Good Faith, Self-Denial and Mandatory Trustee Duties

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Sheikh Tahnoon Bin Saeed Bin Shakhboot Al Nehayan v Kent[1] concerned a joint venture which went badly and ended with a falling out between the parties. The claimant invested money in a hotel and tourism business run by the defendant. The business foundered and the claimant brought proceedings to enforce an alleged agreement under which the defendant had promised to repay some of the claimant's investment. The defendant counter-claimed, alleging that the claimant had owed him a fiduciary duty, meaning a duty to subordinate the claimant's personal interests to the defendant's interests, and also a contractual duty of good faith. The defendant said that both of these duties had been breached when the claimant's representatives had gone behind his back to negotiate a sale of the claimant's share of the business to a third party whom the defendant had previously identified as a potential source of extra finance.

Leggatt LJ, sitting at first instance, held that the claimant had not owed the defendant any fiduciary duty, but that he had owed the defendant a duty of good faith under an implied term of the parties' contract. This duty had been breached because the claimant had engaged in two forms of 'furtive or opportunistic conduct' which were 'incompatible with good faith in the circumstances of this case':[2]

> 'First, it would be inconsistent with that standard for one party to agree or enter into negotiations to sell his interest or part of his interest in the companies which they jointly owned to a third party covertly and without informing the other beneficial owner. Second, while the parties to the joint venture were generally free to pursue their own interests and did not owe an obligation of loyalty to the other, it would be contrary to the obligation to act in good faith for either party to use his position as a shareholder of the companies to obtain a financial benefit for himself at the expense of the other.'

This decision will interest commercial lawyers for whom it is a controversial question whether and if so when duties of good faith should be implied into contracts, and particularly commercial contracts, in cases where a term imposing a duty of good faith has not been expressly included by the parties.[3] For equity lawyers, however, its main interest lies in the distinction drawn by Leggatt LJ between contractual duties of good faith and equitable (fiduciary) duties of self-denial. This prompts some questions. Does a similar distinction exist between equitable duties of good faith and self-denial? What is the content of such duties? What does it mean to say that a person who is entitled to act in a self-serving way nevertheless owes a duty to act in good faith towards another person?

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* FBA, Professor of Law, University College London. A draft of this paper was discussed at a workshop on Legal and Theoretical Aspects of Equity and Commercial Law in Oxford in May 2018. I thank the workshop organisers, Joshua Getzler and Larissa Katz, and the other workshop participants for their comments, particularly Paul Miller. I also thank Jessica Hudson for her very helpful and stimulating feedback on another draft.

[1] [2018] EWHC 333 (Comm).

[2] Ibid [176].

[3] Leggatt LJ's first judicial excursion in this area, in *Yam Seng Pte Ltd v International Trade Corp Ltd* [2013] EWHC 111 (QB), [2013] 1 All ER (Comm) 1321 [120]-[155], has had a mixed reception: e.g. *Compass Group UK and Ireland Ltd v Mid Essex Hospital Services* [2013] EWCA Civ 200, [2013] BLR 265; *Greenclose Ltd v National Westminster Bank Plc* [2014] EWHC 1156 (Ch), [2014] 2 Lloyd's Rep 169; *Carewatch Care Services Ltd v Focus Caring Services Ltd* [2014] EWHC 2313 (Ch) [108]; *MSC Mediterranean Shipping Co SA v Cottonex Anstalt* [2016] EWCA Civ 789, [2017] 1 All ER (Comm) 483; *Ilkerler Otomotiv Sanayai ve Ticaret Anonim v Perkins Engines Co Ltd* [2017] EWCA Civ 183, [2017] 4 WLR 144.

Fiduciary Duties

The obvious starting point when approaching this topic is the law governing the imposition of fiduciary duties on a party who is in a relationship of trust and confidence with another party over whose property and/or affairs she has legal and/or practical control, and to whom she has assumed responsibility for the way in which she exercises this control.[4] Unfortunately, however, the law in this area is in a serious terminological mess that reflects a deeper failure to think clearly about the law's different goals and the ways in which these should be achieved.

Significant problems have been caused by the very loose way in which courts have used the term 'fiduciary duties'. This term has been applied to a duty of undivided loyalty (meaning a duty to prioritise a principal's interests over one's own interests and the interests of other people) and a duty to act in good faith,[5] a duty of confidence, a duty to act in accordance with terms of one's engagement or 'to obey instructions'[6] (which in trusts law translates into a duty owed by trustees to comply with the terms of a trust deed[7]), a duty to act for a proper purpose (if that is different from acting within the terms of one's engagement, which may be doubted[8]), a duty to act with reasonable skill and care, and a duty to take all and only relevant matters into account when exercising discretionary powers.[9]

Describing all these duties as 'fiduciary duties' has created uncertainty and confusion. In particular instances, it can be unclear which of these duties is being referred to when a court speaks of a defendant owing a 'fiduciary duty' to a claimant. More generally, it is also unclear what point is being made when a single descriptor – 'fiduciary' – is applied to all of the duties. Does this denote that they are all variants or aspects of a single duty? That seems unlikely, given their clear differences of content. But in that case, what common feature do they possess?

A possible answer is that they can all be imposed on someone who is in a fiduciary relationship with a principal, but that this does not tell us anything very interesting about most of them, because most of them can also be imposed on other people. The exception is the duty of undivided loyalty, which is only imposed on people in fiduciary relationships. This view can be found in Matthew Conaglen's book, where he also argues – controversially – that the point of imposing the loyalty duty is to support the performance of the other duties.[10]

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[4] To summarise the descriptions offered in a number of cases, although these do not amount – and are not meant to amount – to finely grained tests that can predictably discriminate between cases where a fiduciary relationship exists and cases where it does not: *Reading v Attorney General* [1949] 2 KB 232, 236; *A-G v Blake* [1998] Ch 439, 454; *Arklow Investments Ltd v Maclean* [2000] 1 WLR 594, 598; *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6, (2012) 200 FCR 296 [177].

[5] *Bristol & West Building Society v Mothew* [1998] Ch 1, 18.

[6] *Crocs Europe BV v Anderson* [2012] EWCA Civ 1400, [2013] 1 Lloyd's Rep 1 [47].

[7] *Youyang Pty Ltd v Minter Ellison Morris Fletcher* [2003] HCA 15, (2003) 212 CLR 484 [32].

[8] *Pitt v Holt* [2011] EWCA Civ 197, [2012] Ch 132 [96] (Lloyd LJ): 'Cases of a fraud on the power are similar to [an appointment to someone who is not within the class of objects] … since the true intended beneficiary, who is not an object of the power, is someone other than the nominal appointee.'

[9] Duty to perform a trust in accordance with its terms: *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* [2011] EWCA Civ 347, [2012] Ch 453 [34]. Duty to act for a proper purpose: *Bishopsgate Investment Management Ltd (in liq) v Maxwell (No 2)* [1994] 1 All ER 261, 265. Duty to take all and only relevant matters into account: *Pitt v Holt* [2013] UKSC 26, [2013] 2 AC 108 [73]. Duty of care: *Silven Properties Ltd v Royal Bank of Scotland plc* [2003] EWCA Civ 1409, [2004] 1 WLR 997 [29]. Duty of confidence: *Generics (UK) Ltd v Yeda Research and Development Co Ltd* [2012] EWCA Civ 726, [2013] FSR 13 [79].

[10] M Conaglen, *Fiduciary Loyalty: Protecting the Due Performance of Non-Fiduciary Duties* (2010), developing ideas in M Conaglen, 'The Nature and Function of Fiduciary Loyalty' (2005) 121 LQR 452; critiqued by R Lee, 'In Search of the Nature and Function of Fiduciary Loyalty: Some Observations on Conaglen's Analysis' (2007) 27 OJLS 327 (imposition of the loyalty duty protects a principal from harm caused by a fiduciary's self-serving behaviour; any support thereby given to the performance of other duties is an additional but not the only point of imposing the loyalty duty; performance of other duties by a fiduciary is insufficient to absolve her from liability for breach of the loyalty duty).

Another possible answer is that all the duties can be imposed on someone in a fiduciary relationship with a principal, and that when they are imposed on such a person their content may be more onerous, or at any rate differently focussed, than it would be if they were imposed on someone else. So the reasonableness of her actions may be assessed against an elevated and/or more specifically purposed standard of care, the fairness of her actions may be assessed against an elevated and/or more specifically purposed standard of good faith, and so on. That view has been taken by His Honour Dyson Heydon,[11] Joshua Getzler,[12] Lionel Smith,[13] and Richard Nolan and Matthew Conaglen in an article which appeared after Conaglen's book.[14]

Loyalty

When the courts speak of a fiduciary owing a duty of 'loyalty' or 'undivided loyalty',[15] they have in mind both a duty of self-denial, meaning a duty to subordinate the fiduciary's personal interests to the interests of her principal, and also a duty to subordinate other people's interests to the principal's interests. These duties are manifested in the self-dealing and fair dealing rules which invalidate contracts for the sale of property between principals and their fiduciaries,[16] in rules which prohibit fiduciaries from making a profit out of their position in other ways,[17] and in rules which prohibit fiduciaries from serving two principals with conflicting interests.[18] All of these rules apply by default to parties who are in a fiduciary relationship with a principal, but they can all be disapplied by agreement provided that the principal is fully informed and has not been subjected to improper pressure.[19]

James Penner has persuasively argued that the rules requiring fiduciaries to act exclusively in the interests of their principals are not really concerned with loyalty, as that idea is commonly understood, because they do not require fiduciaries to identify emotionally with their principals' interests and only require fiduciaries to exclude their own, and third parties', interests from consideration when taking decisions that affect their principals' position. Hence, Penner argues, it would be more accurate to speak of a fiduciary owing her principal a duty of 'deliberative exclusivity'.[20]

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[11] The Hon Dyson Heydon QC, 'Modern Fiduciary Liability: The Sick Man of Equity?' (2014) 20 T&T 1006.

[12] J Getzler 'Am I My Beneficiary's Keeper? Fusion and Loss-Based Fiduciary Remedies' in S Degeling and J Edelman (eds), *Equity in Commercial Law* (2005).

[13] L Smith, 'Aspects of Loyalty' (2017); published online at https://ssrn.com/abstract=3009894 .

[14] R Nolan and M Conaglen, 'Good Faith: What Does It Mean for Fiduciaries and What Does It Tell Us about Them?' in E Bant and M Harding (eds), *Exploring Private Law* (2010) esp 320-1, developing RC Nolan, 'Controlling Fiduciary Power' [2009] CLJ 293, 312-3. This appears to mark a departure from the position taken in Conaglen's book, where he seems to say that the content of duties other than the duty of undivided loyalty is the same for fiduciaries and non-fiduciaries, although the chances of the other duties being performed is increased by imposing the loyalty duty.

[15] As in e.g. *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2015] AC 250 [5]; *AIB Group (UK) Plc v Mark Redler & Co* [2014] UKSC 58; [2015] AC 1503 [51].

[16] *Fox v Mackreth* (1791) 2 Cox Eq Cas 320, 30 ER 148; *Tito v Waddell (No 2)* [1977] Ch 106, 240–4; *Barnsley v Noble* [2014] EWHC 2657 (Ch) [261] ff (not doubted on appeal: [2016] EWCA Civ 799, [2017] Ch 191).

[17] *Keech v Sandford* (1726) Sel Cas temp King 61, 25 ER 223; *Boardman v Phipps* [1967] 2 AC 46; *FHR European Ventures LLP v Cedar Capital Partners LLC* [2015] AC 250.

[18] *Moody v Cox* [1917] Ch 271; *Bristol & West Building Society v Mothew* [1998] Ch 1, 19; *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2015] AC 250 [5].

[19] *Kelly v Cooper* [1993] AC 205; *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145, 206. Whether these rules can be disapplied in a trust setting is discussed in the final section of the paper.

[20] JE Penner, 'Distinguishing Fiduciary, Trust, and Accounting Relationships' (2014) 8 J Eq 201, 206-208. Cf LD Smith, 'Fiduciary Relationships: Ensuring the Loyal Exercise of Judgement on Behalf of Another' (2014) 130 LQR 608, who speaks of a duty of 'loyalty', but who similarly stresses that its essence is the other-regarding exercise of judgment when using discretionary powers, to be tested by asking whether the fiduciary believes her decisions to be in the principal's best interest.

Loyalty and Honesty

The duty of undivided loyalty, or of deliberative exclusivity as Penner would have it, may be breached by a party with an honest state of mind,[21] showing us that this duty differs from the duty imposed by general law on everyone in society to behave honestly towards other people. This point was drawn out by Viscount Haldane LC in his speech in *Nocton v Lord Ashburton*:[22]

> 'A man may misconceive the extent of the obligation which a Court of Equity imposes on him. His fault is that he has violated, however innocently because of his ignorance, an obligation which he must be taken by the Court to have known, and his conduct has in that sense always been called fraudulent, even in such a case as a technical fraud on a power. It was thus that the expression "constructive fraud" came into existence. The trustee who purchases the trust estate, the solicitor who makes a bargain with his client that cannot stand, have all for several centuries run the risk of the word fraudulent being applied to them. What it really means in this connection is, not moral fraud in the ordinary sense, but breach of the sort of obligation which is enforced by a Court that from the beginning regarded itself as a Court of conscience…. [Honesty] in the stricter sense is by our law a duty of universal obligation. This obligation exists independently of contract or of special obligation. If a man intervenes in the affairs of another he must do so honestly, whatever be the character of that intervention.'

Honesty and Good Faith

The courts sometimes speak as though this general duty of honesty and the equitable duty of good faith were one and the same, but although these duties overlap, they are not co-extensive either. This can be difficult to understand because the courts often use the term 'good faith' in its everyday sense as a synonym for honesty. However, they often also use it in a more technical sense to capture the idea that a party must act in a candid, rational, and fair-minded way, and refrain from sharp practice and behaviour that is secretive, capricious, perverse, or misleading. Sometimes these different usages of 'good faith' can feature in a single judgment. An example is the Court of Appeal's recent decision in *IBM United Kingdom Holdings Ltd v Dalgleish*.[23] There the court quoted Lord Sumption's observation that a test for the rationality of a person's decision-making:[24]

> 'imports a requirement of good faith, a requirement that there should be some logical connection between the evidence and the ostensible reasons for the decision, and … an absence of arbitrariness, of capriciousness or of reasoning so outrageous in its defiance of logic as to be perverse.'

Yet later on the court also said that the 'type of bad faith necessary to constitute [disingenuous conduct] involves fraud, since it implies a deceptive practice for the purpose of gain.'[25]

Equitable duties of good faith in the former sense are the duties with which this paper is primarily concerned. These have been imposed in a wide variety of circumstances and this makes it hard to pin down their content, as the requirements of good faith can vary from one situation to another. However a theme running through the cases is that a power holder must make a sincere and serious commitment to the purposes for which her powers have been given and this may require her to pay proper regard to the interests of those whose position will be

[21] *Boardman v Phipps* [1967] 2 AC 46.
[22] [1914] AC 932, 954.
[23] [2017] EWCA Civ 1212, [2018] PLR 1.
[24] Ibid [227], quoting *Hayes v Willoughby* [2013] UKSC 17, [2013] 1 WLR 935 [14].
[25] Ibid [402].

affected by the exercise of these powers, even if she is not required to prioritise their interests over her own interests and those of other people.[26] A person's knowledge and motives can be relevant to the question whether she has discharged such a duty,[27] but compliance is tested objectively and not subjectively: what matters is not whether a party believes her own conduct to be appropriate and well justified, but what the court thinks of it,[28] and it is possible for an honest person to breach the duty if she falls below the court's standards of behaviour.

Good Faith and Self-Denial

A good way to test the proposition that equitable duties of good faith and self-denial are distinct is to see whether there are cases where a defendant has been permitted to act in a self-serving way but is nevertheless bound by a duty of good faith. It turns out that there are many.

One group of cases concerns the powers of sale vested in mortgagees, which they are entitled to use for their own benefit but which they are forbidden to use in ways that unfairly prejudice the mortgagors' position. As stated by the editors of *Fisher & Lightwood*:[29]

> 'while the mortgagee may look to his own interest, he must nevertheless pay some regard to the interests of the mortgagor. Thus, the mortgagee owes a general duty in equity to the mortgagor … to act in good faith and to use his powers for proper purposes. Insofar as consistent with the mortgagor's right to put his own interests first, the mortgagee must act fairly towards the mortgagor. Where their interests conflict, he is not entitled to act in a manner which unfairly prejudices or wilfully and recklessly sacrifices the interests of the mortgagor.'

A second group of cases concerns powers affecting the management and distribution of trust property which are vested in the donee of a power who is permitted to exercise the power in a self-interested way, but who must give proper consideration to the beneficiaries' interests when deciding what to do, and must take decisions rational rationally and openly.

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[26] For a similar observation made in connection with the US law governing the exercise of powers by company directors, see M Eisenberg, 'The Duty of Good Faith in Corporate Law' (2006) 31 Delaware Journal of Corporate Law 1, 5: 'The duty of good faith in corporate law is comprised of a general baseline conception and specific obligations that instantiate that conception. The baseline conception consists of four elements: subjective honesty, or sincerity; nonviolation of generally accepted standards of decency applicable to the conduct of business; nonviolation of generally accepted basic corporate norms; and fidelity to office.'

[27] Consider e.g. the rule that majority shareholders can validly use their voting powers in the company general meeting to alter the articles of association only if they act in what they believe to be the best interests of the whole company: *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656; *Shuttleworth v Cox Brothers and Co (Maidenhead) Ltd* [1927] 2 KB 9; *Citco Banking Corp NV v Pusser's Ltd* [2007] UKPC 13, [2007] 2 BCLC 483.

[28] *O'Neill v Phillips* [1999] 1 WLR 1092, 1099, quoted below. See too *Re Guidezone Ltd* [2001] BCC 692 [175]; *Re Brand & Harding Ltd* [2014] EWHC 247 (Ch) [19].

[29] W Clark et al (eds), *Fisher & Lightwood's Law of Mortgage* 12th edn (2006) [30.22], approved *Haydon-Baillie v Bank Julius Baer & Co Ltd* [2007] EWHC 1609 (Ch) [185]. See too *Knight v Marjoribanks* (1849) 2 Mac & G 10, 13-14; 42 ER 4, 5; *Warner v Jacob* (1882) 20 Ch D 220, 224; *Farrar v Farrars Ltd* (1888) 40 Ch D 395, 398 and 410-411; *Kennedy v De Trafford* [1897] AC 180, 185; *Cuckmere Brick Co Ltd v Mutual Finance Ltd* [1971] Ch 949, 965-6; *China and South Sea Bank Ltd v Tan* [1990] 1 AC 536, 545; *Downsview Nominees Ltd v First City Corp Ltd* [1993] AC 295, 317; *Yorkshire Bank plc v Hall* [1999] 1 All ER 879, 895; *Medforth v Blake* [2000] Ch 86, 98, 102 and 103. Discussion in KCF Loi, 'Mortgagees Exercising Power of Sale: Nonfeasance, Privilege, Trusteeship and Duty of Care' [2010] JBL 576.

Such powers are sometimes given by settlors to trust protectors (who may be the settlors themselves),[30] and they are often given to employers under occupational pension schemes.[31]

A third group of cases concern powers vested in the trustees of trusts for multiple beneficiaries including the trustees themselves: as James Penner has written, 'such a trustee may be required, in exercising his judgment to distribute property, at least to consider the interests of all the objects, not just his own interests as one of the objects, and to do so in good faith.'[32] Examples of discretionary trusts which conform to this pattern are discussed in the last section of the paper. Consider, also, *Re Mulligan (deceased)*,[33] where a settlor's widow was the life tenant of his estate, and also trustee (with a firm of solicitors); the remainderman was the settlor's nephew. The widow insisted on the adoption of an investment policy which maximised income at the expense of capital growth, a breach of trust not because she owed a duty of self-denial to subordinate her personal interest to the nephew's interest by adopting the opposite policy (she did not), but because she and the solicitor trustees both acted in bad faith when they failed to hold an even hand between her interest and the nephew's interest.[34]

A fourth group of cases holds that where the rules of a partnership invest a majority of partners with powers, these may not be used against the minority unfairly, for example, to expel a partner without allowing her to advance her own case and giving this fair consideration,[35] or to arrange a meeting at which a partner is 'bounced' into resigning: in Neuberger J's words, 'Bullying, seeking to trap and intentionally taking by surprise with a view to shock … must, in my view, amount to a breach of good faith.'[36]

Similar rules have been exported from partnership law into company law and have been applied in a fifth group of cases, which concern small and closely-held companies that resemble 'quasi-partnerships'. These cases prohibit the unconscionable use of powers vested in the majority shareholders by the articles of association,[37] conduct which may lead either to orders for a just and equitable winding up of the company under the Insolvency Act 1986, s 122(1)(g) or to buy-out orders on the ground of unfair prejudice under the Companies Act 2006, s 994.

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[30] *Re Z Trust* [1997] CILR 248 (Cayman Islands); *Re Internine and Intertraders Trusts* (2005) [2010] WTLR 443 (Jersey); *Scaffidi v Montevento Holdings Pty Ltd* [2011] WASCA 146 [151]-[152] (Western Aus); *Blenkinsop v Herbert* [2017] WASCA 87 (Western Aus). Earlier days: *Duke of Portland v Lady Topham* (1864) 11 HL Cas 32, 54; 11 ER 1242, 1251. Protectors can also be given powers which they are forbidden to exercise in a self-serving way: *Centre Trustees (CI) Ltd v Pabst* [2009] JRC 109, (2009) 12 ITELR 720 (Jersey); *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) [186] and [203].

[31] *Re Courage Group's Pension Schemes* [1987] 1 WLR 495, 514; *Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd* [1991] 1 WLR 589; *National Grid Co plc v Mayes* [1997] PLR 157 [85]-[92] (not contested on appeal); *IBM United Kingdom Holdings Ltd v Dalgleish* [2017] EWCA Civ 1212, [2018] PLR 1. Discussion in M Thomas and B Dowrick, 'The Heart of the Matter – Re-thinking Good Faith in Occupational Pension Schemes' [2007] Conv 495; D Pollard, *The Law of Pension Trusts* (2013) ch 11.

[32] Penner (2014) (n 19) 221.

[33] [1998] 1 NZLR 481.

[34] Cf *Northwest Capital Management Ltd v Westate Capital* Ltd [2012] WASC 121 [295] (Edelman J): 'It is, of course, possible for a trust deed to provide for circumstances in which beneficiaries might be treated differently. Although the equal treatment of all beneficiaries, in all circumstances, is not part of what has been sometimes suggested to be the "irreducible core" of a trust … it is an important default quality of a fixed trust. In *Knox v MacKinnon* (1888) 13 AC 753, 768 Lord MacNaghten said that "[a]ny system of trusts which did not require trustees to act with perfect impartiality as between their cestuis que trust ... would be illusory and mischievous".'

[35] *Const v Harris* (1824) Turn & R 496, 525; 37 ER 1191, 1202; *Blisset v Daniel* (1853) 10 Hare 493, 68 ER 1022; *Wood v Woad* (1874) LR 9 Ex 190.

[36] *Mullins v Laughton* [2002] EWHC 2761 (Ch), [2003] Ch 250 [100].

[37] Note also that shareholder agreements providing for the expulsion of shareholders are enforceable only if they are exercised in good faith and not used 'for unworthy purposes': *Re LCM Wealth Management Ltd* [2013] EWHC 3957 (Ch) [45]-[55].

In connection with the former provision, Lord Wilberforce said in *Ebrahimi v Westbourne Galleries Ltd* that it enables the court:[38]

> 'to subject the exercise of legal rights to equitable considerations … of a personal character arising between one individual and another, which may make it unjust, or inequitable, to insist on legal rights, or to exercise them in a particular way.'

In connection with the latter, Lord Hoffmann said in *O'Neill v Phillips* that:[39]

> 'One of the traditional roles of equity, as a separate jurisdiction, was to restrain the exercise of strict legal rights in certain relationships in which it considered that this would be contrary to good faith. … [So there are] cases in which equitable considerations make it unfair for those conducting the affairs of the company to rely upon their strict legal powers … [for example, because they have used the rules in a way] which equity would regard as contrary to good faith.'

In all of these cases, the courts have required defendants to engage in a fair, rational and transparent decision-making process when exercising discretionary powers, and it has been no answer to a complaint that a defendant has failed to do this that she could have arrived at the same conclusion – even the same self-serving conclusion – after following a better process than the one which she undertook. So a central point established by these cases is that although defendants might conceivably breach an equitable duty of good faith because they are actuated by self-interest, it does not follow that equitable duties of good faith and self-denial are one and the same duty. Good faith is a different concept from self-denial, just as it is a different concept from honesty, and a defendant can fail to act in good faith although she is honest and although she has no personal interest in the outcome produced by her bad faith conduct.[40]

Legitimate Expectations

It is noticeable, too, that all of the foregoing cases concern the exercise of powers which have been created consensually – by contracting parties or by settlors and trustees.[41] But the courts are by no means willing to sit back and let the parties sort out problems of unfairness between themselves on the basis that they are free to create their own private world of rights, powers, and duties. An interventionist paternalism is operating here, though many courts would consider that they were merely holding the parties to the spirit of their own undertakings. In this connection we can compare the justification advanced by Leggatt LJ for implying good faith terms into relational contracts in the *Sheikh Tahnoon* case, namely that the 'legitimate

[38] [1973] AC 360, 379.

[39] [1999] 1 WLR 1092, 1098-9; applied in e.g. *Re Via Servis Ltd* [2014] EWHC 3069 (Ch). Cf *Grace v Biagioli* [2005] EWCA Civ 1222, [2006] BCC 85 [64]: 'The use by the majority of the powers and voting rights conferred by the articles cannot be regarded as contrary to good faith where they are invoked to protect the company from conduct which is itself either in breach of a relevant agreement, or otherwise detrimental to the well-being of the company and its assets'; *Apex Global Management Ltd v FI Call Ltd* [2015] EWHC 3269 (Ch) [47]-[48]: quasi-partners may have to put up with some insulting behaviour, as the duty does not extend 'to control every aspect of one person's interaction with another', but not with denigration of their conduct of the business to an extent that makes 'their constructive continuation in quasi-partnership unrealistic.'

[40] Further evidence of this can be found in the rules which state the consequences of self-interested and bad faith exercises of power: the former are voidable: *Campbell v Walker* (1800) 5 Ves Jun 678, 680-682; 31 ER 801, 803; *Tito v Waddell (No 2)* [1977] Ch 106, 241; the latter are void: *Kennedy v De Trafford* [1897] AC 180, 185; *Dundee General Hospitals Board of Management v Bell's Trustees* [1952] 1 All ER 896, esp 905 (Lord Reid): 'If it can be shown that the trustees … did not act honestly or in good faith, then there was no true decision'.

[41] The donor of a power cannot bring the power into existence unilaterally as the consent of the donee is also required: Law of Property Act 1925, s 156(1).

expectations which the law should protect in relationships of this kind are embodied in the normative standard of good faith'.[42]

So it might be said that employees have a legitimate expectation that their employers will not compromise the relationship of trust and confidence that exists between them when exercising their powers under a pension trust deed and that equity protects these expectations by imposing duties of good faith on the employers.[43] Similarly, mortgagors have legitimate expectations that mortgagees will not foreclose and sell off the mortgaged property for no more than the minimum amount needed to satisfy the mortgagor's debt out of the proceeds of sale. Minority shareholders in closely-held companies have legitimate expectations that the majority will not use their voting rights to win an unfair advantage over the minority. And so on.

The 'Irreducible Core' of Trustee Duties

Given that equitable duties of self-denial and good faith are distinct, it is a question worth asking, whether one or other or both of these duties form part of the 'irreducible core' of trustee duties? This term was used by Millett LJ in *Armitage v Nurse*[44] to express the idea that certain duties must be imposed on trustees, and may not be excluded by a term of the trust deed, if a trust is to exist at all.

The case concerned a clause which stated that 'No trustee shall be liable for any loss or damage which may happen to [the claimant beneficiary's] fund or any part thereof or the income thereof at any time or from any cause whatsoever unless such loss or damage shall be caused by his own actual fraud.' The question was whether this clause was effective to absolve the trustees from liability for several pleaded breaches of trust committed when control of land held for the claimant was transferred to a family company run by her mother (who was also a beneficiary) and her grandmother; the company then farmed the land for the company's benefit. It was alleged that all this was contrary to the trust terms (which provided that no trust property should 'in any circumstances whatsoever be paid or applied beneficially (save for full consideration) or be applied for the benefit whether directly or indirectly of [the claimant's] mother or grandmother'); that the trustees had pursued 'a deliberate course of conduct … to disregard the [claimant's] interests and subordinate them to the interests of her mother or other members of the family who were not objects of the trust, or at the very least a conscious indifference to [the claimant's] interests'; and that as a result of the company's mismanagement of the land it had fallen in value, and that this had occurred as a consequence of the trustees' failure to take reasonable steps to supervise the company.[45] However it was not alleged that the trustees had been motivated by any dishonest purpose.

The Court of Appeal held that even if the alleged breaches of duty had been committed, the trustees would owe no personal liability. The alleged breaches all fell within the scope of the exclusion clause, and the clause was legally valid because it did not purport to absolve the trustees from liability for breach of core duties. The governing principles identified by Millett LJ were that if 'beneficiaries have no rights enforceable against the trustees there are no trusts' and that 'the minimum necessary to give substance to the trusts' was 'the duty of the trustees to perform the trusts honestly and in good faith for the benefit of the beneficiaries'.[46]

The latter dictum has been much cited in later cases, but unfortunately it is worded in a confusing way. One problem is that it runs questions of duty together with questions of liability. The question whether a trust exists because property is held by trustees who owe duties

[42] *Sheikh Tahnoon* (n 1) [167].
[43] See the cases cited in n 27, but note the CA's explanation in the *IBM* case of the extent to which the employees' legitimate expectations are relevant to an assessment of an employer's decision-making.
[44] [1998] Ch 241.
[45] Ibid 249-50.
[46] Ibid 253-4.

affecting their use of the property is distinct from the question whether the trustees must make good losses resulting from their breach of such duties. Millett LJ speaks as though these were different aspects of a single issue, but as James Penner has written, the content of trustees' duties matters for deeper reasons than the fact that breaches of duty may expose the trustees to personal liability, for it determines the nature of the trust and 'dealings with trust property in compliance with the terms of the trust are the justification in law for those transactions being valid for the parties involved'.[47]

Another problem with Millett LJ's dictum is that it runs the trustees' duty to adhere to the trust terms together with their duty of honesty and good faith, producing the dubious proposition that in order to bring a trust into existence a settlor need not place the trustees under a positive duty to perform the trust terms: she only needs to place them under a negative duty to avoid departing from the trust terms with the dishonest intention of stealing from the beneficiaries or otherwise acting against their interests.[48] Obviously trustees must not do that, but there are other important things which also need to be said about trust relationships, which distinguish them from the generality of social relationships that import a duty not to steal.

Trustee Accountability and Mandatory Duties

A more helpful approach to this topic is therefore to start with the principle that a trust cannot exist unless the trustees are accountable for their handling of the trust property to beneficiaries or other parties with enforcement rights, and then to ask what mandatory duties are needed to give content to this principle.[49] This methodology has been adopted by various scholars, who have arrived at different (but overlapping) lists of duties which they believe to be mandatory.[50] The same approach has also been taken by the New Zealand Law Commission, which has proposed a statutory codification of trustee duties divided into 'mandatory' and 'default' duties.[51] These proposals have been accepted (with some modifications) by the New Zealand government and lists of mandatory and default duties are now contained in clauses 22-26 and 27-36 of the Trusts Bill that is currently making its way through the New Zealand Parliament.[52]

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[47] J Penner, 'Exemptions' in P Birks and A Pretto (eds) *Breach of Trust* (2002) 252. But cf D Clarry, 'The Irreducible Core of a Guernsey Trust' [2014] Jersey & Guernsey LR [46]: 'as a matter of law and public policy, trusts comprise an irreducible core of legal relations that cannot be excluded (i.e. "duty exclusions") and persons that owe those duties cannot be exempted from liability for failing to discharge those obligations (i.e. "liability exemptions"). Trusts do not have "legal substance" simply because core duties exist, if no liability will arise from breaching those duties. … [So] the conceptual distinction between duty exclusions and liability exemptions, whilst noted, should be treated rather cautiously.'

[48] A ppoint well made in Penner (2002) (n 44) 250-252.

[49] M Bennett, 'Competing Views on Illusory Trusts: The *Clayton v Clayton* Litigation in its Wider Context' (2017) 11 J Eq 48, 62-3. In *Clayton v Clayton* [2016] NZSC 29, [2016] 1 NZLR 551 [123]-[124] the court said that where a settlor appoints herself as trustee but retains such broad powers that she can do what she likes with the property it may be that she does not owe 'the irreducible core of trustee obligations referred to in *Armitage v Nurse*'; in that case she may intend to create an arrangement which the law does not recognise as a trust; some courts describe such an arrangement as an 'illusory trust', but 'we do not see any value in using the "illusory" label: if there is no valid trust, that is all that needs to be said.' In *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) [167]-[169], Birss J agreed that it is unnecessary and misleading to use the 'illusory trust' label in such cases because the only question that matters is whether the trustee owes the irreducible core of duties: it makes no difference whether the settlor had any intention to deceive as no allegation of sham needs to be made. Further discussion in D Russell and T Graham, 'Illusory Trusts' (2018) 24 T&T 307.

[50] DJ Hayton, 'The Irreducible Core Content of Trusteeship' in AJ Oakley (ed), *Trends in Contemporary Trust Law* (1996); Penner (2002) (n 44) 250-252; JH Langbein, 'Mandatory Rules in the Law of Trusts' (2004) 98 North Western Univ LR 1105, esp 1121-1126; AS Butler and DJ Flinn, 'What is the Least that We Can Expect of a Trustee? Exclusion of Trustee Duties and Exemption of Trustee Liability' [2010] NZLR 459; D Fox, 'Non-excludable Trustee Duties' (2011) 17 T&T 17.

[51] New Zealand Law Commission, *Review of the Law of Trusts: A Trusts Act for New Zealand* (Report No 130, 2013) ch 5.

[52] http://www.legislation.govt.nz/bill/government/2017/0290/latest/DLM7382815.html

Clauses 37 and 39 separately invalidate any clause which purports to limit or exclude a trustee's liability for any breach of trust arising from the trustee's dishonesty, wilful misconduct, or gross negligence, treating the issue whether a duty is 'mandatory' as distinct from the issue whether liability for breaching it can be restricted by reference to the degree of fault committed by a breaching trustee.

The mandatory duties set out in the bill are: a duty to know the terms of the trust; a duty to act in accordance with these terms;[53] a duty to act honestly and in good faith; a duty to act for the benefit of the beneficiaries or to further the permitted purpose of the trust; and a duty to exercise their powers for a proper purpose. One might argue that other duties should also appear on this list to ensure the trustees' accountability, although it may be that these are thought to follow by necessary implication from the duties which have been listed: e.g. a duty to segregate trust property from the trustee's own property, a duty to keep trust accounts, a duty to inform the beneficiaries that they are beneficiaries, a duty to provide beneficiaries with information, and a duty to submit to the court's supervisory jurisdiction (or to binding arbitration).[54]

For present purposes, however, the most interesting inclusion in the list of mandatory duties is the duty to act 'honestly and in good faith' and the most interesting omission is the duty of self-denial, variants of which are listed instead as default duties: a duty not to exercise powers for the trustees' own benefit; a duty to avoid conflicts of interest; a duty not to profit; and a duty to act for no reward. The decision to treat these duties of self-denial as default rather than mandatory duties is in line with the Law Commission's statement that:[55]

> 'The terms of a trust may allow trustees to exercise discretion to benefit themselves, particularly if they are beneficiaries, or to be in a position where their personal interests conflict with those of other beneficiaries or with their role as a trustee. However, the terms of the trust would not be able to allow trustees to self-benefit without honestly considering the interests of other beneficiaries.'

Are Duties of Good Faith Mandatory?

This brings us to the question whether duties of good faith and self-denial are, and should be, mandatory under English law? Plenty of cases identify a duty of 'good faith and honesty' as a non-excludable core duty, following Millett LJ's statement to this effect in *Armitage*.[56] However it seems likely that the courts intend this term to be read conjunctively and not disjunctively, i.e. that they conceive the 'duty of good faith' to be synonymous with a duty of honesty, in which case their decisions are surely correct, but do not tell us the answer to the question whether the duty of 'seriousness' with which this paper is concerned is also a mandatory duty?

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[53] Cf *Crossman v Sheahan* [2016] NSWCA 200 [308]: 'the duty to adhere to the terms of the trust can readily be accepted as falling within the "irreducible core of obligations" of the trustee.'

[54] Variously considered in *Permanent Trustee Company v Dougall* (1934) 34 SR (NSW) 83, 86-87; *Re Rabaiotti's Settlement* (2000) 2 ITELR 763, 773-4; *Schmidt v Rosewood Trust Ltd* [2003] UKPC 26, [2003] 2 AC 709 esp [51]; *AN v Barclays Private Bank & Trust (Cayman) Ltd* [2007] WTLR 565, 597; *BQ v DQ* [2010] SC (Bda) 40 Civ (well discussed in J Palmer, 'Controlling the Trust' (2011) 12 Otago LR 473); *Welker v Rinehart (No 2)* [2011] NSWSC 1238 [24]; *Re an Application for Information about a Trust* [2013] SC (Bda) 16 Civ, [2015] WTLR 559; *Patel v Patel* (2016) 19 ITELR 958 (Guernsey Royal Ct); *Royal National Lifeboat Institution v Headley* [2016] EWHC 1948 (Ch), [2016] WTLR 1433; *Valard Construction Ltd v Bird Construction Co* [2018] SCC 8; *Lewis v Tamplin* [2018] EWHC 777 (Ch).

[55] NZLC Report No 130 (n 48) 109.

[56] See n 43 and accompanying text. *Armitage* has been followed in e.g. *Fattal v Walbrook Trustees (Jersey) Ltd* [2010] EWHC 2767 (Ch); *Spread Trustee Co Ltd v Hutcheson* [2011] UKPC 13, [2012] 2 AC 194; and *Barnsley v Noble* [2016] EWCA Civ 799, [2017] Ch 191.

Looking back at the list of mandatory duties contained in the New Zealand Trusts Bill, we can see that this includes a 'duty to exercise powers for a proper purpose', the reasoning being that trustees are vested with powers by settlors in order to carry out the terms of the trust, and that they cannot be permitted to exercise them for any other purpose since this would destroy the whole arrangement. By the same reasoning one might argue that it should also be a mandatory duty to exercise powers rationally and transparently, and not to exercise them capriciously or perversely, as failures of this kind could also fatally undermine the settlor's purposes. If that is correct, however, then it suggests that further thought should be given to the rules absolving the trustees of the need to explain their decision-making when exercising discretionary powers.[57] These are suspect in any case, since although they may give effect to the wishes of settlors they may also enable trustees to hide irrational, capricious and perverse decision-making processes behind a shield of confidentiality.

Are Duties of Loyalty Mandatory?

Turning to the question whether loyalty is a mandatory duty, some English courts have said that it is, and some scholars have argued that in some cases at least it should be, on the grounds, first, that allowing a trustee to distribute all the trust property to herself will create insuperable temptation that will disable her from exercising fair judgment, and second, that allowing this would be inconsistent with the 'axiomatic trusts law idea of the trustee being a fiduciary steward of property … for the benefit of others.'[58] So in *British Coal Corporation v British Coal Staff Superannuation Scheme Trustees Ltd*, Vinelott J said that:[59]

> 'I find the idea that a person who has a power to distribute a fund amongst a class which includes himself should be able to apply the fund or any part of it for his own benefit … outrageous. This does not rest on any technical rule of trust law; common sense dictates that no man should be asked to exercise a discretion as to the application of a fund amongst a class of which he is a member. He cannot be expected fairly to weigh his own merits against the merits of others.'

Meanwhile, Tobias Barkely has argued that it is incompatible with the essential idea of a trust (namely that a trust entails placing a trustee under a duty 'to actually use property for the benefit of someone other than the trustee'), for a trustee to be included among a class of discretionary beneficiaries and empowered to appoint the property to herself to the exclision of the others.[60]

Against the flow of these arguments, however, there is the Pensions Act 1995, s 39, which abrogated Vinelott J's finding that member trustees should be forbidden to exercise powers under pension schemes for their own benefit. Outside the pensions context there are also many cases which support the contrary view that the duty of loyalty is not mandatory, and that settlors are free to arrange matters so that trustees can benefit themselves provided that they act in good faith towards other objects and beneficiaries when they exercise these powers. For example, in *Re Beatty (deceased)*,[61] trustees were given a power to appoint property out of

[57] *Re Londonderry's Settlement* [1965] Ch 918; *Lemos v Coutts & Co (Cayman) Ltd* [1992] CILR 460 (Cayman Islands CA); *Breakspear v Ackland* [2008] EWHC 220 (Ch), [2009] Ch 32. Discussion in D Hayton et al, *Underhill and Hayton: Law Relating to Trusts and Trustees* 19th edn (2016) [56.46]-[56.47].
[58] Discussion in Bennett (n 46) 65-9.
[59] [1993] PLR 303 [62], responding to criticism of his previous judgment in *Re William Makin & Son Ltd* [1992] PLR 177 [26].
[60] T Barkley, 'The Content of the Trust: What Must a Trustee be Obliged to Do with the Property?' (2013) 19 T&T 452, 453. Cf J Mowbray, 'Choosing among the Beneficiaries of Discretionary Trusts' [1998] PCB 239.
[61] [1990] 1 WLR 1503.

a testator's estate to a class of objects, and were authorised to exercise this power in their own favour. Hoffmann J held that:[62]

> 'The rule that a trustee cannot profit from his trust would ordinarily exclude the trustees themselves from the ambit of the powers, but clause 12(c) of the will allows the trustees to exercise any power conferred by the will, notwithstanding that they may have a direct personal interest in the mode of its exercise. This arguably allows the trustees, subject to having proper regard to their overall fiduciary duties, to make gifts or payments to themselves.'

Again, in *Citibank NA v MBIA Assurance SA*,[63] Arden LJ held that a contractual term which permitted and indeed obliged a trustee to disregard the beneficiaries' interests when exercising a power did not reduce its duties to such a significant extent that it 'cease[d] to be a trustee'.[64] Among other reasons this was because the trustee owed an 'obligation of good faith' when exercising the power, and also had other powers and duties to perform for the benefit of the beneficiaries.

Arden LJ has been criticised for her findings in the *Citibank* case on the basis that the trustee must have owed a core duty to subordinate other people's interest to the beneficiaries' interests that could not have been validly excluded by the parties' contractual arrangements.[65] However, there is a difference between saying that a trustee owes no duty of loyalty to the beneficiaries at all, and empowering her to ignore their interests in some situations. Or to put the same point in another way, it may be legitimate to exclude duties of loyalty for specific transactions without excluding them for all purposes. For example, the trustee in the *Citibank* case could not validly have taken a bribe from any of the parties to exercise the relevant power in a particular way, and there is nothing in Arden LJ's judgment to suggest otherwise.

Furthermore, if the duty of loyalty were a mandatory duty that could never be excluded, it would be impossible for settlors to create discretionary trusts with several beneficiaries because the trustees could not benefit one beneficiary without disadvantaging the others. Nor could they create discretionary trusts with beneficiaries that included the trustees since, once again, the trustees could not benefit themselves without disadvantaging the other beneficiaries. Yet the law clearly allows settlors to create trusts of both kinds. For example, in *Whaley v Whaley*,[66] trustees were given various powers and the trust deed expressly authorised them when exercising these powers 'in favour of any particular person to ignore entirely the interests of any other person interested or who may become interested' under the settlement. And in *Jones v Firkin-Flood*,[67] a trustee was empowered to exercise distributive discretionary powers 'notwithstanding that he or she is one of the discretionary beneficiaries and will or may benefit from any such exercise'.

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[62] Ibid 1506. Cf *Karger v Paul* [1984] VR 161, 163-6, where McGarvey J considered that good faith was one of the 'essential component parts' for the valid exercise of discretionary power by a trustee but that self-denial was not; the HCA implicitly accepted the correctness of these propositions, at least outside the superannuation context, in *Finch v Telstra Super Pty Ltd* [2010] HCA 36, (2010) 242 CLR 254.

[63] [2007] EWCA Civ 11, [2007] 1 All ER (Comm) 475.

[64] Ibid 497.

[65] e.g. A Trukhtanov, 'The Irreducible Core of Trust Obligations' (2007) 123 LQR 342, 346; M Yip, 'The Commercial Context in Trust Law [2016] Conv 347, 356-9.

[66] [2011] EWCA Civ 617, [2011] WTLR 1267 [51].

[67] [2008] EWHC 2417 (Ch) [265]. For additional discussion see T Barkely, 'Is the Trustee-Beneficiary Relationship Necessarily Fiduciary?', paper given at the Obligations VII Conference in Hong Kong, 16 July 2014; Penner (2014) (n 19) 221.

The law also allows settlors to appoint trustees with a pre-existing interest in another capacity that conflicts with the beneficiaries' interests,[68] it allows them to insert charging clauses under which professional trustees can take remuneration for their services out of the trust fund,[69] and it allows them to insert clauses into trust deeds which permit the trustees to engage in self-dealing provided that they act in good faith: so, for example, in *Barnsley v Noble* the defendant trustee successfully invoked a clause which provided that:[70]

> 'My trustees shall have power to enter into and complete contracts or other transactions with themselves or any of them (acting in their own interests as individuals or in some other fiduciary capacity) for the sale purchase exchange or otherwise of any part or parts of my residuary estate provided that:— (i) every trustee personally interested therein shall have acted in good faith … [etc]'.

None of this is to deny that duties of loyalty, including duties of self-denial are duties which settlors often wish to impose on their trustees. The question with which we are concerned, however, is a different one, namely whether it is possible for a settlor to create a trust where the trustees are permitted to exercise their powers over the trust property for their own benefit. The foregoing authorities all show that to some extent at least this is possible, and that duties of self-denial are therefore default duties which can be excluded for some purposes, provided that the trustees are subject to a duty of honesty and a duty of good faith.

[68] *Mordecai v Mordecai* (1988) 12 NSWLR 58, 66-67. Cf *Hordern v Hordern* [1910] AC 465, 475.
[69] *Space Investments Ltd v Canadian Imperial Bank of Commerce Trust Co (Bahamas)* Ltd [1986] 1 WLR 1072, 1074-5.
[70] [2016] EWCA Civ 799, [2017] Ch 191 [16].