



Gerard Kilpatrick

Fiduciary Obligations

Gerard Kilpatrick, partner in the Warkworth Lawlink firm of Webster Malcolm & Kilpatrick, looks at an important recent Supreme Court case on fiduciary obligations, and the consequences that follow if these are breached.

“Equity” is a word that in ordinary language means overall fairness, taking into account all relevant factors. But to any lawyer trained under a system of law based on English law, the word “equity” has a distinct meaning. It refers to a power possessed by our courts to provide some relief from the stricter rules of the common law where these worked unfairly, and to enable the courts to do justice in the particular circumstances. Although equity in time lost some of its flexibility to meet the needs of the individual case, as a system of law it remains an important component of our law today.

The recent Supreme Court decision in *Chirnside v Fay* [2007] 1 NZLR 433 is a reminder of the court’s powers in equity. Mr Chirnside and Mr Fay had collaborated on a site development project in Dunedin, which they called the *Harvey Norman* project. In planning the project they conferred frequently, identified a purchase price for the site, and entered into a conditional purchase agreement (in Mr Chirnside’s name as “trustee for a company”). They also dealt extensively with Harvey Norman as to the terms of a future tenancy to ensure that any development of the site would be profitable. In the course of the planning, Mr Fay moved to Christchurch to live, and Mr Chirnside took over dealing with Harvey Norman, which eventually committed to becoming a tenant, thus ensuring the project would be profitable. Despite this working together, Mr Chirnside lost confidence in Mr Fay, and without telling him, decided to exclude him from the venture. He found other participants, who, for a payment, came into the venture in Mr Fay’s place. The development proceeded to completion as between Mr Chirnside and the new participants.

When Mr Fay eventually found out what was happening, he commenced a court action against Mr Chirnside, claiming what he said was his share of the profits from the venture.

HAD MR CHIRNSIDE DONE ANYTHING WRONG?

Mr Chirnside denied that he had done anything wrong. He asserted that he and Mr Fay had not reached any legally binding agreement, and they did not have a legal partnership of any kind. Mr Chirnside was here talking about a strict legal agreement or contract, whether or not reduced to writing. In this, Mr Chirnside was undoubtedly right, so the law could not turn to the principles of contract or partnership to regulate his relations with Mr Fay. Importantly, even though there was no contract, the court did hold that the parties, by reason of the work they undertook towards fulfilment of the project, were engaged in furthering a “joint venture”. The Court of Appeal had earlier described a “joint venture” as:

two or more persons associating together to a common commercial end

Instead of looking to contract, the court invoked a principle of equity, that is, the concept that the parties, in their association for what was a “joint venture” and without a contract, owed each other “fiduciary obligations”. In *Bristol and West Building Society v Mothew* [1998] Ch 1 Millet LJ in the England Court of Appeal had described a fiduciary obligation as follows:

A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a

fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations. They are the defining characteristics of the fiduciary.

This case was referred to with approval in a Privy Council case from New Zealand, *Arklow Investments Limited v MacLean* [2000] 2 NZLR 1.

Earlier, when Mr Fay’s claim had been before the Court of Appeal, that court had asked the following question:

Was the relationship between Mr Fay and Mr Chirnside at the relevant time such that they were obliged to act towards each other with appropriate bounds of loyalty, and hence good faith? We think the answer to this question is “yes”.

Counsel for Mr Chirnside had argued vigorously that no fiduciary obligation could arise in the absence of a contract or other formal legal relationship, but all the courts rejected this argument. By excluding Mr Fay from the development in a context where the parties had embarked upon what was to be a joint venture, Mr Chirnside had breached a fiduciary obligation. In particular, the courts all held that it was unnecessary for there to be any contract between the parties for such an obligation to arise. In total, there were nine judges involved in this

case, one in the High Court, three in the Court of Appeal, and five in the Supreme Court. All nine agreed with this finding, although in the Supreme Court, two of the judges differed slightly in their reasoning.

COMPENSATION

It followed that Mr Fay was entitled to monetary compensation. The question now before the courts was the basis on which that compensation was to be assessed. In the Court of Appeal, the judges decided to assess damages on the basis that at the time of the breach of fiduciary obligation, Mr Fay had only the "chance" of a successful venture before him, and that damages should therefore be assessed on the basis of the "loss of a chance". The court took into account, among other things, that at the time of Mr Chirnside's breach, the development may not have proceeded, and that possibility and other contingencies needed to be reflected by way of a reduction in any award of damages or compensation. When the case came to the Supreme Court on appeal, the judges would have none of that as a basis for assessing compensation. Their view was that Mr Fay had more than a chance; he actually had a then existing "joint venture". Tipping and Blanchard JJ in their joint judgment said:

The key problem with the loss of a chance approach in the present case is that it is inconsistent with the essence of the liability finding that the parties were joint venturers: see [69] above. Mr Fay did not lose the chance of entering into a profitable joint venture. He was already a party to that venture.

The court had regard to the fact that the loss of chance approach to the assessment of compensation involves discounting the damages award for contingencies. The court ruled that in this case, there were no contingencies. The appropriate compensation for breach of fiduciary duty was the more robust remedy that equity provided, inelegantly called a "disgorgement". This meant that Mr Chirnside had to pay to Mr Fay the whole of the profit that Mr Chirnside had made from the venture at Mr Fay's expense. Interestingly, the company Mr Chirnside had formed to conduct the venture was also liable to Mr Fay for this profit.

The judges of the Supreme Court differed slightly in their assessment, but in the result, the majority

calculated Mr Chirnside's gain at Mr Fay's expense as being \$850,000, and Mr Fay was awarded this sum plus interest and costs. Arguably, had Mr Fay and Mr Chirnside had a contract, the award to Mr Fay may have been less, as the court may have held that the amount awarded should have been discounted for contingencies. As it was, equity provided the more effective remedy for Mr Fay, both as to liability and as to the generosity of the amount of damages awarded.

THE SUPREME COURT

The decision gives us an opportunity to look at the working processes of our Supreme Court, which has now been our final appellate court in place of the Privy Council for over two years. At first glance, the judgments appear unusually discursive and lengthy, given the matters under review. The five judges of the court were unanimous in finding that Mr Chirnside was liable to Mr Fay for breach of fiduciary obligations and it is surprising that Mr Chirnside was given leave to appeal on this point. The second issue lengthening the judgment is the court's consideration of the basis of assessment of compensation. In the normal course, the court would very likely have referred the assessment of damages back to the High Court for calculation on a "disgorgement" of profit basis, which would have considerably shortened the Supreme Court judgments. The Supreme Court did not do this because of an issue relating to the availability of the High Court judge who had originally heard the case. The principal Supreme Court judgment is a journey dealing with counsel's extensive submissions on the facts in relation to the liability issue, followed by a damages assessment exercise that would normally not be undertaken by a superior court. The need to review the facts also – as often happens – meant that there were differences between the five judges in their findings from those facts. The result is that instead of a single unanimous statement of the law, there are several judgments expressed in different ways and reaching slightly different conclusions.

Given the importance of judgments in a final appellate court, it is unfortunate that the court did not take the opportunity to deliver a single judgment from all five judges, at least on the liability issue. This would have provided a useful restatement for New Zealand of

the law on fiduciary obligations, as well as re-stating the law on the appropriate way to measure compensation when fiduciary obligations are found to be breached.

FAMILY TRUSTS AND DAY TO DAY SITUATIONS WHERE FIDUCIARY OBLIGATIONS ARISE

The Chirnside decision is a reminder to all those who enter into relationships with others that the relationship itself will often engender a special duty of loyalty and give rise to a fiduciary obligation. In the Privy Council, Lord Wilberforce in *New Zealand Netherlands Society "Oranje" Inc v Kuys* [1973] 2 NZLR 163 stressed the variety of situations in which a fiduciary obligation might arise:

whether the case is one of trust, express or implied, of partnership, of directorship of a limited company, or principal and agent, of master and servant...

One important area where a fiduciary obligation arises is with the common family trust, many thousands of which have been formed in New Zealand. The trustees of family (and other) trusts have fiduciary obligations to act with loyalty and integrity towards the beneficiaries of the trust. Many trustees may be surprised to learn of their exposure at the suit of beneficiaries if they fail to run their trusts as the law requires.

In addition, we add that fiduciary obligations arise between the (currently topical) real estate agent and vendor client, as well as between a solicitor and client. The instances where a fiduciary obligation can arise are wide ranging, and the remedies courts have are wide and discretionary, including the ability to ensure a wronged person receives proper compensation. As well as awarding monetary compensation the court may issue injunctions and has other remedies in equity to enforce its decision. Where a fiduciary relationship does arise, the courts will not allow the absence of a formal legal structure, such as a partnership or a joint venture company, to assist the offending party to undermine the integrity and good faith that must go with a fiduciary relationship.

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