parties. The fiduciary relationship, if it is to exist at all, must accommodate itself to the terms of the contract so that it is consistent with, and conforms to, them. ...”

Lord Browne-Wilkinson made the same point in *Henderson v Merrett Syndicates*:²⁹

“The existence of a contract does not exclude the co-existence of concurrent fiduciary duties (indeed, the contract may well be their source); but the contract can and does modify the extent and nature of the general duty that would otherwise arise.”

²⁷ I set out this argument at greater length in P. Sales, “Use of Powers for Proper Purposes in Private Law” (2020) 140 LQR (forthcoming).

²⁸ *Hospital Products Ltd. v. United States Surgical Corporation* (1984) 156 C.L.R. 41, 97. For example, Lord Browne-Wilkinson cited it in *Kelly v Cooper Associates* [1993] AC 205, PC, 214-215; also see *Ranson v Customer Systems Plc* [2012] EWCA Civ 841, [25]-[26].

²⁹ [1995] 2 AC 145, 206.

Some scholars have suggested that fiduciary duties should be seen as a species of contractual obligation, arrived at by a process of implication.³⁰ However, in *White v Jones* in 1995 Lord Browne-Wilkinson explained:

"The paradigm of the circumstances in which equity will find a fiduciary relationship is where one party, A, has assumed to act in relation to the property or affairs of another, B. ... By so assuming to act in B's affairs, A comes under fiduciary duties to B. ... the special relationship (i.e. a fiduciary relationship) giving rise to the assumption of responsibility ... does not depend on any mutual dealing between A and B, let alone on any relationship akin to contract. Although such factors may be present, equity imposes the obligation because A has assumed to act in B's affairs. Thus, a trustee is under a duty of care to his beneficiary whether or not he has had any dealing with him..."³¹

The better view, therefore, is that fiduciary duties arise by imposition of Equity where a particular role has been assumed by the putative fiduciary.³² In this area, it seems to me that it is not valid to collapse equitable doctrine into contract. Equity imposes fiduciary obligations for reasons which are normatively independent of contract.

However, where there is a contractual relationship, the fiduciary's obligations fall "to be moulded and informed by the terms of the contractual relationship".³³ On the one hand, the imposition of fiduciary duties where A has assumed to act in relation to B's property or affairs in a contractual context promotes trust and hence encourages B to rely on A, making B more willing to engage in economic activity with A.

Pension saving is a good example. The longer the relationship between the parties is supposed to exist, the more difficult it is for the parties to specify in advance precisely what their rights and obligations should be throughout to accommodate unanticipated events, and the greater the scope for the rights specified and their underlying rationale to pull apart over time, exposing the vulnerable party to opportunistic behaviour by the

³⁰ See e.g. J. Edelman, "When Do Fiduciary Duties Arise?" (2010) 126 LQR 302; the literature is reviewed in Samet, *op. cit.*, 116-122.

³¹ [1995] 2 AC 307, 271.

³² For academic discussion to support this view, see Samet, *op. cit.*, 122-151.

³³ As Lord Walker of Gestingthorpe put it in *Hilton v Barker Booth & Eastwood* [2005] UKHL 8; [2005] 1 WLR 567, at [30]; and see *Hawkes v Cuddy* [2009] EWCA Civ 291; [2009] 2 BCLC 427, at [44].

party with control over his property or affairs. The imposition of fiduciary obligations provides protection against this. The strong protection provided by Equity thus enhances the freedom and practical capacity of B to do valuable things, such as to save for a pension. The duties imposed provide guidance to A based on the morality of his assuming a role in which he has a special commitment to promote the benefit of B.

Conversely, the ability of A, under the principle of freedom of contract, to stipulate the areas within which he undertakes duties of the kind to be regarded as fiduciary, enhances the willingness of A to act in that role. So also does his ability to limit by contractual exclusion clauses his liability for acting in that role, subject to an honesty limitation.³⁴

In an important article entitled, “The Scope of Fiduciary Obligations: How Contract Informs But Does Not Determine the Scope of Fiduciary Obligations”,³⁵ Mark Leeming traces the way in which fiduciary obligations may extend beyond those arising from contract. A person may become subject to fiduciary duties through dealings in pre-contract negotiations. Fiduciary obligations may come to be expanded by virtue of the pattern of dealings between the parties after the contract is up and running, or conversely may be reduced below the extent of those originally contemplated if during the execution of the contract the conduct of the parties narrows the area in which it can be said that the criteria for fiduciary responsibility are satisfied. And very significantly, fiduciary obligations may survive the termination of the contract, for example when the fiduciary withdraws from a contract in order to take advantage of a corporate opportunity identified while he was a fiduciary.³⁶

The parties’ contract may be highly relevant to defining the area within which fiduciary duties have, on analysis, been assumed.³⁷ Equity looks to the substance of the tasks being carried out by the alleged fiduciary. He will not be able to avoid Equity’s gaze simply by stating in the contract that no fiduciary relationship is created under it.³⁸ This is precisely

³⁴ See the discussion in P. Sales, “Exemption Clauses in Trusts”, Ch. 7 in Paul S. Davies et al. (eds), *Defences in Equity* (2018).

³⁵ (2009) 3 J. Eq. 181.

³⁶ See also Samet, *op. cit.*, p. 122.

³⁷ See *Henderson v Merrett Syndicates* [1995] 2 AC 145, 206 per Lord Browne-Wilkinson. For example, Leeming cites *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22; (2007) 230 CLR 89, in which it was found that a joint venture agreement related to development of a small parcel of land, and not land adjacent to it: [103].

³⁸ See Leeming, *loc. cit.*, 191; Samet, *op. cit.*, 144-145.

because in this area contract intersects with another legal relationship with its own independent criteria of application. One may compare *Street v Mountford*,³⁹ in which the House of Lords found that a tenancy had been created despite the contract being labelled a “Licence Agreement”, because the terms of the contract showed that the criteria for a tenancy, in particular a right of exclusive occupation, were satisfied.

However, the principle of freedom of contract means that the parties are at liberty to specify not just the scope of the task to be performed, but also to specify with precision what their rights and obligations are to be, and it is possible that the degree of precision with which this is done is such that it excludes the possibility of an additional overlay of equitable obligation. In *Breen v Williams* Gummow J said that ‘a contractual term may be so precise in its regulation of what a party may do that there is no scope for the creation of a fiduciary duty’.⁴⁰ The contract may be exhaustive.

These three features of the interaction of Equity and contract – namely, exclusion clauses, definition of scope of the area in which fiduciary obligations may apply and the possibility of exhaustive definition of rights – make it difficult to accept a further suggestion by Samet that it is not possible to agree broad *ex ante* exclusions of the duty of loyalty inherent in fiduciary relationships.⁴¹ I think the position is more nuanced than that.

There is no conceptual difficulty about fiduciary duties existing alongside contractual ones. The powerful moral imperative of honesty and self-denial reflected in equitable doctrine is such that a fiduciary duty of loyalty will not readily be found to be excluded. Where the contract sets out a task in relation to which Equity would impose a fiduciary duty, that will only be excluded by very clear and very precise drafting in the contract.

The strong presumption is against exclusion. It is, I would say, even stronger than the presumption that a contract does not remove ordinary common law remedies⁴² and the

³⁹ [1985] AC 809.

⁴⁰ (1997) 186 CLR 71, 132-133

⁴¹ Samet, *op. cit.*, 141-147.

⁴² *Modern Engineering (Bristol) Ltd v Gilbert-Ash (Northorn) Ltd* [1974] A.C. 689, at 717. See also *Henderson v Merrett Syndicates* [1995] 2 AC 145, 182-4 per Lord Goff: a contractual statement that underwriting names could act according to their “absolute discretion” did not exclude them from being subject to an implied or fiduciary duty to act with reasonable care.

presumption that an exclusion clause in a contract does not affect rights apparently given by the contract itself.⁴³ As often happens, it is in the interstices of interpretation that competing principles and interests are brought into account and balanced against each other.⁴⁴

That brings me to a category of case which is not always clearly identified and analysed. What happens when a person is placed by a contract in a fiduciary role but one in which their duty of loyalty is in conflict with their own interests? In *Bristol and West Building Society v Mothew*⁴⁵, a case involving a solicitor acting for both parties in a transaction, Millett LJ said that a fiduciary's duty of loyalty or good faith is so strict that if he finds himself in a position where he comes to owe such a duty to two different parties, he must cease to act altogether.⁴⁶ A fortiori, one would expect that to be the case where the fiduciary's duty of loyalty conflicts with his own self-interest; alternatively, he would have to get the beneficiary's informed consent for specific acts taken whilst subject to such a conflict.

But this is not always inevitably the position. I will refer to three cases.

Hordern v Hordern, a Privy Council decision of 1910, concerned a partnership between brothers of a drapery business. According to the partnership instrument, on the death of one brother the survivor was to pay to the executor of the other a defined share of the value of the stock and assets of the partnership, to be assessed. One brother died, having named the other as his executor. If he acted as executor, the survivor would thus have a conflict between his own interest and the fiduciary duty owed as executor to his brother's estate. Critically, the Privy Council held that in the circumstances the survivor was not obliged to decline the executorship in order to avoid that conflict. The brother who had made the will had, in effect, asked the survivor to act in circumstances where the conflict must inevitably arise. The survivor had acted properly in making the valuation, by seeking advice from a respectable third party, and in these circumstances the validity of the survivor's actions was upheld.⁴⁷ In substance, a more modulated equitable duty was

⁴³ *Photo Production Ltd v Securicor Transport Ltd* [1980] A.C. 827, 850-851.

⁴⁴ Cf P. Sales, "Legislative Intention, Interpretation and the Principle of Legality" (2019) 40 Statute Law Review 53.

⁴⁵ [1998] Ch 1.

⁴⁶ [1998] Ch 1, 19.

⁴⁷ [1910] AC 465, PC, at 475 per Lord Shaw.

found to have replaced the usual bright-line rule of Equity that a fiduciary cannot act where there is a conflict of interest: the survivor had to act with reasonable or fair regard for the interest of the estate, but was not required to forego all reference to his own interest.

As I put it in another case:

“Depending on the circumstances, the trustee may legitimately consider that his primary responsibility is to continue to act, as the settlor intended he should, rather than to step down to allow someone else, less well-qualified than him, to take over. If that is the case, the trustee's conscience in continuing to act as trustee will not be affected by the fact that an actual conflict of interest has arisen, provided he seeks in good faith to take proper account of the interests to be promoted by the trust alongside his own interests.”⁴⁸

Edge v Pensions Ombudsman concerned trustees of a pension fund which was in surplus. They had to decide how to use the surplus. There were nine employer trustees, nine trustees were current employees and two trustees were former employees now in receipt of pension (pensioners). The trustees decided to use the surplus in such a way as to benefit the classes of employers and current employees, but not pensioners. This was challenged by the pensioners on grounds of want of impartiality, but the challenge was dismissed by Sir Richard Scott V-C. He pointed out that in this context it was not analytically helpful to say that the trustees had a duty to act impartially. Rather, their obligation was to act honestly, exercising their power of disposal for a proper purpose and without having regard to irrelevant considerations. They had complied with that obligation; their decision could not be criticised “on the footing that they showed no concern for the interests of the excluded beneficiaries”; but they had been entitled to decide that the interests of the employers and current employees outweighed those interests.⁴⁹ The decision and reasoning were upheld on appeal.⁵⁰ Again, it seems that the fiduciary obligation was of a more limited, modulated kind, to act with reasonable or fair regard for competing interests while also having regard to their own, where the trustees were put in a position which obliged or entitled them to act in circumstances where

⁴⁸ *F&C Alternative Investments (Holdings) v Barthelemy* [2011] EWHC 1731 (Ch), [230].

⁴⁹ [1998] Ch 512, 533-538.

⁵⁰ [2000] Ch 602, CA.

competing interests were in play. Note also how that modulated fiduciary obligation was moulded around the exercise of a power for proper purposes, which I have already argued is a matter falling within the province of interpretation of the relevant instrument, such as a contract.

Finally, I hope you will forgive me if I refer to a case I decided as a first instance judge. Unfortunately (or perhaps fortunately for me!) it did not go on appeal. It set me thinking about today's topic some years ago. It is *F&C Alternative Investments (Holdings) v Barthelemy*.⁵¹ The case concerned a corporate vehicle in the form of a LLP set up to conduct a joint venture between F&C and two individuals to run a hedge fund. The founding agreement created various committees of the LLP which, in various contexts, acted like a board of directors. The committees were composed of the individuals and representatives of F&C and, as in the *Edge* case, I found that it was not possible to analyse the fiduciary duties to which committee members were subject in terms of strict impartiality. The whole purpose of setting the committees up in this way was to allow each side to have a voice for its own interests on those committees. But at the same time, the committee members had fiduciary duties to have reasonable or fair regard to the interests of the other side, standing behind the interests of the LLP as a corporate entity.

This is, of course, a more difficult standard to apply than the usual strict, bright-line obligation of loyalty and avoidance of conflict. But it is not an impossible task, and it may be that, as in *F&C*, the agreement made by the parties requires the court to apply this test.

(3) *The Imperial Group duty*

In the *Imperial Group Pension Trust* case⁵² Sir Nicolas Browne-Wilkinson V-C held that where an employer had powers to exercise in respect of an employment pension scheme which it had established, those powers were subject to a duty equivalent to the implied duty of an employer under a contract of employment to act so as to maintain the employee's trust and confidence in the employment relationship.⁵³ The Court of Appeal

⁵¹ [2011] EWHC 1731 (Ch); see in particular [223]ff.

⁵² *Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd* [1991] 1 WLR 589

⁵³ cf *Malik v BCCI* [1998] A.C. 20.

recently affirmed the implication of this duty in *IBM United Kingdom Holdings Ltd v Dalgleish*.⁵⁴

The duty implied in an employment contract is a duty implied in law, in recognition of the need to ensure in such a long term relationship that one party will not take opportunistic advantage of the strict terms of their contract in unforeseen future circumstances.⁵⁵ It thus operates like the analogue of an equitable obligation, but of the modulated type I have just described. The employer is entitled to have regard to its own interests when acting, but must take the interests of the employee fairly into account. As has been said, “to some extent at least, the existence and scope of standardised implied terms [in an employment contract] raise questions of reasonableness, fairness and the balancing of competing policy considerations ...”.⁵⁶

In the *Imperial Group* case Sir Nicolas Browne-Wilkinson said that the powers in issue could not be regarded as fiduciary powers, precisely because the employer representatives were entitled to have regard to their own interests when deciding how they should be exercised.⁵⁷ Nor, for the same reason, were the powers subject to any implied reasonableness requirement.⁵⁸ However, in ruling that the exercise of the powers was subject to the implied duty he identified, he in fact held that there was *some* level of obligation to have regard to the interests of the employee beneficiaries of the scheme; and in doing so he prayed in aid a trust analogy.⁵⁹

Despite Sir Nicolas’s statement that the powers could not be regarded as fiduciary in nature, I would argue that they could be regarded as subject to limited fiduciary obligations of the kind identified in the *Edge* case. There was scope for an equitable and a contract analysis to run in parallel.

⁵⁴ [2017] EWCA Civ 1212; [2018] ICR 1681, [3].

⁵⁵ There is a similar implied duty on employees: *Secretary of State for Employment v ASLEF No. 2* [1972] 2 Q.B. 455.

⁵⁶ *Crossley v Faithful & Gould Holdings Ltd* [2004] EWCA Civ 293; [2004] ICR 1615, at [36] per Dyson LJ.

⁵⁷ [1991] 1 WLR 589, 596.

⁵⁸ I would agree with this. A reasonableness requirement imposes a more demanding obligation and authorizes more extensive court intervention than a proper purposes or equitable analysis would support: see P. Sales, “Proper Purposes” (n. 27).

⁵⁹ Based on *Jones v Challenger* [1961] 1 QB 176: in the purchase of a matrimonial home to be held subject to a trust for sale, a joint tenant might be required by equity to agree not to sell if that was necessary to secure the object of the arrangement by virtue of which the property was acquired. See [1991] 1 WLR 589, 598. In that type of situation, the agreement between the parties in effect governs the execution of the trust.

The *Imperial Group* duty essentially borrows from the law of contract. In view of what I have said about competing traditions, it is perhaps telling that Sir Nicolas Browne-Wilkinson combined being a leading employment judge with being a chancery expert.

(4) *The duty to exercise reasonable care in the administration of a trust and carrying out fiduciary obligations*

The donee of a trust or fiduciary power must exercise the power with reasonable care and skill.⁶⁰ The rule in *Hastings-Bass*, as analysed by the Supreme Court in *Pitt v Holt*, is probably best located under this heading.⁶¹ As Lord Browne-Wilkinson said in *White v Jones*, in situations where a fiduciary obligation arises owed by A to B, a duty of care is owed as well: “A, having assumed responsibility, pro tanto, for B's affairs, is taken to have assumed certain duties in relation to the conduct of those affairs, including normally a duty of care.”⁶²

In *Henderson v Merrett Syndicates*⁶³ the House of Lords held that underwriting agents owed concurrent duties in contract and tort to the Names for whose accounts they wrote insurance business, to exercise duties of skill and care in the conduct of that business. The members of the appellate committee contemplated that certain concurrent fiduciary duties might be owed as well.⁶⁴ However, it was doubted whether the concurrent duties of skill and care should be analysed as distinctly fiduciary, or whether they should be seen rather as arising in tort by reason of the obligation assumed in tort from acting in the circumstances in which certain fiduciary duties also might arise. Lord Browne-Wilkinson regarded the separate alternative claims for breach of fiduciary duty in that case as misconceived, saying:

“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

⁶⁰ See e.g. *Apostolovski v Total Risk Management Pty Ltd* [2010] NSWSC 1451; (2010) 79 NSWLR 432 (negligent failure to consider exercise of power within reasonable time)

⁶¹ *In re Hastings-Bass, decd.* [1975] Ch 25; *Pitt v Holt* [2013] UKSC 26; [2013] 2 AC 108.; and see M. Ashdown, *Trustee Decision Making: The Rule in Hastings-Bass* (2015).

⁶² [1995] 2 AC 207, 271.

⁶³ [1995] 2 AC 145.

⁶⁴ See [1995] 2 AC 145, 202-203 (Lord Goff); 205-206 (Lord Browne-Wilkinson)

imposed by law on those who take it upon themselves to act for or advise others.’⁶⁵

Whether analysed as a duty of care owed by a fiduciary in tort or as an aspect of equitable obligations, the case indicates that the substantive content of the duty of care to be applied where all the duties – contract, tort and/or fiduciary – is to be derived from the terms of the contract. The contract takes priority on this as a matter of analysis, because it is on the terms specified in the contract that the fiduciary has assumed the responsibility to act.⁶⁶

Conclusion

The contract tradition and the Equity tradition have moved closer together. They are large bodies of law with their own internal coherence and values, and each exerts a sort of gravitational pull on the other like large planets spinning into each other’s orbit. The resulting pattern of law is not one of outright fusion of law and Equity, but of a degree of confluence and of significant, though nuanced and subtle, interaction between them.

⁶⁵ [1995] 2 AC 145, 205. Lord Goff preferred to leave the issue of concurrent fiduciary duties open: 196-197.

⁶⁶ See [1995] 2 AC 145, 193 and 194-5 (Lord Goff)