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Obligations in the Shade: The Application of Fiduciary Directors' Duties to Shadow Directors[1]

Colin R Moore

Kent Law School, University of Kent

ABSTRACT

This paper argues that shadow directors, as defined in English law, ought to owe the full range of directors' duties enacted in the Companies Act 2006 (CA 2006), ss 171-177, to the relevant company under their power and control. Following the enactment of CA 2006, s 170(5), such an argument is contingent upon the shadow director–company relationship being fiduciary in nature. It is argued here that such a relationship is fiduciary in nature, but the current approach of the English courts of applying Finn's original formulated 'undertaking' test alone is inadequate. This argument is demonstrated via critical analysis of both the 'undertaking test' and the decisions of the English courts in Yukong Line v Rendsburg (1998), Ultraframe (UK) v Fielding (2005) *and* Vivendi v Richards (2013).

Given these inadequacies, it is proposed that the Canadian 'power and discretion' test be deployed alongside the 'undertaking' test, in order to provide a far more comprehensive justification for the application of fiduciary obligations to shadow directors. This position is supported by establishing a theoretical basis for the 'power and discretion' test, via Paul Miller's 'fiduciary powers theory', as well as considering the application of such a test to shadow directors.

Colin R Moore, Associate Lecturer, Kent Law School, Eliot College, University of Kent, Canterbury CT2 7NZ, UK. Email: c.r.moore@kent.ac.uk.

INTRODUCTION

English company law recognises three basic categories of director: de jure directors who have been properly appointed, de facto directors who act as directors despite their lack of appointment and shadow directors, who exercise indirect control over the company by issuing instructions to obedient de jure directors. Given the pivotal role played by company directors in relation to corporate governance, it is vital that the power wielded by all types of directors is subject to regulation via the

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directors' duties. The seven directors' general duties from the Companies Act Companies Act 2006 (CA 2006), Pt X, ss 171-77 usually provide the primary source of both duty and potential liability for directors, notwithstanding other potential liability in the event of insolvency,[2] or in circumstances where a director has acted whilst disqualified.[3] The directors' general duties facilitate, for example, the application of equitable remedies against a director who exploits a profitable 'corporate opportunity' that rightfully belongs to the company,[4] engages in self-dealing,[5] or accepts bribes or other benefits from third parties.[6] Furthermore, the general duties also require that the director concerns promotes the success of the company,[7] as well as acting within powers defined in the company's constitution,[8] amongst a range of other duties. A breach of directors' duties generates potential for claims on behalf of the company against the errant director, by a range of interested actors associated with the company, including the board of directors itself, shareholders by majority resolution, or minority shareholders via a statutory derivative action.[9] Consequently, the normative claim made here is that shadow directors ought to owe the full range of directors' duties to the company, due to the important accountability structures such duties provide.

The problem is that whilst de jure and de facto directors clearly owe directors' fiduciary duties to a company, the position in relation to shadow directors has been the subject of a number of conflicting judicial decisions. Shadow directors clearly owe some specific statutory duties to the company in English law,[10] yet the scope and application of the general directors' duties is more problematic, since the general duties apply to shadow directors, 'to the extent that, the corresponding common law rules

[2] See generally Insolvency Act 1986, Part IV, Ch X.
[3] See Company Directors Disqualification Act 1986, s 15.
[4] CA 2006, s 175.
[5] CA 2006, s 177.
[6] CA 2006, s 176.
[7] CA 2006, s 172.
[8] CA 2006, s 171.
[9] CA 2006, s 260.
[10] See CA 2006, Pt X, Ch 3 and 4. For example see CA 2006, s 187 in relation to the shadow directors' duty to declare an interest in an existing transaction.

or equitable principles so apply'.[11] Consequently, the application of the general directors duties to shadow directors by the courts is not a matter of statutory interpretation, but instead an application of the equitable principles relating to fiduciary obligations. Given that almost all of the general directors' duties are probably fiduciary in nature, with the exception of the codification of negligence under the duty to 'exercise reasonable, care, skill and diligence',[12] the key question is whether the application of general equitable principles results in shadow directors owing fiduciary duties to the relevant company.

The identification of fiduciaries in English law rests primarily on the presence of one of the previously-established settled categories of fiduciary relationship (the status or relationship-based fiduciary) and, unlike de jure and de facto directors, the relationship between a shadow director and a company has yet to become settled. This is perhaps unsurprising given that the term 'shadow director' was first used as short-hand for the definition in the Companies Act 1980,[13] despite the concept itself having existed for nearly a century.[14] Outside of the accepted categories of fiduciary relationships, fiduciary duties are also recognised on an individual factual basis, when an individual makes an express or implied undertaking to act as a fiduciary (fact-based fiduciaries). This so called 'undertaking' test has also been deployed to determine whether the shadow director-company relationship is generally fiduciary in nature.

[11] CA 2006, s 170(5). For a full discussion of how s 170 was altered after recommendations made by the Law Society, see I Moore 'Duties of a shadow director: recent developments considered' (2013) 345 CLN 1, at 2-3.
[12] CA 2006, s 174.
[13] P Davies and S Worthington *Gower & Davies: Principles of Modern Company Law* (London: Sweet & Maxwell, 9th edn, 2012) p 513.
[14] Since Companies (Particulars as to Directors) Act 1917, s 3.

The first part of this paper will demonstrate that, as evidenced by an analysis of the English cases of *Yukong Line,*[15] *Ultraframe*[16] and *Vivendi SA v Richards*,[17] that the 'undertaking test' alone is an inadequate basis for determining whether fiduciary duties ought to apply to shadow directors. Furthermore, it will also be argued that the justifications offered thus far by the courts to supplement the 'undertaking test', are practically and theoretically flawed. These arguments will be made by first defining the shadow director concept, before considering the theoretical basis for imposing fiduciary duties, followed by a critical examination of the 'undertaking test' both theoretically and in its practical application to shadow directors by the English courts.

The second part of this paper will argue that the Canadian 'power and discretion' test should also be deployed to provide a principled justification, for demonstrating that shadow directors ought to owe fiduciary duties to the company. The 'fiduciary powers theory' of Paul Miller[18] will be used to justify the application of the 'power and discretion test', and to argue that fiduciary relationships can be justified without resorting to wider legal, moral or public policy justifications. The application of the 'power and discretion' test in Canada will also be examined, both generally, and in terms of a potential application to shadow directors. Finally, it will argued that both the 'undertaking test' and 'power and discretion test', should be applied as part of a wider process for identifying shadow directors as fiduciaries.

SHADOW DIRECTORS

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[15] *Yukong Line of Korea Ltd v Rendsburg Corp Investments of Liberia Inc* [1998] 1 WLR 294.

[16] *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch).

[17] [2013] EWHC 3006 (Ch).

[18] P Miller 'A Theory of Fiduciary Liability' (2011) 56 McGill LJ 235; 'Justifying Fiduciary Duties' (2013) 58 McGill LJ 969; 'The Fiduciary Relationship' forthcoming in A Gold and P Miller (eds) *Philosophical Foundations of Fiduciary Law* (Oxford: Oxford University Press, 2014) p 63.

A shadow director is defined by CA 2006, s 251 as 'a person in accordance with whose directions or instructions the directors of the company are accustomed to act'.[19] In the Court of Appeal decision in *Deverell,*[20] Morritt LJ emphasised that whilst a shadow director may frequently lurk in the shadows, this is not a required attribute of a shadow director. The judge also identified that influence did not need to be exercised over the entire field of corporate activities, and whilst it is sufficient to show that the de jure directors cast themselves in a subservient role, there was no requirement to demonstrate that they had done this in all circumstances. The court also highlighted that it was dangerous to use epithets to describe the board, such as 'cat's paw, puppet or dancer to the tune of the shadow director', given that this suggested a greater degree of control then the statutory definition actually required.[21]

However, it seems that in *Deverell* that the notion of 'accustomed to act' from CA 2006, s 251 was somewhat under-played, given that earlier cases had found that control of the board, or at least a majority of the board, was needed in order for an individual to become a shadow director.[22] Subsequent case law,[23] and indeed the important later case of *Ultraframe*, has also suggested that control of the board is needed, given that the underlying policy ground of the statute was to ensure that those who effectively control the activities of a company be subject to the same statutory liabilities as a de jure director.[24] Hence, the shadow director is a powerful controlling figure within the unofficial hierarchy of the company concerned, and would seem to be a prime candidate for possessing fiduciary duties to the company.

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[19] The definition of shadow directors in CA 2006 does not apply to parent companies, or professional advisors acting in a professional capacity (CA 2006, s 251(3) and s 251(2) respectively).
[20] *Secretary of State for Trade and Industry v Deverell* [2001] Ch 340 at paras 3 and 36.
[21] Ibid, at 36.
[22] See *Re Unisoft Group Ltd (No. 3)* [1994] 1 BCLC 609, at 620 (per Harman J).
[23] *Lord v Sinai Securities Ltd* [2004] EWHC 1764 (Ch), [2004] BCC 986, at 993, para 27.
[24] *Ultraframe* at para 1270-1272 (per Lewison J).

FIDUCIARY THEORY

Prior to examining the judicial approach to the application of fiduciary duties to shadow directors, it is first useful to briefly identify the theoretical arguments that have developed regarding the nature of fiduciary duties.[25] Several possible justifications for fiduciary duties will be identified,[26] to facilitate the later theoretical contextualisation of a number of judicial decisions relating to the fiduciary duties of shadow directors. The key problem is that historically judges were prepared to, and to some extent still do, impose fiduciary duties between individuals providing a relevant relationship could be found, without explaining why such a relationship is deemed to be fiduciary in nature.[27] In order to fill the gap created by the courts, a number of theoretical justifications have subsequently been provided by academics for justifying the application of these duties.

Three primary strategies have emerged for justifying fiduciary relationships: reductivist, instrumentalist and juridical. The reductivist justification denies that fiduciary relationships are unique, often using economic analysis in the form of agency theory,[28] and attempts to justify fiduciary duties with reference to other facets of private law. Most justifications of this type have primarily been

[25] Good general theoretical summaries and critiques include: Miller (2013), above n 18, pp 975–1004, L Rotman *Fiduciary Law* (Toronto: Thomson Carswell, 2005) pp 53 – 152 and J Shepherd *The Law of Fiduciaries* (Toronto: Carswell, 1981) pp 51 – 92.

[26] See P Birks 'Equity in the Modern Law: An Exercise in Taxonomy' (1996) 26 W Aust L Rev 1, at 3 in relation to problems with the fiduciary concept. See also D DeMott 'Fiduciary Obligations Under Intellectual Siege' (1992) 30 Osgoode Hall LJ 471 and Rotman, above n 25, pp 12-13.

[27] For a discussion of this problem and the early development of fiduciary law see L Sealy, 'Fiduciary Relationships' [1962] CLJ 69; Rotman, above n 25, pp 56-79 and P Parkinson (ed) *The Principles of* Equity (Sydney: LBC Information Services, 1996), pp 336-342.

[28] See F Easterbrook and D Fischel 'Contract and Fiduciary Duty' (1993) 36(1) JL & Econ 425, at 438; Miller (2011), above n 18, at 251-252; R Sitkoff 'An Economic Theory of Fiduciary Law' in A Gold and P Miller (eds) *Philosophical Foundations of Fiduciary Law* (Oxford: Oxford University Press, 2014) p 197; R Cooter and B Freedman, 'The Fiduciary Relationship: Its Economic Character and Legal Consequences' (1991) 66 NYULR 1045; F Easterbrook and D Fischel 'The Corporate Contract' (1989) 89(7) Colum L Rev 1416 and M Jensen and W Meckling 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 J Fin Econ 305.

developed from the law of contract,[29] and have been widely criticised,[30] but others have been based on other facets of private law such as property,[31] unjust enrichment[32] and tort.[33] Conversely, instrumentalist justifications[34] accept the unique nature of the fiduciary relationship, but deny or decline to consider that a single essence or property can define fiduciary relationships,[35] instead justifying fiduciary relationships with reference to an 'independently-valuable end'. Such justifications have been based on morality[36] (including loyalty[37] or trust[38] based justifications), public policy,[39] or

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[29] Cooter and Freedman, above n 28; Easterbrook and Fischel, above n 28, and J Langbein 'The Contractarian Basis of the Law of Trusts' (1995) 105(3) Yale LJ 625.

[30] See Miller (2013), above n 18, pp 982-984; Rotman, above n 25, pp 108-126; Brudney 'Contract and Fiduciary Duty' (1997) 38(4) BCL Rev 595, at 605; W Bratton 'The 'Nexus of Contracts' Corporation: A Critical Appraisal' (1989) 74(3) Cornell L Rev 407; Tamar Frankel 'Fiduciary Duties as Default Rules' (1995) 74(4) Or L Rev 1209; Scott FitzGibbon 'Fiduciary Relationships Are Not Contracts' (1999) 82(2) Marq L Rev 303; M Eisenberg, 'Corporate Law and Social Norms' (1999) 99(5) Colum L Rev 1253; Gregory S Alexander, 'A Cognitive Theory of Fiduciary Relationships' (2000) 85(3) Cornell L Rev 767; Conaglen, *Fiduciary Loyalty* (Oxford: Hart Publishing 2011) pp 214-21 and S Galoob and E Leib 'Intentions, Compliance, and Fiduciary Obligation' (2014) 20(2) Legal Theory 106.

[31] This theory will be discussed in relation to its application in the *Ultraframe* case.

[32] Gareth Jones 'Unjust Enrichment and the Fiduciary's Duty of Loyalty' (1968) 84 LQR 472.

[33] See Miller (2013), above n 18, at 991-994 for an analysis of a potential tort basis for fiduciary obligations. See also T Frankel *Fiduciary Law* (Oxford: OUP, 2011), pp 240-241. Matthew Conaglen lists the following examples: Birks, 'The Concept of a Civil Wrong' in Owen (ed*) Philosophical Foundations of Tort Law* (Oxford: OUP, 1995) p 31 at 35; P Birks 'Definition and Division: a Meditation on Institutes 3.13' in P Birks (ed), *The Classification of Obligations* (1997) p 1, p 14 (referring to them as "meta-torts"); A Burrows, *Understanding the Law of Obligations: Essays on Contract, Tort and Restitution* (1998), pp 14 and 31 and M Conaglen 'The Nature and Function of Fiduciary Loyalty' (2005) 121 LQR 452.

[34] See Miller (2013), above n 18, p 994. See generally R Summers *Instrumentalism and American Legal Theory* (Ithaca: Cornell University Press, 1982) and D Lyons 'Legal Formalism and Instrumentalism: A Pathological Study' (1981) 66(5) Cornell L Rev 949.

[35] D DeMott 'Breach of Fiduciary Duty: On Justifiable Expectations of Loyalty and Their Consequences' (2006) 48(4) Ariz L Rev 925, at 934-935 and J Glover 'The Identification of Fiduciaries' in Peter Birks (ed) *Privacy and Loyalty (*Oxford: Clarendon Press, 1997) p 269, p 275. For a critique of these views see See Miller (2013), above n 18, at 1010 and for a defence of fiduciary law as a separate legal category see Frankel, above n 33, pp 217-242.

[36] For example see T Frankel 'Fiduciary Law' (1983) 71 Cal L Rev 795, at 829-30. For a criticism of morality as an instrumental justification see See Miller (2013), above n 18, pp 995-999.

[37] See the discussion of *Ultraframe* below for an analysis of loyalty-based justifications for fiduciary obligations.

[38] See Frankel, above n 33, pp 6-12 and L Rotman, 'Fiduciary Law's "Holy Grail": Reconciling Theory and Practice in Fiduciary Jurisprudence' (2005) 91 Boston U LR 921, on the importance of trust or entrustment. See also L Mitchell 'The Naked Emperor: A Corporate Lawyer Looks at RUPA's Fiduciary Provisions' (1997) 54(2) Wash & Lee L Rev 465, at 480-81 and R Flannigan 'The Fiduciary Obligation' (1989) 9(3) Oxford J Legal Stud 285, at 297. See Miller (2013), above n 18, pp 997-999 for a discussion of number of problems with the trust justification. For a discussion of trust as a general characteristic of fiduciary relationships see: M Harding 'Trust and Fiduciary Law' (2013) 33(1) OJLS 81.

[39] The potential for a public policy justification is discussed in relation to the *Vivendi* case.

other ends based upon 'a legal principle or a consideration peculiar to legal institutions or the integrity of law.'[40]

Conversely, juridical justifications accept that fiduciary duties are unique, and can be justified based upon the formal characteristics of the fiduciary relationship itself.[41] This category provides a justification for the Canadian 'power and discretion test', via Paul Miller's 'fiduciary powers theory' for justifying fiduciary relationships.[42] Whilst a definitive theoretical justification cannot be provided for Paul Miller's theory, it is nevertheless argued that the theory does provide a sound justification for adopting the 'power and discretion' test alongside the 'undertaking test'. This is particularly pertinent given the difficulties suffered by the English courts in identifying whether shadow directors ought to be fiduciaries using the 'undertaking' test alone, as the next two sections will demonstrate.

THE ORIGINAL 'UNDERTAKING' TEST

Whilst a number of early cases posited a property-based justification for fiduciary duties,[43] a key moment for fiduciary law generally arose when the American academic Austin W Scott asked himself

[40] Miller (2013), above n 18, at 973. See P Birks, 'The Content of Fiduciary Obligations' (2000) 34 Lsr LR 3, Conaglen, above n 30, and Conaglen, above n 33, for arguments of this type. See Miller (2013), above n 18, pp 1001-4, Galoob and Leib, above n 30, and J Edelman 'The Importance of the Fiduciary Undertaking' (2013) 7 J Eq 128, at 135-138, for criticisms of Matthew Conaglen's argument.

[41] Miller (2013), above n 18, at 973 explains that, 'Juridical justificatory argument aims to reveal the justificatory structure of the settled practices and principles of liability constitutive of a given legal form of an institution or mode of interaction'. For a further explanation of the concept of juridical justification, and a comparison with Zipursky's pragmatic conceptualism, plus Weinrib's formalist method, see Miller (2013), above n 18, pp 1007-1009. See also B Zipursky 'Pragmatic Conceptualism' (2000) 6(4) Legal Theory 457, at 459 and E Weinrib, *The Idea of Private Law* (Oxford: OUP, 2012) p 25. See generally E Weinrib 'Legal Formalism: On the Immanent Rationality of Law' (1988) 97(6) Yale LJ 949; E Weinrib, 'The Juridical Classification of Obligations' in P Birks (ed) *The Classification of Obligations* (Oxford: Clarendon Press, 1997) p 37, pp 37-56 and N Simmonds *The Decline of Juridical Reason: Doctrine and Theory in the Legal Order* (Manchester: Manchester University Press, 1984).

[42] Shepherd, above n 25, pp 93-109 offers a similar power-based theory. For a functional based theory of fiduciary liability, with fiduciary law cast as part of equity's safety valve, 'aimed at countering opportunism', see H Smith 'Why Fiduciary Law is Equitable' in A Gold and P Miller (eds) *Philosophical Foundations of Fiduciary Law* (Oxford: Oxford University Press, 2014) p 261.

[43] See *Soar v Ashwell* [1893] 2 QB 390 and *Tintin Exploration Syndicate Ltd v Sandys* (1947) 111 LT 41.

rhetorically in 1949, 'Who is a fiduciary?'. His answer was somebody who had undertaken to act in the interests of another person, and thus the 'undertaking' test was born.[44] The writing of Australian academic and judge Paul Finn is also often cited in support of the concept of the 'undertaking test', although it should be noted that the oft-cited passage describing a fiduciary as, 'somebody who undertakes to act for or on behalf of another in some particular matter or matters,'[45] is a definition from which Finn subsequently retreated and his later alternative approach is considered below. Nevertheless in England, the 'undertaking test' has become the cornerstone for the identification of fact-based fiduciaries in the English jurisdiction, having received support from the Law Commission in 1995[46] and the House of Lords in *White v Jones,*[47] albeit under the terminology of an 'assumption of responsibility'. In *Bristol & West Building Society v Mothew*,[48] Millet LJ (as he then was) specifically adopted Finn's initial 'undertaking' formulation[49] and subsequently such a formulation has been generally accepted by the English courts.[50]

While Scott deployed morality, in the form of loyalty,[51] as a justification for the undertaking test, more recent vociferous support has come from the reductivist contract-based theory of Australian judge and academic James Edelman. He argues that it is only possible to understand when fiduciary duties will arise, 'if we conceive of them as obligations based upon manifestations of a voluntary undertaking to another'. Consequently, he suggests that the scope of the obligations depends upon the scope of

[44] A Scott 'The Fiduciary Principle' (1949) 37 Cal L Rev 539 at 540.
[45] P Finn *Fiduciary Obligations* (Sydney: The Law Book Company Ltd, 1977) p 201, para 467; For example cited by G Moffat *Trusts Law* (Cambridge: CUP, 5th edn, 2009) p 839.
[46] *Fiduciary Duties and Regulatory Rules* (Law Com no 236) (1995) para 1.3; See Moffat, above n 45, p 838.
[47] [1995] 2 AC 207 at 271 (per Lord Browne-Wilkinson).
[48] [1998] Ch 1.
[49] Millet LJ at p 18 stated, 'The concept encaptures a situation where one person is in a relationship with another which gives rise to a legitimate expectation, which equity will recognise, that the fiduciary will not utilise his or her position in such a way which is adverse to the interests of the principal'.
[50] English authorities for this statement include *Arklow Investments Ltd v Maclean* [2000] 1 WLR 594 at 599-600; *Peskin v Anderson* [2001] BCC 874 at para 34; *Hooper v Gorvin* [2001] WTLR 575 at 590; *Kyrris v Oldham* [2003] EWCA Civ 1506 [2004] BCC 111 at para 142; *Button v Phelps* [2006] EWHC 53 (Ch) at paras 58 – 61. See generally J McGhee (ed) *Snell's Equity* (London: Thomson Reuters, 32nd ed, 2010) at para 7-005.
[51] See Scott, above n 44, for numerous examples.

the express or implied undertaking, and therefore fiduciary duties should be treated like any other express or implied term, 'by construction of the scope of voluntary undertakings,'[52] using the standard principles of construction and implication.[53] However, Edelman's justification has been criticised by Miller, firstly on the basis that whilst many fiduciary relationships are voluntarily undertaken, others are imposed constructively, notably in England by CA 2006. Secondly, whilst consent reconciles fiduciary duties with the notion of personal autonomy, it would be an insufficient basis for establishing that one individual ought to serve another as a fiduciary, and does not provide sufficient grounds for imposing the key fiduciary duty of loyalty. Thirdly, whilst Edelman suggested that implication is warranted by 'trust, confidence, power, vulnerability and/or discretion', he failed to explain why these concepts provide support for implying fiduciary duties. Miller suggests that in fact Edelman's argument, 'appears to be that fiduciary duties are implied terms governing interactions that have the classic hallmarks of a fiduciary relationship'.[54] In other words the problem is that the undertaking test does not provide a full justification for the imposition of fiduciary duties, or even any sort of rationale for doing so. This then leads to practical application problems in the courts, as the next part of the analysis will demonstrate.

THE DECISIONS IN *YUKONG LINE* AND *ULTRAFRAME*

In terms of application of the 'undertaking test' to shadow directors, the earliest English case that considered the fiduciary duties of shadow directors, *Yukong Line*,[55] fell into the 'historical trap' of defining the shadow director–company relationship as fiduciary without supplying a *ratio decidendi*

[52] J Edelman, 'When do fiduciary duties arise?' (2010) 126 LQR 30.
[53] Ibid, p 30.
[54] See Miller (2013), above n 18, pp 986-987.
[55] At para 311.

for the decision.[56] The 'undertaking test' was in fact first applied to shadow directors in *Ultraframe*, where Lewison J considered whether the relationship between a shadow director and the relevant company was fiduciary in nature. Prior to this application, Lewison J first identified that 'shadow director' was a narrower statutory concept then 'director',[57] thus justifying differential treatment of shadow directors compared to de jure and de facto directors. In terms of the 'undertaking' test itself, he adopted Millett LJ's formulation from *Bristol & West BS v Mothew*, but emphasised that the key component of the fiduciary duty is loyalty, which required the presence of a direct relationship of trust and confidence between the company and the shadow director.[58] Again this suggests that the undertaking test alone cannot satisfactorily demonstrate whether shadow directors ought to be fiduciaries, as the key element, as Lewison J saw it, of loyalty required separate consideration.

Whilst loyalty can provide a morality-based instrumental justification for fiduciary obligations, and indeed has been the basis of a number of such justifications,[59] a number of problems have been identified with deploying loyalty as a defining characteristic. Loyalty is almost as difficult to define as the fiduciary concept itself,[60] it is a concept that also appears outside fiduciary relationships[61] and it fails to provide a rationale for equitable intervention,[62] so whilst it may be an important part of a fiduciary relationship, it alone cannot define the nature of a fiduciary relationship.[63] In *Ultraframe*

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[56] Rotman, above n 25, pp 75-76 refers to this as 'innate recognition identification' or the 'I know one when I see one' approach. For a practical example see the Canadian case of *Lefebvre v Gardiner* (1988) 27 BCLR (2d) 294 at para 17 (Huddart J).
[57] At para 1279.
[58] At para 1286.
[59] A number of moral justifications use philosopher Josiah Royce as a starting point. See J Royce, *The Philosophy of Loyalty* (New York: Macmillan Company, 1908) Ch 1); Demott, above n 35, p 925 and Scott, above n 44, p 540. See also E Scallen, 'Promises Broken v. Promises Betrayed: Metaphor, Analogy, and the New Fiduciary Principle' (1993) U Ill L Rev 897; Frankel, above n 36, p 830. See generally See Miller (2013), above n 18, p 995 and Rotman, above n 25, pp 140-145.
[60] See Scallen, above n 59, p 909 and Rotman, above n 25, p 144.
[61] Rotman, above n 25, p 143 refers to J McCamus 'The Evolving Role of Fiduciary Obligation' in *1998-99, Meredith Lectures, Faculty of Law, McGill University* (Cowansville: PQ: Yvon Blais, 2000) p 200.
[62] Rotman, above n 25, p 144 refers to J Glover *Commercial Equity: Fiduciary Relationships* (Sydney: Butterworths, 1995) p 142.
[63] See L Hoyano 'The Flight to the Fiduciary Haven' in P Birks (ed) *Privacy and Loyalty* (Oxford: Clarendon 1997) p 182 and Rotman, above n 25, pp 143-145.

itself, Lewison J never really defined loyalty, but instead pursued a reductivist property-based justification for fiduciary duties, by applying trust law to fiduciaries generally. He referred to *Paragon Finance v BB Thakrar & Co*,[64] where Millett LJ differentiated between those who receive trust property knowing that another has a beneficial interest in the property, and therefore become trustees, as against those who simply participate in a fraud and may never receive the trust property at all and consequently are not trustees.[65] Only those who have possessed the trust property can owe fiduciary duties, beyond this those in the second category will attract personal liability but are not fiduciaries, even though at times they have been confusingly referred to as 'constructive trustees' rather than the more comprehensible 'dishonest assistant'. Lewison J in *Ultrafram*e placed shadow directors in the second 'accessory' category on the basis that their influence is indirect, since shadow directors are not necessarily dealing directly with the company's assets.[66] So the decision in *Ultraframe* finds that being a 'shadow director' is not a relevant relationship for the purposes of imposing fiduciary duties, as it not a 'relationship of trust and confidence', due to the lack of a proprietary nexus between the shadow director and the company.

Whilst fiduciary relationships have been justified on property grounds, [67] such justifications are simply not adequate when considering fiduciary duties generally, and are even more problematic when considering the difficult case of the shadow director. Fiduciary relationships may concern the exercise of power over property, but particularly in the case of the company director, the interests and responsibilities of the director extend far beyond the company's tangible property to issues such as

[64] [1999] 1 All ER 400.
[65] Confirmed by Lord Millet in *Dubai Aluminium Co Ltd v Salaam* [2003] 2 AC 366, at 404.
[66] At para 1289 Lewison J did suggest that shadow directors may have limited fiduciary duties to the company due to particular actions that they undertake, but relied on the words of Rimer J in *Brinks Ltd v Abu-Saleh* (no 3) [1999] CLC 133 at 148, to suggest that this would not mean the full range of directors' fiduciary duties were then automatically owed.
[67] See Miller (2013), above n 18, pp 987-989. See also L Ribstein 'Are Partners Fiduciaries?' [2005] 1 U Ill L Rev 209 at 212 for a key example of a property-based justification.

reputation, and of course fiduciary requirements to avoid conflicts of interest.[68] Consequently, the justification Lewison J provides is not sustainable theoretically, as it fails to consider the full extent of fiduciary duties owed by a fiduciary generally and particularly those owed by a company director. After *Ultraframe* shadow directors are at best dishonest assistants rather than fiduciaries. This leaves shadow director liability dependent on overcoming an additional barrier in the form of a test of dishonesty,[69] as well as severely limiting the remedies that are likely to be available.[70] There are also doubts generally about the application of 'dishonest assistant' principles to those assisting a company director,[71] and it is also a concern that a controlling shadow director would have a lesser degree of liability compared to those de jure directors being controlled.[72]

THE REFORMULATED UNDERTAKING TEST

Finn himself subsequently suggested that the original formulation of 'undertaking' test itself was unhelpful, as noted above, given that fiduciary duties are in reality imposed rather than being accepted. The point Finn made is that what whilst it is important to recognise what the alleged fiduciary has agreed too, public policy considerations will define the breadth and depth of the fiduciary

[68] See general criticism of property theory by Miller (2013), above n 18, p 989. For an alternative 'critical resource theory' see D Smith 'The Critical Resource Theory of Fiduciary Duty' (2002) 55(5) Vand L Rev 1399 and the corresponding criticism by Miller (2013), above n 18, pp 989-991. See also Rotman, above n 25, pp 86-93.

[69] The requirement of dishonesty for accessories was established in *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378 at 389 (Lord Nicholls). For subsequent controversy over the correct formulation of the test see *Twinsectra v Yardley* [2002] 2 AC 164; *Barlow Clowes International Ltd v Eurotrust Ltd* [2005] UKPC 37; *Abou-Rahman* [2006] EWCA Civ 1492 and Moffat, above n 45, pp 762-764. See generally E Hadjinestoros, 'Stigmata of fiduciary duties in shadow directorship' (2012) 33(11) Comp Law 331.

[70] Although the recent Court of Appeal decision in *Novoship (UK) Ltd v Mikhaylyuk* [2014] EWCA Civ 908 did allow the equitable account of profits remedy to be applied to a dishonest assistant.

[71] The principles were successfully applied in *Baden v Société Generale* [1993] 1 WLR 509 at 573, but not in *Ultraframe* itself, and have been doubted or left open elsewhere see *Goose v Wilson Sandford & Co* [2001] Lloyd's Rep PN189 and *Gencor ACP Ltd v Dalby* [2000] 2 BCLC 734 at 757. See generally McGhee, above n 50, paras 30-076 to 30-087.

[72] See generally Moore, above n 11.

obligations owed to the principle. Consequently, Finn ventured to offer the following reformulation, both in his academic work, and in his subsequent judicial decisions,

‘a person will be in a fiduciary in his relationship with another when and insofar as that other is entitled to expect that he will act in that other’s or in their joint interest to the exclusion of his own several interest.’[73]

The theoretical status of Finn’s reformulation is controversial. Edelman argues that Finn’s reformulation becomes part of the ‘undertaking test’, with the analysis of ‘legitimate expectations’ taking place by implication or expression in order to define ‘the nature of fiduciary duties which have been undertaken.’[74] If this reformulation is part of the ‘undertaking test’, then the majority of the criticisms regarding Edelman’s theory continue to apply. Alternatively, the reformulation could be described as a justification based on reliance, which unfortunately suffers from similar problems to those justifications based on loyalty,[75] and therefore also fails to provide an adequate justification. However, Finn’s maintains that the fiduciary principle is an instrument of public policy, deployed ‘to maintain the integrity, credibility and utility of relationships perceived to be of importance in society,’ as well as protecting personal and economic interests.[76] The problem is that, as Miller identifies, whilst Finn emphasises the public importance of certain fiduciary relationships, he still provides no clear policy justification for fiduciary duties in general.[77] In any case, regardless of which of these theoretical approaches is deployed, all accept that fiduciary duties can be imposed by the courts beyond those

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[73] P Finn ‘The Fiduciary Principle’ in Youdan (ed) *Equity, Fiduciaries and Trusts* (Toronto: Carswell, 1989) p 54; P Finn, ‘Fiduciary Law’ in E McKendrick (ed) Commercial Aspects of Trusts and Fiduciary Obligations (Oxford: Clarendon Press, 1992) p 9 and as Finn J in *Grimaldi v Chameleon Mining NL* (No.2) [2012] FCAFC 6 at para 177.
[74] Edelman, above n 52, at 318.
[75] See J Shepherd 'Towards a Unified Concept of Fiduciary Relationships' (1981) 97 LQR 51, at 58-59.
[76] Finn (1989), above n 73, p 26.
[77] See Miller (2013), above n 18, p 1001.

originally objectively agreed between the parties,[78] but unfortunately no clear guidance is provided by the reformulation as to when such an imposition of fiduciary duties should occur. Consequently, whilst the reformulation potentially widens the categories of potential fiduciaries, a complete definition of the fiduciary relationship is still absent.

APPLICATION OF THE REFORMULATED 'UNDERTAKING' TEST IN *ULTRAFRAME*

Finn's later reformulation was recognised in the Privy Council case of *Arklow Investments v Maclean*,[79] but has not been universally applied by English judges, and was not applied in *Ultraframe*, despite longstanding approval from the venerable Snell's Equity.[80] However, Finn's reformulation was applied to shadow directors in the recent High Court decision in *Vivendi SA v Richards*, which saw a re-evaluation of a number of key issues in relation to the previously discussed case law.[81] Firstly, Newey J identified that there was more support for the position taken in *Yukong Line* then had been acknowledged in *Ultraframe*, namely from the Law Commission in a 1998 consultation paper[82] and in the unreported High Court case of *John v Price Waterhouse*.[83] Secondly, he identified that *Ultraframe* had received much academic criticism on the basis that it was 'odd' that the full range of directors' fiduciary duties were not owed,[84] and that it was 'unfortunate' that the true mover of the company was able to easily distance themselves from liability for the decisions taken.[85] In the case itself, Newey

[78] Edelman, above n 52, p 327, does accept that fiduciary duties will be imposed in certain circumstances.
[79] [2000] 1 WLR 594 at 598 (per Henry J).
[80] For example see the current *Snell's Equity*: McGhee, above n 50, para 7-005.
[81] The key part of the judgement is paras 133 to 145.
[82] As Newey J (para 134) identified, the assertion that a shadow director could be regarded as akin to a de facto director was made in *Law Commission Consultation Paper, Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties* (Law Com. No.153, 1998) (at para 17.15). Indeed this view was supported by the majority of the respondents and was subsequently echoed in the Company Law Review (*Modern Company law for a Competitive Economy: Completing the Structure*. URN 00/1335 (2000) at para 4.7).However, the white paper, *Company Law Reform* (Cm 6456, March 2005) (at para 3.3) made it clear that some duties would apply differently to shadow directors. See Moore, above n 11, p 2.
[83] Unreported, High Court, 11 April 2001, WL 273028.
[84] D Prentice and J Payne 'Case Comment: Directors' Fiduciary Duties' (2006) 122 LQR 558, at 562 as endorsed by D Kershaw *Company Law in Context* (Oxford: OUP, 2nd edn, 2012) p 330. Newey J's comment is at para 136.
[85] Davies and Worthington, above n 13, pp 512-513.

J focussed on establishing the existence of a fiduciary relationship by finding an undertaking or assumption of responsibility. He advanced a number of other authorities in support of the undertaking test, including the opinions of Finn,[86] Edelman,[87] as well as Australian[88] and English case law.[89] Ultimately, he combined these opinions to identify two basic features of the 'undertaking' test,

'first, the question whether there was such an undertaking/assumption must be determined on an objective basis rather than by reference to what the alleged fiduciary subjectively intended; secondly, the taking on of a role or position must be capable of implying an undertaking/assumption of responsibility'[90]

He further concluded that an individual cannot escape fiduciary duties simply because he did not want to assume them, or because nobody would expect him to assume them because he was known as a dishonest person, the duties instead arising solely on the assumption of the relevant position.[91]

However, despite applying this formulation, the judge still examined whether the position of shadow director was a 'relevant position' for purpose of the above test, in order to establish whether individuals so labelled would owe fiduciary duties to the company.[92] So once again the 'undertaking' test alone fails to provide a complete justification for fiduciary duties. While Newey J did use the 'assumption of responsibility' formulation of the undertaking test as one reason for suggesting that

[86] Finn (1989), above n 73, p 54.
[87] Edelman, above n 52, p 317.
[88] *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41 at p 97-98 (per Mason J).
[89] *F & C Alternative Investments (Holdings) Ltd v Barthelemy (No.2)* [2011] EWHC 1731, [2012] Ch 613 at para 225 (per Sales J), and Ross *River Ltd v Waveley Commercial Ltd* [2012] EWHC 81 (Ch) at para 256 (per Morgan J).
[90] At para 139.
[91] At para 139.
[92] At paras 139-145.

shadow directors are fiduciaries,[93] and also deployed a public policy justification, the majority of the justifications he provided were analogies between shadow directors and other established fiduciary relationships. He suggested that shadow directors are similar to promoters, in the sense that both can use powers which 'greatly affects the interest of the corporation',[94] and to de facto directors in that 'a shadow director's role in company may be every bit as important as that of a de facto director'.[95] The problem with analogies is that these often emerge when there is a 'perceived need' to identify a relationship as fiduciary, yet often there is a lack of clear principles guiding the analogical approach.[96] Whilst analogies may be useful, they should not be substitutes for analytical reasoning, as results maybe be confusing, ineffective,[97] and serious mistakes may be made.[98] Nevertheless, Newey J found that shadow directors owe a fiduciary duty of good faith and loyalty to the company, given that shadow directors should reasonably be expected to act in the company's interests rather than their own.[99]

The decision in *Vivendi* is arguably a step in the right direction in that shadow directors are found to be fiduciaries, but unfortunately theoretical and practical difficulties still remain. The 'undertaking' test alone was still insufficient to conclusively identify fiduciary obligations, which is perhaps unsurprising given that even Edelman has subsequently suggested that an objective undertaking is a necessary yet not sufficient basis for imposing fiduciary duties.[100] Furthermore, supplementing the undertaking test with an analogical approach, as happened in *Vivendi*, seems just a problematic as using the property-based justification deployed in *Ultraframe*. Whilst a number of the other potential

[93] Citing *White v Jones* at 271 (per Lord Brown-Wilkinson).
[94] Newey J cited Lord Penzance (at 1229), Lord Cairns (at 1236) and Lord Blackburn (at 1268–1269) in *Erlanger v New Sombrero Phosphate Co* (1878) LR 3 App Cas 1218.
[95] At para 142.
[96] See Rotman, above n 25, pp 74-75.
[97] D DeMott 'Beyond Metaphor' (1988) Duke LJ 879, at 923-24; Rotman, above n 25, pp 74-75.
[98] Birks, above n 40, at 23. See Rotman, above n 25, p 75.
[99] [2013] BCC 771 at 143.
[100] Edelman, above n 40, p 128.

justifications, both reductivist and instrumentalist, could be applied by the courts to the shadow director question, criticism of these justifications suggests that they too would be inadequate.

THE 'POWER AND DISCRETION' TEST

The proposal is that a better theoretical basis for identifying shadow directors as fiduciaries could be achieved by introducing the Canadian 'power and discretion test' into English law, given that it better illuminates the essential elements of a relationship that compels the imposition of fiduciary duties,[101] as well as having a strong theoretical justification via Paul Miller's 'fiduciary powers theory'.[102] Miller argues that a fiduciary relationship is a distinctive and coherent type of legal relationship that can be defined as, 'one in which one party (the fiduciary) exercises discretionary power over the significant practical interests of another (the beneficiary).'[103] In dissecting this definition, Miller identified definitive properties which delimit the types of relationship identified by the definition, and structural properties which identify implications of a particular relationship for the parties concerned.[104] According to Miller, the key definitive property of fiduciary relationships is power, and having identified the definitional problems associated with the concept,[105] he proceeds to identify a new fiduciary form of power. He argues that 'fiduciary power' is unique by virtue of the fact that the fiduciary acts as a substitute in exercising a legal capacity, which derives from the principal's legal personality.[106] Miller also argues that due to its source, fiduciary power is expressly devoted to serving the practical interests of the other, which represents another key definitive property of the 'fiduciary

[101] For arguments that such essential characteristics of the fiduciary relationship cannot be defined see Demott, above n 35, pp 934-5 and Glover, above n 35, at p 275. See Miller (2013), above n 18, p 1010 for a counter-argument.
[102] For a full justification of his juridical approach see Miller (2013), above n 18, pp 1007-1015.
[103] Miller (2014), above n 18, pp 73.
[104] Miller (2014), above n 18, pp 69.
[105] See Miller (2014), above n 18, pp 69-71 and Shepherd, above n 25, pp 83-88. See also W Hohfield 'Some Fundamental Legal Conceptions as Applied in Judicial Reasoning' (1913) 23 Yale LJ 16.
[106] Miller (2014), above n 18, pp 70-72. Such a definition overcomes a number of previous criticisms of 'power and discretion' theories, see Rotman, above n 25, pp 147-148

powers theory'.[107] Beyond this, Miller identifies the three structural properties of this theory as inequality, dependence and vulnerability. Inequality typifies fiduciary relations due to unequal levels of fiduciary power within the relationship, which exists independently of 'any circumstantial inequality' that might exist between the parties. So the principal is always subordinate within the fiduciary relationship, despite being potentially ascendant in every other aspect. Both dependence and vulnerability are, according to Miller, reflective of the 'structural inequality generated by the formation of a fiduciary relationship'.[108]

Whilst Miller provides a theoretical basis for identifying fiduciary relationships, it is necessary to consider how such elements can be formulated as a practical test, which can then be applied to shadow directors. In the Canadian Supreme Court case of *Frame v Smith*,[109] Wilson J identified three general characteristics of fiduciary relationships that have come to be known as the 'power and discretion' test. Whilst a number of justifications for these elements have been proposed by the Canadian courts, which fall foul of many of the criticisms described above,[110] the 'power and discretion' test nevertheless offers a clear practical approach to the implementation of Miller's theory. The elements from *Frame v Smith* are,

'(1) The fiduciary has scope for the exercise of some discretion or power.

(2) The fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests.

[107] Ibid, pp 17-18.
[108] Ibid, p 19.
[109] (1987) 42 DLR (4th) 81.
[110] For example Forrest J in *Hodgkinson v Simms* [1994] 117 DLR (4th) 161 at paras 45-52, uses both public policy and morality considerations. See Rotman, above n 38, pp 965-969.

(3) The beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power.' [111]

Subsequently these three characteristics have become the established method for identifying fiduciary relationships in both Canada and New Zealand, and have even been applied at least once by the Court of Appeal in England.[112] The three characteristics will be considered in turn, both in relation to Canadian Supreme Court jurisprudence generally and in terms of a potential application to shadow directors in English law.

In relation to the first requirement, that the fiduciary must have scope for the exercise of some discretion or power, it is immediately obvious that power is vital characteristic. Without the ability to exercise such power, as Wilson J emphasised in Frame *v Smith*,[113] there is no need to restrict the individual concerned by the imposition of fiduciary obligations. Of course the possession of such power is not a wrong in itself,[114] as the fiduciary will require such power to function as a substitute for the principal, but crucially it must only be used for the given purpose. [115] In terms of application of this principle to shadow directors, it is clear that the shadow director has scope to exercise both power and discretion over at least a proportion, and indeed possibly all, of the decisions of the board of directors, therefore shadow directors have the requisite scope for the exercise of some discretion or power.

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[111] At para 39-42.
[112] This test has been approved by *LAC Minerals Ltd v International Corona Resources Ltd* [1989] 61 DLR (4th) 14, (per Sopinka and La Forest JJ), *Canson Enterprise Ltd v Boughton & Co* [1992] 85 DLR (4th) 129. (per McLachlin J, Lamer CJC and L'Heureux-Dubé J) and *Norberg v Wynrib* at para 70 (per La Forest J, with Gonthier J and Cory J concurring), amongst others in Canada. See *DHL International (NZ) Ltd v Richmond Ltd* [1993] 3 NZLR 10 at 22, CA in New Zealand, and *Goose v Wilson Sandford & Co (No.2)* [2001] Lloyd's Rep PN189 in England.
[113] At para 43.
[114] See *Norberg v Wynrib* [1992] 92 DLR (4th) 449 at para 72 (per McLachlin J). The judge also referred Frankel, above n 36, p 809, who stated that 'the fiduciary must be entrusted with power in order to perform his function'.
[115] See Frankel, above n 36, pp 808-809.

The second requirement, that ‘a fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests’, is also important.[116] Without leeway or discretion, as Weinrib states, ‘there is nothing on which the fiduciary obligation can bite’,[117] but the danger is that the power will be misused to injure the principal rather than benefitting him.[118] The phrase ‘legal or practical interests’ is also crucial, since it allows fiduciary obligations to extended beyond mere financial or property interests, and emphasises that, for example, company directors’ duties extend to other interests such as the general financial wellbeing of the corporation, and possibly to intangible interests such as the corporations’ public image and reputation.[119] Given that a shadow director by definition possesses similar power and control to a de jure director, it is unproblematic to conclude that a shadow director will fulfil this second requirement.

The third, and arguably the most important, requirement that the ‘beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power’, is possibly the most difficult of the three principles to apply to shadow directors. Wilson J in *Frame v Smith* defined vulnerability as ‘the inability of the beneficiary (despite his or her best efforts) to prevent the injurious exercise of the power or discretion combined with the grave inadequacy or absence of other legal or practical remedies to re-dress the wrongful exercise of the discretion or power’.[120] He also suggested that fiduciary obligations were seldom present in the dealings of experienced businessmen, since any vulnerability could have been prevented by a more prudent exercise of bargaining power.[121] However,

[116] E Weinrib 'The Fiduciary Obligation' (1975) 25 UTLJ 1 at 7, describes this requirement as the hallmark of a fiduciary relationship, this is also approved by Dickson J in *Guerin v R* [1985] 13 DLR (4th) 321.
[117] Weinrib, above n 116, p 7.
[118] Frankel, above n 36, p 809.
[119] *Frame v Smith* at para 44 (Wilson J).
[120] *Frame v Smith* at para 45.
[121] Ibid.

fiduciary relationships, as Professor Weinrib[122] and various Canadian judges have emphasised,[123] should be assessed according to the position of the parties resulting from the agreement, rather than their relative positions prior to the agreement. So in fact the key question is whether the vulnerability arises from the relationship itself.[124] In terms of assessing vulnerability, Frankel suggests that the level of risk of abuse of power, will depend upon the amount and extent of the power delegated to the fiduciary, along with the availability of protective mechanisms to reduce the likelihood of abuse.[125] Given that the de jure directors have generally delegated significant amounts of power to the shadow director, and whilst the de jure director could intervene, the reality is that the company as a whole is highly vulnerable to the power wielded by the shadow director. Consequently this requirement, and indeed all other requirements of the 'power and discretion' test, are fulfilled, providing a strong indication that shadow directors ought to owe fiduciary duties.

One potential concern is that in Canada the concept of a fiduciary relationship has been widely extended to other professional relationships, such as doctor-patient,[126] and also to personal and private relationships, such as parent and child.[127] Clearly Canadian jurisprudence emphasises very strongly that the categories of fiduciary relationship should not be considered closed.[128] However, such a widening of the categories of fiduciary is due to the Canadian definition of 'legal or practical interests', rather than as a necessary consequence of applying the 'power and discretion' test. So

[122] Weinrib, above n 116, p 6. Frankel, above n 36, p 810 makes a similar point.
[123] *Perez v Galambos* at para 68 and *Hodgkinson v Simms* at para 27.
[124] *Perez v Galambos* at para. 67-68; *Hodgkinson v Simms* at para 25-27 and *Elder Advocates* at para 28. It has also been emphasised that describing the aim of fiduciary duties as the protection of the vulnerable alone is simply too broad. See *Norberg v Wynrib* at para 74; *Perez v Galambos* at para 67; *Hodgkinson v Simms* at para 25-27 and *Elder Advocates of Alberta Society* at para 28.
[125] Frankel, above n 36, p 810.
[126] See Norberg v Wynrib (McLachlin J).
[127] See *KM v HM; Women's Legal Education and Action Fund, Intervener* (1992) 96 DLR (4th) 289.
[128] Weinrib, above n 116, p 7 and *Guerin v R*, at para 99. Although it was noted by McLachlin CJC in *Elder Advocates* at para 54, citing M Ellis, *Fiduciary Duties in Canada* (loose-leaf), at pp 19-3 and 19-24.10, that this does not mean that hopeless claims should proceed to trial.

whilst such a widening of the definition of fiduciary would be possible if the English courts so wished, it would not be a definite effect of applying the power and discretion test.

A DUAL TEST FOR FIDUCIARY RELATIONSHIPS

Although the 'power and discretion' test does help clearly identify fiduciary relationships, a number of criticisms have arisen of the test on the basis that many relationships protected by contract and negligence liability, also fulfil all of these characteristics. Such conflicts have been resolved by emphasising the strength of the vulnerability,[129] or the requirement to identify 'total reliance', in fiduciary relationships,[130] but it is submitted that such problems can be avoided by using the 'undertaking' test as well as the 'power and discretion' test.[131]

The undertaking requirement has also been recently reemphasised in Canada by McLachlin CJC in *Elder Advocates of Alberta Society v Alberta*.[132] The judge found that the 'power and discretion' test alone is not a complete code for the identification of fiduciary duties,[133] and that an undertaking must be identified,[134] alongside two other further requirements.[135] Despite McLachlin CJC's perceived need for restatement in *Elder Advocates*, the undertaking requirement appears to have been present in Canadian fiduciary case law to a greater or lesser extent in the last 30 years, even with the general

[129] *Frame v Smith* at para 45 (Wilson J).
[130] *Hodgkinson v Simms a*t paras 132 – 133 (Sopinka J and McLachlin J).
[131] See generally Hoyano, above n 63, pp 178-189.
[132] [2011] 331 DLR (4th) 257. See also P Maddaugh 'The Centrality of Undertaking in Identifying Fiduciary Relationships: Galambos v. Perez' (2011) 26 BFLR (Canada) 315, for a look at the earlier cases on this point.
[133] *Elder Advocates* at para 29.
[134] At para 36.
[135] At paras 33, 34-35 and 36. The two additional requirements are 'a defined person or class of persons vulnerable to a fiduciary's control' and a 'legal or substantial practical interest' likely to be effected by the principal's actions. Neither of these two requirements are likely to be problematic in the case of shadow directors.

focus on the 'power and discretion' test. It can be identified in *Frame v Smith*, when Wilson J refers approvingly to the speeches of Gibbs CJ and Mason J in the Australian case of *Hospital Products Ltd. v. U.S. Surgical Corp*.[136] Additionally, as McLachlin CJC identifies, the undertaking requirement is explicitly stated by herself in *Norberg v Wynrib*,[137] La Forest J in *Hodgkinson v Simms*,[138] and Cromwell J in *Perez v Galambos*.[139] The test for finding an undertaking is discussed in some detail in this latter case. According to Cromwell J in *Perez v Galambos*, Canadian law requires an undertaking by a fiduciary that may result from, 'statutory powers, the express or implied terms of an agreement or, perhaps simply an undertaking to act in this way.' He further suggested that the key question was whether there was some form of undertaking, whether express or implied, on the part of the fiduciary to act with loyalty.[140] Having noted the academic support for such a requirement,[141] Cromwell J identified that an express undertaking was not necessarily required, since the undertaking might 'be implied by the particular circumstances of the parties' relationship'. He suggested that relevant factors for establishing an implied undertaking should include 'professional norms, industry or other common practices', as well as whether the fiduciary induced the principal to rely on the fiduciary's loyalty.[142]

Applying the 'power and discretion' test and the 'undertaking' test as part of a wider formulation, solves many of the difficulties from the English case law, particularly the question of whether the shadow director to company relationship is one of 'trust and confidence'. Despite the fact that 'undertaking' in shadow director cases is far from express, it is submitted that given the requirements to become a shadow director are expressly laid down in CA 2006, those who act in the manner

[136] (1984) 55 ALR 417. See Gibbs CJ at 432 and Mason J at 454.
[137] At para 98.
[138] At paras 33-34 (La Forrest J).
[139] [2009] 312 DLR (4th) 220 at paras 66 and 71.
[140] At para 77. Cited with approval by McLachlin CJC in *Elder Advocates* at para 32.
[141] Scott, above n 44, p 540; Finn, above n 45, para 15 and more recently L Smith, 'Fiduciary relationships - arising in commercial contexts - investment advisors' (1995) Can Bar Rev 714, at 717.
[142] [2009] 312 DLR (4th) 220 at para 78-79. For a general discussion of undertaking in Canadian fiduciary law see Rotman, above n 25, pp 93-100.

prescribed have undertaken to be shadow directors. Whether being a shadow director constitutes a fiduciary relationship with the company then becomes a matter of deploying the 'power and discretion test', as described above. Thus the courts would have much clearer guidance on both the reasons for shadow directors being fiduciaries and, if the dual test is deployed more widely, greater guidance on interpreting and identifying fiduciary relationships generally.

CONCLUSION

The shadow director holds a powerful position in relation to the affairs of the company. She has power and control in one or more, or even all, areas of corporate management that, for whatever reason, the other de jure or de facto directors have been unable to resist. She can legitimately be described as the controller of the company, with powers perhaps analogous to or even exceeding that of a de jure director, yet somehow doubts have pervaded English law about the fiduciary status of the relationship shadow director. This is largely due to the lack of a sufficiently principled basis for determining whether the company-shadow director relationship is fiduciary in nature, the lack of which is perhaps unsurprising given that genuine potential additions to the 'settled category' list of fiduciary relationships have arisen relatively rarely.

It has been shown that whilst the 'undertaking' test alone can possibly be deployed successfully to demonstrate that shadow directors ought to have fiduciary duties to the company, the test itself is not a complete solution for identifying fiduciary relationships. Due to the incomplete nature of the 'undertaking' test, the courts have struggled to make consistent decisions about the fiduciary status of shadow directors, and this has not been aided by the deployment of a variety of different justifications for fiduciary duties and relationship. It has been argued here that such problems can be avoided in future by deploying the 'power and discretion' test alongside the 'undertaking' test. It is

also possible that the combined approach of using both the ‘undertaking’ and ‘power and discretion’ tests could be deployed for the identification of fiduciary relationships generally, and thus provide a clear practical, and theoretically sound justification, for the implication of fiduciary duties.

While the proposed approach is somewhat more formulaic then the approach currently deployed by the courts, in that key elements of fiduciary relationships are clearly identified, nevertheless a certain level of flexibility will continue to exist in the recognition of fiduciary relationships. So hopefully this formulation offers a more principled application for finding fiduciary relationships, without realising Shepherd’s fear that such a definition might damage the fiduciary concept, by robbing it ‘of its dynamics and therefore its soul’.[143] The proposed formulation offers a good balance between certainty of application and respect for the equitable nature of the fiduciary doctrine,[144] and certainly avoids being too narrow,[145] although potentially does allow the concept of fiduciary to expand far beyond the traditionally-accepted categories. It is important that the ‘power and discretion’ test is implemented in England without developing a, ’fiduciary relationships industry’,[146] or having only three classes of people, ‘those who are fiduciaries; those who are about to become fiduciaries; and judges’,[147] which are criticisms that have been previously levelled at the Canadian courts, primarily from Australia. As has been identified here, such an expansion in Canada has been primarily predicated on the expansive interpretation of the phrase ‘practical interests’, rather than being a necessary consequence of implementing the ‘power and discretion’ test in English law for the more limited purposes discussed here.

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[143] Shepherd, above n 25, p 3.
[144] See generally Rotman, above n 25, pp 6-7.
[145] For a discussion of the problems with establishing definitions in law, see Rotman, above n 25, pp 79-80.
[146] P Finn, ‘Equitable Doctrine and Discretion in Remedies’ in W Cornish, R Nolan, J O’Sullivan and G Virgo (eds) *Restitution Past, Present and Future: Essays in Honour of Gareth Jones* (Oxford: Hart, 1998) p 251, at p 257.
[147] Sir A Mason, as quoted by Rotman, above n 25, p 48.

A final question for consideration is whether the status-based method of identifying fiduciary relationships ought to be abolished. Edelman has strongly advocated the abolition of status-based fiduciary relationships, on the basis that better explanation of the reasons for the existence of fiduciary obligations is needed. [148] Miller has also argued that using the status based approach leads to 'undisciplined analogical reasoning',[149] and that a particular relationship may, 'enjoy merely notional membership in a legal category of which fiduciary power is a constitutive characteristic'.[150] In other words more accurate results are arguably achieved when each individual relationship is measured against the 'power and discretion' standard. While it is clear that the test proposed can justify fiduciary relationships in individual cases, it is submitted that such an approach is undesirable due to potential inconsistencies that would almost certainly arise as evidenced by the difficulties seen in *Yukong*, *Ultraframe* and *Vivendi*. Therefore, it is proposed that status-based fiduciary relationships remain, but ought to be justifiable via a dual 'undertaking' and 'power and discretion' test.

[148] Edelman, above n 52, pp 325-326 and Edelman, above n 40. See Miller (2013), above n 18, pp 980-987.
[149] Miller (2011), above n 18, pp 270-271.
[150] Miller (2011), above n 18, p 271.