## Keynote Address by Professor Barry RIDER, Counsel, Bryan Cave LLP and Professorial Fellow in Development Studies, University of Cambridge, United Kingdom

# Old Weapons for New Battles — The Role of Stewardship in the Development of the Common Law in its Fight Against Corruption and Self-dealing

Financial crime over the last thirty or so years has become of concern, both directly and indirectly, to governments throughout the world. This concern has focussed on different issues as the impact of financial crime varies in different contexts. However, it is today widely recognised that the prevalence of crime that is economically motivated, in many societies is a substantial threat to the development of economies and their stability. Financial crime is almost inevitably one of the best examples of crime that is economically motivated. While the scope and content of financial crime may vary depending upon the sophistication of the environment and legal systems within which it occurs, a constant feature is the motivation of those involved. The relationship of corruption to other economic crimes is both complex and significant. Indeed, while attempts have been made for institutional and political reasons to separate the two areas of law and in particular its enforcement, the justification for so doing is open to debate. Indeed, with the development of effective initiatives against the proceeds of crime and the laundering of criminal wealth, the line becomes even more blurred. This has been mirrored in the civil law as established principles have been stretched to catch crooks and deprive them of their ill-gotten gains. Perhaps from the perspective of Hong Kong there is no better example than the opinion of Lord Templeman in *Attorney General for Hong Kong v. Reid* (1994) 1 All ER 1. In this case when faced with principles of law that had been traditionally interpreted somewhat conservatively Lord Templeman had no difficulty in cutting to the chase and asserting *'…a fiduciary acting dishonestly and criminally who accepts a bribe and thereby causes loss and damage to his principal must also be a constructive trustee and must not be allowed by any means to make any profit from his wrongdoing…'* the Courts must prevent *'the proceeds being whisked away to some Shangri-La which hides bribes and other corrupt moneys in numbered bank accounts.'* At the time this was radical stuff and doubted by the more traditional legal establishment.

The author on the kind invitation of Hong Kong's Independent Commission Against Corruption (ICAC) seeks to set out, primarily for the benefit of scholars and observers from non-common law jurisdictions, the relevant concepts relating to the control and inhibition of self-dealing and abuse of fiduciary office that have been developed in English law over the years. Of course, within the constraints of space and time the selection of issues and material is inevitably partial and in some respects perfunctory. It is also parochial in that it focuses on the English common law. Notwithstanding this limited and perhaps self-indulgent perspective it is noticeable that the inter-play between the criminal and civil law is not always helpful or well rehearsed. Indeed, the impact of anti-money laundering laws has added to the potential for uncertainty and has created very real legal and regulatory risks for those who mind other people's money. A good example is the obligation not to reveal, to anyone other than the appropriate public authority, one's suspicion of money laundering. In the United Kingdom, as in Hong Kong and most other jurisdictions, the unauthorised disclosure of this information may well amount to the serious crime of 'tipping off'. While this offence is intended to facilitate effective law enforcement by allowing the secret monitoring of transactions by the authorities, the relationship of this crime with the obligations occasionally imposed under the civil law were not sufficiently recognised. For example, there are situations, which we examine in detail later on, where a person, in a fiduciary relationship or in a position which may result in the imposition of fiduciary obligations, is under a duty, in the proper discharge of those fiduciary responsibilities, to search out and

inform those who may, in line with the suspicions that he has properly formed, have a claim against the property in question. (See for example, *Finers v. Miro* (1991) 1 WLR 35 and generally *Banking on Corruption, The Legal Responsibilities of those who Handle the Proceeds of Corruption* (Sir Richard Scott and Lord Steel of Aikwood, 2000), Society of Advanced Legal Studies.) There are other situations, in which, there would be a duty in the civil law, to take steps on protect the relevant property, which might have the effect of 'tipping off' those under suspicion. (See for example *Bank of Scotland v. A.Ltd* (2001) EWCA Civ 52.) The Courts have been required to consider such situations, but have not always found it possible to provide a degree of guidance, let alone protection, that would meet the expectations of those engaged in legitimate business. (See *C. v. S.* (1999) 2 All ER 343, *Amalagamated Metal Trading Ltd v. City of London Police Financial Investigation Unit* (2003) *EWHC 703 Com* and *Hosni Tayeb v. HSBC and Al Farsan International* (2004) EWHC 1529 Comm.) Again, while it is clear, under the relevant statutory provisions, that liability for breach of contract or disclosure of confidential information, when reporting a *bona fide* suspicion to the proper authorities, is unlikely, although in certain cases not entirely unthinkable, there are real and unresolved issues in the law of defamation. Therefore, in seeking to comply and ensure proper compliance, with these laws and the various rules they have spawned, care needs to be taken in regard to the general law as well. It is often the case that compliance systems and advice focus almost exclusively on the criminal and administrative laws and ignore the legal environment within which the relevant transactions or conduct occur. (See generally B. Rider, *Memorandum 15, Organised Crime, Minutes of Evidence and Memoranda*, Home Affairs Committee SI Session 1994-95, HMSO and B. Rider and M. Ashe (eds), *Money Laundering Control* (1996), Sweet & Maxwell, Ch 1 and B. Rider, 'Recovering the Proceeds of Corruption' *10 Journal of Money Laundering Control* (2007).)

## The Allure of Profit!

Let us now attempt to place financially motivated crime and self dealing in context. Given the chaos that so many of the world's financial systems now find themselves in and the constant debate as to the boundaries between manifestations of mere self-interest and what might be regarded as rather more culpable it is appropriate to focus on where the line of legal responsibility has been drawn in the past. While ancient history records many examples of individuals cheating those in authority or in possession of wealth and privilege, it is not in every case that such conduct is condemned. Indeed, many societies had a perverse regard for those who achieved what was considered a good result, by cunning. However, where dishonesty or unfairness is involved most societies tended to disapprove of such conduct irrespective of the result. Consequently, the sort of conduct that we characterise as financial crime today almost always has the qualities of dishonesty and unfairness. Of course, dishonesty is not always an easy concept to understand and in some respects it may in its perimeters vary from one society to another and alter over time. None the less, at its core, most have little difficulty in recognising dishonesty when they perceive it. Establishing it in a court of law – particularly beyond a reasonable doubt, may be a rather different matter. Unfairness as a protein concept in many manifestations of financial crime may be equally specific to time and place. Having said this, in many cases what is fair is generally self-evident — although difficult to articulate as a legal standard. It is because honesty and fairness are so important in the fabric of society that those responsible for the welfare of society have increasingly recognised the importance of taking firm and effective action against financial crime. If conduct which is widely regarded as dishonest and results in unfairness in the allocation of wealth is permitted then what incentive is there for those to achieve wealth by working and acting with integrity? To this extent financial crime is a cancer that eats away and the very essence of civilization – as was emphasised by the Court of Appeal in Hong Kong in April 1972 in *R. v. Hong Kong Dragon Co Ltd* (Crim App No 889 of 1971.)

It is possible to divide financial crime into two essentially different although highly related types of conduct. There are those activities which dishonestly and unfairly generate wealth in the hands or under the

control of those who engage in the conduct in question. For example, the exploitation of inside information or the acquisition of another person's property by deceit will invariably be done, at least with the intention of securing a material benefit. Of course, this may be complicated by other issues. A person in possession of inside information may decide to sell shares that he possesses before the market price plunges, thereby avoiding a loss. A person may engage in deceit to secure a benefit for another, rather than himself. However, such conduct is entered into for a direct material benefit for that person or another. There are also financial crimes that do not involve the unfair taking of a benefit, but which are concerned to protect a benefit that has already been obtained or facilitate the taking of such. A good example of such conduct is attempting to place the proceeds of a crime, perhaps another financial crime, beyond the reach of the law, through laundering. Therefore, we can see that at a very basic level financial crime involves actions of an acquisitive character and those of essentially a facilitative nature. All, however, tend to be motivated directly or indirectly by greed.

It is often said that corruption is a facilitative crime in that corrupt conduct occurs generally, albeit not always, in the context of furthering some other unlawful or at least undesirable activity. Of course, the notion of corruption is complex and may well involve conduct that is more directly integrated into the taking of an illicit benefit. Having noted this, in our present discussion we will tend to focus, when we refer to corruption, rather more to bribery which of its very nature is facilitative.

## The Financial Element in Crime

While it would be trite to say that financial crime is all about finance, there is obviously some truth in this. The object of all financial crime is to achieve and retain a material benefit. As we have already noted, this may be by making an illicit profit or avoiding improperly a loss that would otherwise have been incurred. While many forms of financial crime involve money, rather more in terms of value involve valuable instruments and in particular securities and other forms of transferable wealth. It is also the case that certain types of financial crime are applicable to all types of wealth and even privileges — that will have an actual or perceived financial value. In many cases the more complex the economic environment within which the activity occurs the more likely the benefit sort to be obtained will take the form of complex financial instruments and rights over intangible property. In practice, in the understanding of financial crime and in particular its detection and control, this is a serious problem. The complex and sophisticated nature of the documentation creating and expressing the financial value of rights, may well serve to inhibit effective action to protect them. Of course, if the improper conduct and objectives of those seeking to benefit are stripped back to the bone, it should not matter whether the fraud or other crime is focussed on 'stealing' a bank note or some complex financial right. Having said this, the more complicated the environment within which fraud and similar abuses take place the greater the inhibition to the effective control of financial crime. Indeed, criminals deliberately create an aura of complexity to obscure their often quite obvious and objectionable conduct. The recent collapse of the western banking system as in part a result of the so called sub-prime mortgage market has been attributed, by some, to the failure of those responsible for assessing and monitoring risk to appreciate what was taking place because of the complexity in the instruments that were being used.

In the modern world where there are in reality few barriers to the transmission of wealth from one country to another it is inevitable that physical and material wealth will be represented by documents. Indeed, it is increasingly the case that the documentation will be virtual and communication electronic. There is also a tendency to centralise in registries the deposit of valuable documentation, resulting in the issue of documents which in effect indicate entitlement to other documentation which itself represents ownership of certain rights. At the end of the day, however, what is in issue, is the property rights that have a financial value often to some other form of underlying or related property. Thus, a share certificate indicates ownership of the shares in a particular company, but the share is, in most systems of law, merely

a contractual claim on the assets of the relevant issuing company in certain circumstances. With the development of derivative securities and particularly debt based securities the situation is often rather more complicated. None the less, what will be in issue in most case of fraud is an attempt to appropriate by dishonest means the ownership of or control over the rights to the underlying property.

It is important to also note when considering the economic aspects of financial crime that the impact of the conduct in question may have a far greater economic impact than the amounts of money or value of the securities in question. This is particularly so in cases of corruption. Lord Templeman in an important case to which we have already referred: *Attorney General for Hong Kong v. Reid* (1994) 1 All ER 1 emphasized that *'bribery is an evil practice which threatens the foundations of any civilised society. In particular, bribery of policemen and prosecutors brings the administration of justice into disrepute…in the present case the amount of harm caused to the administration of justice in Hong Kong…cannot be quantified.'* Indeed, some contend that the corruption of this one official in the Government's Legal Department undermined the position of the United Kingdom Government in its negotiations with the People's Republic of China in regard to the future status of Hong Kong.

Sometimes law enforcement agencies and commentators speak of cash or property at risk from fraud. Often the amounts spoken of are far in excess of the amounts actually improperly appropriated or diverted. There is little reliable information even in the more developed jurisdictions as to the financial impact of financial crime as a whole. While it may be possible to estimate the sums actually misappropriated in certain acquisitive crimes this is only part of the story. It is also the case that given the inter-relationship of actors and institutions within the economy and from one economy to another financial risk can have serious and relayed effects. While the various investigations into the causes of the traumatic collapse of the US financial markets in the 1920s which contributed so much to the Great Depression found many cases of financial fraud, insider dealing and manipulation, it would be misleading to attribute such as a primary cause of the collapse. As in the collapse of the financial markets in South East Asia and the Far East in the 1990s, such misconduct certainly contributed to the vulnerability of institutions and investors. The collapse of the Indian financial markets in the late 1980s has been attributed to excessive speculation and manipulation. The prevalence of questionable and illegal practices in the financial markets undoubtedly contributes to their potential instability and given the threat of contagion is of international concern.

The financial costs of weakening the systems and institutions which would otherwise buttress the markets and individual enterprises may as we have seen be disproportionate to the actual rewards obtained by those engaged in abusive conduct. A similar issue of quantification arises in regard to facilitative financial crimes. For example, the amount of money that is actually being laundered in a particular situation may in no way represent the costs to society of the predicate crime that has generated the illicit wealth in question. On the other hand it is misleading to lump together the amounts of money that it is guesstimated may be in the criminal pipeline with estimates of wealth at risk. The two are essentially different. For example, as we have no convincing mechanism for determining that wealth that represents the proceeds of crime, whether financial or otherwise, has ceased to be tainted, there will come a time when the greater part of the world's economy is at least notionally 'dirty money'.

## Financially Motivated Crime

Criminologists and others who are interested in classifying crime have hesitated to adopt motivation as the primary test. Rather they focus on the nature of intent, distinguishing between planned and causal crime. In the case of most financial crime we are concerned with crimes of commission that have been reasonably carefully planned and structured, but with the one over-riding objective of profit. The vast majority of criminal activity that we may describe as financial crime is motivated by the desire to acquire or protect financial wealth. Those who engage in financial crime desire more than society has allocated them and in most cases their greed becomes infectious. Of course, it is not only in cases of typical financial crimes that

the motivation is financial advancement. Most enterprise crimes are structured and run in the expectation of profit. Those who engage in trafficking activity, whether of drugs, people, arms or cultural heritage, do so with one primary object — financial benefit. In motivation the drug lord is no different from the fraudster or insider dealer. This somewhat simplistic assessment understandably does not sit well with the desire of criminology to characterise and perhaps intellectualise deviant behaviour. However, from the stand point of those concerned to construct systems that serve to reduce exposure to crime and interdict those who engage in it, identification of motivation is of key significance.

The importance of focussing on the acquisitive nature of many crimes, that perhaps may at first glance appear to have little in common with each other, is underlined by the significance that is now attached, throughout the world, to attacking criminals through their assets. The development of financial intelligence has made an important contribution to the fight against serious crime, whether in the financial world or in the more traditional areas of organised crime. We increasingly see the use of such strategies in fighting corruption and in particular in the provisions of the *United Nations Convention against Corruption 2003* in which so much emphasis is placed on the interdiction and recovery of criminal property. (See B. Rider 'Recovering the Proceeds of Corruption' 10 *Journal of Money Laundering Control* (2007) 5 and see also B. Rider 'Fei Ch'ien Launderies – The pursuit of flying money' 1 *Journal of International Planning* (1992) 77.)

Focussing on the economic motivation of criminals indicates that one of the best strategies in discouraging profitable crime is to render it relatively unprofitable. (See B. Rider 'Combating International Commercial Crime – A Commonwealth Perspective' (1985) 2 *Lloyds MCLQ* 217.) The more it costs to engage in such criminal activity the less likely are criminals and would be criminals to embark upon it. Of course, in this context we are not talking simply in terms of actual costs in money, but rather risk exposure. For example, while the laws requiring the reporting and recording of all financial transactions over a certain amount, such as under Currency Transaction Reporting (CTR) regulations, may be evaded or circumvented the process of so doing will involve additional risks and costs. Thus, engaging in 'smurfing' whereby transactions are structured just below the reporting threshold will necessitate the involvement of other persons and the creation of numerous accounts or fronts. All this represents a direct cost and greatly increases the risk of something going wrong for the launderer. A primary objective of many disruption strategies now operated by law enforcement and security agencies around the world is to render it financial unattractive to engage in illicit activity in a particular jurisdiction. Of course, this does not necessarily inhibit the conduct taking place, at a price, elsewhere and therefore there is a real risk of displacing serious criminal activity to other locations — perhaps even less able to protect themselves.

While these strategies aimed at undermining the profitability of crime have become extremely important, often sanctioned by international initiatives, their effectiveness has been questioned. It is not clear that the amounts of wealth actually seized by law enforcement agencies let alone confiscated by the courts, are significant when compared with the *'guesstimates'* as to how much criminal wealth is actually out there. The persistent fall in the real price in many consumer countries of illegal drugs puts a question mark against the efficacy of such strategies. In the USA and certain other jurisdictions such as Canada, Australia and Italy relatively large amount of criminal property have been seized, but there is little convincing evidence that this has had a measurable impact on criminal activity. It may be that the profitability of certain types of crime is so great these otherwise worthy and logical strategies just cannot bite deep enough into the criminal pipeline. It is also the case, given the extent to which most legal systems seek to protect private property and human rights, the relevant legal provisions are often just too difficult to operate. In this context, tax and similar fiscal laws may have a more significant role to play.

By focussing on the financial aspects of crime and attempting, through a variety of weapons to render crime relatively unprofitable, it is sometimes said that society loses sight of the seriousness of the criminal activity which gives rise to the illicit wealth. Thus, in places where law enforcement focuses excessively

on asset interdiction and removal operations in fighting criminal enterprises, the process becomes simply one of taxation or even licensing. Obviously, in any society there needs to be a balance and it is the case that in most criminal activity the margins are such that only a significant additional cost that cannot be easily passed on to the consumer or someone else is likely to achieve the desired result. Because of the practical difficulties faced by law enforcement in many countries, governments have increasingly attempted to facilitate the attack on criminal assets by scaling down the standards of proof and employing civil and administrative legal procedures. Laws have also placed an increasing burden on those in the banking and financial sector to report suspicious activity and in other ways facilitate law enforcement. To a significant extent these laws have shifted risks and responsibilities on to those who in the ordinary course of their business handle other peoples' wealth. The full implications and costs to society of this have not been properly measured.

## Facilitative Financial Crimes

Mention has already been made of a distinction between criminal and abusive activity which is designed to result in profit and other conduct which is rather more concerned to protect and safeguard illicit wealth. Criminals and others do not engage in money laundering as an end in it self. Structuring and running a money laundering operation is often expensive and involves additional risk exposure. Criminal organisations and enterprises will not engage in needless risk and cost. Consequently, the laundering process is essentially facilitative providing criminals with protection for their illicit wealth or apparently clean and untraceable wealth for their legitimate and illegitimate activities. Of course, it is interesting to consider the extent to which criminals engage in laundering to avoid the treat of seizure of the proceeds of their criminal activities by the authorities. It has been suggested that one of the reasons why London has become so significant in money laundering operations is because of the threat, of which much has made by the authorities, that the proceeds of serious crime will be uncovered and confiscated. When one considers the amount of money that has actually been taken out of the criminal pipeline, however, his threat is in reality less convincing. None the less, it needs to be remembered that the more criminals consider their assets and lifestyle is at risk, the more likely they will justify the costs and risks of laundering. The problem is that the laundering process may have the effect of criminalising otherwise innocent businesses and individuals and, of course, passing risk to the financial and banking sectors. It is also the case that unless the wealth is connected to an ongoing criminal enterprise it represents the proceeds of crimes that have already occurred and thus, interdiction will not have a direct impact on prevention.

Corruption in its various forms, as we have noted, is also by nature facilitative. People do not bribe or unjustly enrich others as an end in it self. Those who seek to corrupt others, whether by bribery or by blackmail, do so with the intention of achieving an objective. Invariably this objective will have economic significance. It is also the case, that the economic significance of the corruption both in terms of what is done in consequence of facilitation and in terms of taint will vastly exceed the financial benefit to the recipient of the bribe. Indeed, the bribe will often be wholly disproportionate to the benefit obtained by the briber. We have already pointed out that as in other crimes where confidence in the integrity of a system or institution is undermined the consequences even in pure economic terms can be exceedingly serious. For example, there are many examples where companies have found difficulty in securing new finance or credit as a result of the exposure of corruption or abuse on the part of their management. In some instances this has resulted in the insolvency of the business to the loss of all concerned, including the shareholders, creditors, employees, suppliers and the tax authorities. Indeed, in one case in Britain the authorities were accused of refraining from exposing the frauds of management so that the business could continue long enough to pay off its tax bill to the revenue authorities. Indeed, more recently it has been claimed that the British Government was reluctant to heed such warnings signs as there were about the rash and reckless activities of many within the City of London because such contributed so much to the tax revenue.

## Financially Related Crimes

There are numerous offences in corporate and regulatory law that have been put in place to facilitate the exposure of wrongdoing or assist in the detection of crime. It was said by one leading US jurist many years ago that 'sunlight is the best disinfectant and electric light the best policeman'. In other words, the greater transparency the more likely people will behave honourably. Indeed, much of the US Federal law that was introduced by President Roosevelt as part of the 'New Deal' was designed to promote integrity and in particular good stewardship through requiring financial activity to be done in the 'fish bowl'. It is debateable how far the disclosure philosophy works in discouraging highly profitable misconduct. It is often said that the 'badge of fraud' is secrecy and it is certainly true that many frauds require the victim to remain ignorant as to the true facts. Secrecy also undoubtedly impedes detection and intervention. Fraudsters will exploit deficiencies in disclosure and asymmetric information. Insiders trading on price sensitive information can only expect to benefit to the extent that the market is unaware of the relevant event and this information has not been discounted in the market price. (See generally B. Rider and H.L. French, *The Regulation of Insider Trading*, 1979, Macmillan and B. Rider, K. Alexander, L. Linklater and S. Bazley, *Market Abuse and Insider Dealing* (2009) (2nd Ed) Tottle.)

Disclosure can have three distinct, albeit often related, roles in financial crime control. Firstly, effective mechanisms for the disclosure of relevant information assist decision makers to take sensible decisions. Effective disclosure of material information, allows decision makers to protect themselves in their own self-interest. Of course, the problem in most jurisdictions is that these disclosure mechanisms are not particularly efficient. Disclosure of information may also be used to facilitate the efficient and effective enforcement of other laws and principles. A good example of this is the obligation imposed upon many public officials under law or leadership codes to disclose their assets and report significant changes in their wealth. This mechanism is an important tool in promoting integrity. In some cases, such as under Section 10 of the Prevention of Bribery Ordinance in Hong Kong, where there is no or an improper disclosure, this indicates that the assets that have not been properly disclosed have been obtained unlawfully. It is, of course, often rather easier to prove that someone has failed in complying with such a disclosure requirement than the wealth in question has been improperly obtained. The extent to which mere failure to report a crime or suspicions that a crime may have been or is about to be committed, is a controversial issue. Generally speaking few jurisdictions impose a legal obligation on members of the public to report ordinary crimes let alone suspicions of crime. Having said this there are a number of specific obligations in most systems of law. For example, the obligation imposed in the majority of anti-money laundering laws to report suspicion of money laundering where this information comes to a person in a specified capacity. Thus, under most laws a stockbroker would himself commit an offence if he did not report to the authorities his suspicion that one of his colleagues was laundering money for someone else. It is also the case that in many substantive anti-money laundering provisions a person who engages in what might amount to money laundering has a defence if they report their suspicions to the relevant authorities at the first reasonable opportunity. Thus, such mechanisms can be used as both a 'carrot and a stick'.

It should also be remembered that often a statutory duty to disclose or report information will exist among other laws and rules imposing disclosure duties. For example, in certain cases there may be a duty of disclosure arising by virtue of the civil law. It does not always follow that a mere civil obligation to disclose cannot result in criminal liability. For example, generally in the law relating to fraud, the circumstances where a person is under a duty to tell the truth are determined by the ordinary civil law. It has also been held in certain common law jurisdictions that a conspiracy to hide information that should be disclosed, according to the civil or corporate law, may amount to a criminal conspiracy to defraud. Indeed, where persons under such a duty deliberately conduct their affairs to hide such information, this may well indicate dishonesty.

The third role of disclosure in controlling misconduct in the present context, is where it is used as a sanction itself. For example, in England in the seventeenth century brokers and dealers found guilty in the

City of London of engaging in fraud or even merely failing to act fairly, could not only be fined but placed in the pillory for public criticism. (See B. Rider, C. Abrams and M. Ashe, *Guide to Financial Services Regulation* (3rd Ed, 1997) CCH, Chs 1 and 2.) It is also not without interest that in Hong Kong for a period attempts were made to control 'culpable insider dealing' through public criticism by the Insider Dealing Tribunal. (See B. Rider 'Insider Trading – Hong Kong Style' (1978) 128 *New Law Journal* 897.) Reliance on public censure has also been a feature of numerous anti-corruption initiatives by the Chinese Communist Party. In fact, where there is a relatively defined community with more or less shared standards, public criticism particularly if it is reinforced by exclusion can have a significant effect. Indeed, the City of London was able until 1986 to operate without a great deal of legal regulation, relying on self regulation to police the conduct of those engaged in the financial sector. (See B. Rider B. Rider and E. Hew, 'The Regulation of Corporation and Securities Laws in Britain – The Beginning of the Real Debate' (1977) 19 *Mal. L. Rev* 144.) On the other hand the perception both in the City of London and Hong Kong was that when pitched against the prospect of significant profits, mere public censure was not sufficient to curb insiders abusing their positions. Having noted this we have also seen a significant revival of the use of 'naming and shaming' in regard to failures of governance and in relation to social and environmental issues. It has also proved to be a powerful tool in encouraging governments to conform to international standards on for example, anti-money laundering and corruption. To some extent, where determinate sanctions are lacking, such as in international law, it also has its uses.

In considering the scope of our topic, it is important to remember that even in the most simplistic financial markets, there will be a mix of laws and other rules and regulations, much of which does not involve in the conventional terms crime. Indeed, while many would agree that one of the most effective agencies in the world in promoting high standards of conduct in the financial markets and policing misconduct — US Securities and Exchange Commission, as a Federal regulatory agency does not have authority under the US Constitution to prosecute criminal offences. Its undoubtedly excellent record in bringing financial fraudsters and insiders to justice has been achieved in the main through the use of civil and administrative law — not the criminal law. (See B. Rider 'Civilising the Law — The use of civil and administrative proceedings to enforce Financial Services Law' 3 *Journal of Financial Crime* (1995) 11 and B. Rider, 'Policing the City – Combating Fraud and other abuses in the corporate securities industry' 41 *Current Legal Problems* (1988) 47.)

We have already noted that most financial crimes are what criminologists and lawyers describe as crimes of commission. In other words they are deliberate and planned and involve acts rather than omissions. Of course, there are situations where the fraud is perpetrated through a failure to act or rather disclose information. None the less there are relatively few examples in the legal systems of circumstances where there is a positive duty to disclose information absent some action by the perpetrator inducing a false sense of security or impression. It is true that most legal systems impose, almost always by statute, an obligation on promoters of companies to disclose material information when they offer shares and other securities to the public. Indeed, there are some legal systems that recognise this duty regardless of statutory provisions. However, promoters who do not disclose information that they should, invariably plan this as part of their fraudulent offer. Consequently, there crime is still properly regarded as one of commission. It is more likely that a pure crime of omission will occur in the context of what the law regards a 'special relationship'. While legal systems vary in detail, it is generally the case that in circumstances of dependency where there is the prospect of the dominant party taking unfair advantage of the other, then a duty of good faith disclosure will arise. A dishonest decision not to disclose material information would in many cases amount to a crime. Furthermore, in some common law jurisdictions even an 'innocent' failure to disclose, for example, a conflict of interest might well amount to what the law describes as 'constructive fraud' with civil consequences. Generally speaking, however, as frauds and many other financial crimes, such as money laundering and false accounting, require for the successful execution of secrecy, they are carefully planned. Therefore, such crimes generally involve a series of steps — often over a period of time.


A significant exception to the general rule are those legal and regulatory obligations that are specifically cast on persons who by virtue of their position, often essentially as facilitators, or as a result of their becoming involved in a potentially criminal act, to disclose the facts or report their suspicions to specified authorities. We have already noted this in the context of proceeds of crime and terrorist finance related laws. (See generally, B. Rider 'The Financial War on Terror' *CISP Proceedings* (2003) NATO 34.)

What has been said of financial crime is more or less also true in regard to the somewhat wider category of 'white collar crime'. Indeed, it is the character of a crime that requires planning and specialised application, that distinguishes so called 'white' and 'blue' collar crimes. It may fairly be asked whether this categorisation actually has any practical impact on the prevention and control of such crimes. While there is a risk that commentators may become too engrossed in their own logic resulting in little practical benefit to those who have the responsibility for discouraging and interdicting crime, it is important to distinguish crimes that usually involve planning and a structuring of acts (or omissions) over a period of time. This does have obvious implications for the fashioning and administration of preventive compliance orientated procedures. The longer a crime is in its planning and commission stages the greater the opportunity for disruption, prevention and control. A real problem for those guarding in particular financial and banking systems is the seemingly random attack that comes from a wholly unexpected source.

## Syndicated and Organised Crime

There is always the danger that, for a variety of reasons, the extent and nature of organised crime may be overstated and even sensationalised. Having said this, it is probably the case that most governments and even law enforcement agencies tend to under-estimate the impact of organised crime activity. (See generally *Misha Glenny, McMafia – Crime without Frontiers* (2008) Bodely Head and B. Rider *Organised Crime, Memoranda of Evidence* to the Home Affairs Committee, House of Commons 1996.) Thirty years ago a senior detective in Scotland Yard was the object of much derision not least by his colleagues, when he claimed in a book that he wrote that the extent and character of organised crime in Britain, and in particular London, had been significantly underestimated. He received little or no support from government, the media or academic commentators. Within fifteen years, the Government recognised that organised crime was one of the greatest threats facing the United Kingdom and the stability of Western Europe. The Home Affairs Committee of the House of Commons in 1996 chronicled a startling array of organised crime groups engaged in criminal enterprises in Britain. It also received evidence, not least from the intelligence and security services, of vast amounts of criminal and questionable wealth being laundered and even invested in the United Kingdom. Today the threat is considered to be so great that the UK's national police agency is called the Serious Organised Crime Agency!

Criminologists have gone to considerable efforts in attempting to discern the essential elements in organised crime and provide a definition. There are, as a consequence many definitions, but the one favoured by the present author was worked out at a meeting of Attorney Generals and Chief State Prosecutors of US States in 1965. While dated and certainly not to the liking of some commentators, it emphasises the important factors in identifying organised crime from the perspective of those who have to deal with it. Having said this, it must be remembered that our understanding — based on much better intelligence — and in particular financial intelligence, of the structures and operations of organised crime groups has moved on, and what we have in this definition is really a description of traditional organised crime on the model of the *la cosa nostra*.

*'Organised crime is a product of a self perpetuating criminal conspiracy to wring exorbitant profits from our society by any means fair or foul, legal or illegal. It survives on fear and corruption. By one or another means it obtains a high degree of immunity from the law. It is totalitarian in organisation, a way of life. It imposes rigid discipline on underlings to do the dirty work, while the top men of organised crime are generally insulated from the criminal act and consequent danger of prosecution'.*

This definition emphasises the continuing criminal conspiracy character of organised crime. This central concept has been employed in a number of jurisdictions including Hong Kong. (See generally A. Schloenhardt, 'taming the Triads: Organised Crime Offences in PR China, Hong Kong and Macau' *38 HKLJ* (2008) 645), but first and perhaps most significantly in the USA, to justify special legal provisions. The Racketeer Influenced and Corrupt Organisation (RICO) statute in the USA has played a very significant role in combating conspiracies involving various aspects of financial crime. Some criminologists have questioned whether it is always appropriate to see organised crime as a continuing criminal conspiracy as, for example, how would this accommodate a series of separate but perhaps co-ordinated activities. With the diversification in the structures of crime and in particular the development of essentially confederated and cellular criminal enterprises, there is some merit in this criticism. However, what this particular definition does is to emphasise the enterprise aspect of such activity. The business nature of organised crime is emphasised by its concern to make profits, whether by legitimate or illegitimate means. It is important to remember that as a business concerned to maximise its profits over a period, organised crime will seek out opportunities and will not confine itself to crime. Our definition also illustrates the relationship between organised crime and corruption. Those engaged in criminal enterprises will be concerned to protect their investments, returns and security. Given the fact that many organised crime activities are relatively profitable, the payment of bribes whether for facilitation or protection is merely a cost of doing business. It also has the advantage of criminalising those with whom the criminal enterprise has to deal and thereby rendering it less likely that they will in the future wish to collaborate and assist law enforcement agencies. It would seem that the more profitable the criminal enterprises become the less inclined the organisation is to use violence and other high risk methods to resolve disputes and problems. Bribery is a far less risky solution. The new UN Convention against Corruption recognises the fundamental importance of addressing corruption in dealing with organised crime.

Today many organisations are project determined in terms of their operations and financial structure and increasingly based on cellular networks. What has remained the case, however, is that the 'top men of organised crime' are removed from direct criminal activity and therefore the consequent danger of prosecution. It is the lower levels of membership who engage in the risky business of crime and are therefore more likely to be sanctioned by the criminal justice system. The bosses, at the top of the pyramid – or co-ordinating the active cells, while clearly involved in the conspiracy will be physically distant from the actual enterprise. Most legal systems are capable of imposing effective criminal liability only on those who are close to the criminal activity in question. Few, even if they have conspiracy laws or special anti-organised crime provisions, are able to establish proof to the standard required by the criminal courts. Of course, control over the proceeds of the crimes will rise in the structure and be directly or indirectly in the hands of the 'top men'. It is for this reason that strategies designed to disrupt the control of funds generated by such criminal enterprises appeals so much to those concerned with fighting organised crime. The one thing that does rise to the top is wealth! If this can be attacked even by tax laws, the bosses of these criminal networks are hurt.

## Elite and Access Crimes

Criminologists and other commentators often describe financial crimes as 'elite crimes'. To be able to perpetrate many such offences it is necessary for the persons concerned to be in a position to dispose of assets or at least influence their disposal. For example, there would be little point in offering a bribe

to someone who had no influence over the matter in regard to which the briber wished to secure some advantage or privilege. Consequently, certain financial and economic crimes are particularly relevant to those in a leadership position. This is as true in the private sector as it is the public.

The fact that such crimes are particularly the preserve of those already in positions of influence and leadership gives them an additional dimension. The perpetration of profitable crimes, in the eyes of those who might otherwise look up to such persons, is particularly damaging in terms of respect and confidence. Thus, where leaders and persons in positions of authority are seen, or even suspected of, looting the property of the state, or of other organisations, their suitability to be in such positions is thrown into issue. The system that allowed such persons to assume positions which they now exploit for their own ends, appears if not corrupt, at least unfair and inefficient. Often in societies where there is a clear division between those who have authority, whether this is as a result of class, ethnicity, tribal or family connections, the perception that those in a privileged position are unfair benefiting from their offices, promotes even greater social and cultural pressures.

Access crimes are those crimes which require privileged or special access before they can be committed. In other words they are crimes involving a special position, but perhaps not an 'elite' position, in the sense we have just been discussing. For example, crimes committed in the course of employment, as a pre-requisite necessitate the perpetrator being employed. To embezzle customers' money from a bank or other financial institution requires that the criminal has access to that institution and its procedures. In other words the crime occurs in a particular environment to which the criminal has access.

This throws up a number of issues in terms of detection and control. Because the crime has occurred in a special environment, such as a bank, it may not be easily discovered by those outside. Furthermore, it will not always be easy for outsiders to obtain the same level of access so as to properly investigate and pursue the criminals. The privileged access of the criminal will often involve the possession of special attributes and training, which the investigator may not have. Of course, in this context specialised knowledge may itself constitute a barrier to access. It will not always, however, be the case that the access which has facilitated or permitted the crime to occur will have been legitimately acquired. The criminal may have falsified the documentation or other qualification which permits him access. He may also have unlawfully assumed the identity of another or even effectively taken over that person's access by virtue of threats or violence. Thus, the notion of access is really more concerned with the environment within which the crime occurs than the status of the criminal. In this sense, it is a different analysis than, for example, elite crime. Of course, having said this most persons that have lawful access, will be in a privileged position. It is this factor, which underlines the importance of effective selection of those who are given access to opportunities to commit such crime and their proper and timely monitoring.

## Insider Crimes

Only those with a defined relationship to another person may commit what might be described as 'insider crimes'. It will often be the undermining of the trust and confidence that arises by virtue of this relationship, by the criminal, that creates or enables the crime. Perhaps the best example is insider dealing. In the vast majority of countries it is a serious criminal offence for a person in a position of trust to use unpublished price sensitive information in personal investment dealings. While the details of the offence may vary a little from country to another, generally speaking directors, officers and others with a privileged position in a company commit an offence if they deal in securities on the basis of unpublished price sensitive information that comes into their hands by virtue of their position. The offence will be committed if the securities in regard to which the information is price sensitive, are those of the company with whom they have the special relationship, or some other company, provided the information came to them by virtue of their insider status. Indeed, it will also be an offence if they improperly disclose this information to another with the intention that person will deal, and provided that other person is aware of the insider source, he

will commit an offence if he deals or passes on the information. These laws which are often highly complex, and thus, difficult to prosecute, are concerned to ensure the integrity of the special relationship in which the information was obtained and promote confidence in the fairness of the securities market.

While there is a tendency to base liability on the mere possession of unpublished price sensitive information which you appreciate is from an unpublished source, rather than on the breach of a specific pre-existing relationship, most anti-insider dealing laws impose criminal liability on those who are in a defined 'insider' relationship. This may be described as primary insider dealing, as the liability is predicated on the 'abuse' of a specific insider position. If you do not possess the status of an insider, then you cannot be guilty of this offence. However, it is the case that in some jurisdictions, possession of inside information will, as we have seen, create a relationship resembling that of 'an access insider'. Thus, in the USA, for example, liability is based, in some cases, on the notion that the offence is committed by the 'misappropriation' of the inside information that belongs to the company.

Most legal systems impose special obligations on persons who by office or agreement have accepted to act in the best interests of another person. Most common law systems describe this as a fiduciary relationship. However, even in civilian and Islamic systems of law, where the fiduciary concept is not so finely developed, agency will create similar obligations. The circumstances in which a fiduciary relationship exists have been determined, in most legal systems, with some degree of certainty. Typical examples include the relationship of a company director to his company and the relationship of a stockbroker to his client. A person in a fiduciary position must act in good faith in the best interests of his principal or beneficiary. He must avoid all conflicts of interest and ensure that his own self-interest is never put before that of the person with whom he has a fiduciary relationship. A fiduciary must, according to his duty of good faith, disclose all material facts to his principal or client in any dealings with such. This is an affirmative obligation and mere non-disclosure will be unlawful. Thus, given the special relationship of the fiduciary it may well be that conduct that would not be regarded as potentially fraudulent by a person outside such a relationship, would be objectionable by a fiduciary. Furthermore, in many systems of law, the deliberate taking advantage of a fiduciary relationship to the profit of the fiduciary might be considered a criminal breach of trust. Thus, while it may be a little confusing to regard fiduciaries as insiders, although many will be as we shall see, their special status, creates the prospect of their committing certain crimes that without that status they could not.

## Dishonesty – a Common Thread!

It has been said that a common thread running through economic and financial crimes is the dishonesty of those involved. While this is not entirely misleading, it is important to remember that many offences that can quite properly be included in the control of financial crime, do not involve proof of dishonesty. For example, dishonesty is not a relevant concept in any of the usual offences relating to money laundering. It may well be that one of the principal justifications for disallowing criminals to retain their illicit wealth, is that it is unfair to the rest of society, but this is not what we normally mean by dishonesty. It has been argued that laws penalising the use of unpublished price sensitive information by those who have learnt the information in a privileged position are a sort of anti-fraud law. While it is true that one of the principal Federal statutory provisions in the USA which was used to develop rules relating to insider abuse was a broad anti-fraud provision, the law as it developed had little to do with dishonesty in the normal sense. But even if it is possible to argue on the basis of heritage and fiduciary principles that in the USA the law relating to insider abuse is a manifestation of the laws concern to punish acts of dishonesty, this argument would be inappropriate in most other jurisdictions that have developed their statutory law on the basis of market integrity.

It is true that many of the early laws relating to the integrity and efficiency of markets – usually markets for commodities, were concerned with essentially manipulative conduct and making false representations. For example, there were very early common law offences in England outlawing interference with the bringing of goods to market and attempting to distort prices in the market. Markets were seen to be the best method

for determining a fair price based on supply and demand and therefore unjustified interference with this mechanism was regarded as a serious crime. When statutes and other formal laws were later developed for the better organisation of markets and in particular the early financial markets, provisions were often included, outlawing manipulative and fraudulent practices. Indeed, one of the best examples is the English Statute of 1697 'to restrain the number and ill practices of Brokers and Stock-jobbers.' In the Preamble to this Act, it is recorded that 'divers Brokers and Stock-jobbers or pretended Brokers' had been guilty of 'most unjust practices and designs' and had 'unlawfully combined and confederated themselves together to raise or fall from time to time the value of securities'.

The early law in Canada and the United States relating to the sale of and trading in securities was aimed at fraudulent practices. Indeed, the Provincial and State laws were and still are referred to as 'Blue Sky Laws'. This refers to the attempts by some unscrupulous brokers and dealers to sell lots in the sky! A major component of the so called 'New Deal' Federal securities legislation in the USA in the 1930s was to curb the many fraudulent practices which were thought to have played a significant role in the collapse of the markets and the Great Depression. Until the mid-1980s in the United Kingdom, the principal legislation relating to the financial markets was the Prevention of Frauds (Investments) Act 1958. The laws of many other jurisdictions have a similar history and therefore it is not surprising that the misconception has grown that financial regulation and in particular financial crime is all about fraud.

While the laws of most jurisdictions do not penalise abuses such as insider dealing on the basis that the practice is not fraudulent, it is true that most would recognise the argument that to permit insider dealing corrupts the integrity of the market. Care needs to be taken, however, in developing this into some notion of a 'fraud on the market'. Generally speaking insiders who abuse unpublished price sensitive information make no representation and it could be argued that to the extent that they are relying on more accurate information, it is the market itself that is falsely valuing the relevant securities. Thus, there are clearly limits to how far essentially market regulation can be based on traditional notions of fraud and its prevention. Suffice it to say here, that the best justification for penalising what is considered, albeit perhaps irrationally as unfair, is the need to promote and protect public confidence in the market as an efficient and fair determinant of value.

Dishonesty in so far as it manifests itself in the taking of advantage or the seeking of an unjustified profit, by means that of dubious integrity, can be seen in most economically motivated crime. In this context, dishonesty imports doing something, or exceptionally omitting to do something, realising that honest and reasonable people would act otherwise. It is generally not the element of dishonesty that gives rise to liability. But the dishonesty taints the conduct or omission, by which the advantage is obtained or harm caused. It has been argued that in certain circumstances, dishonesty might itself give rise to an obligation, for example, to disclose highly material information, but this is not the case in the vast majority of legal systems. For example, where there is a duty of disclosure, the state of mind of the person deliberately omitting material facts in breach of this duty, will often determine whether his conduct is criminal or not and the nature of the civil remedy. In other words his dishonesty will give character to the breach of duty, but not create a duty where none pre-exists.

Within the concept of dishonesty is knowledge. This is a most difficult area of jurisprudence in most systems of law. Albeit in practice, the facts often speak for themselves and it is not always the courts must determine the exact state of knowledge of the person concerned. We will examine this in more depth in due course. However, it is important to note that a person cannot be dishonest if he is ignorant of the facts that would indicate to an honest person that the conduct in question lacks integrity. Of course, in a criminal case it is usually for the prosecution to establish beyond a reasonable doubt that the defendant did in fact know and often understand the true state of affairs, and yet acted in disregard to the ordinary standards of honesty. This can be difficult, although as we have pointed out there comes a point when incredulity serves as proof. In the civil law the courts are often more willing to adopt a more robust and objective standard and if no reasonable person in the circumstances would not have appreciated the facts, then it will be difficult for

the defendant to assert his ignorance. Indeed, in some situations his negligence may itself justify liability.

Dishonesty does, however import more than just knowledge. It involves a notion of culpability. While it is important to keep separate the issues for whatever intention, over and above the dishonest state of mind of the defendant must be proved, and this will vary on the facts. In the context of many financial crimes, this will manifest itself as a disregard of the rights and interests of others or a desire to appropriate something that he is not entitled to. Consequently, in determining whether a person in regard to a particular action or non-action is dishonest involves partly subjective and partly objective issues. The standard of honesty, in most jurisdictions, is that of reasonable and honest people, and the defendant will only be considered dishonest if he realises that he is acting contrary to that standard. Thus, the test is partly dependent on what reasonable and honest people consider and partly what is in the mind of the defendant. Then defendant cannot justify his actions because he himself, given whatever are his personal and education standards, considered what he has done unobjectionable. The crucially important issue of who determines what a reasonable and honest person would consider as dishonest will not be the same in every jurisdiction. In common law systems this is an issue of fact, rather than law. Some civilian jurisdictions are somewhat more ambiguous on this issue. In the common law tradition, as a question of fact, this is a matter for the jury, who will be asked to form their own view as to exactly what the standards of an ordinarily honest and reasonable person are in their society. Where there is no jury, then the matter will be determined, as a question of fact, by the judge. It is not without interest that after much debate and consideration in 'codifying' the fraud related offences in the Fraud Act 2006, the British Government decided that the determination of what is and what is not dishonest, should remain the common law standard determined by the ordinary reasonable man.

## Stewardship – the Touchstone

In this paper the author has been asked to address the significance in the common law tradition of stewardship, a concept that President Roosevelt identified as being at the heart of his New Deal legislation in the USA and a concept that President Obama has seized upon in his Administration's consideration of reform. The notion of stewardship is ancient and has changed little over time. (In the context of insider abuse see B. Rider 'The Control of Insider Trading – Smoke and Mirrors' 1 *International and Comparative Corporate Law Journal* (1999) 271). Lord Chancellor Herschell, in the leading English case of *Bray v Ford* [1896] AC 44 emphasized that it is an inflexible rule that the courts will not permit a person in a fiduciary relationship to place himself in a position where his own interests conflict with those he is bound to serve. Nor is he to be permitted to derive an unauthorised benefit – a 'secret profit' – from his position of trust. He must be loyal to his principal. Of course, with all such simple rules, their application in practice is anything but simple. For example, there is still debate as to whether Lord Herschell intended to require those in a fiduciary position to eschew all conflicts of interest and duty no matter how insubstantial or theoretical. Nor is it certain whether the rule that a fiduciary should not benefit – without express authority – from his position is a separate rule or stems from the primary obligation to avoid all conflicts of interest. It is also uncertain as to how far it is appropriate to apply these rules to the situation where a fiduciary is in a conflict of duties to different principals, as opposed to merely his own self-interest. A broad approach could create serious problems for those in several fiduciary relationships. Also, there is the real problem of financial intermediaries who engage in activities which might well produce conflicts between their different customers. Chinese Walls and similar devices may inhibit the flow of actual information from one function within the bank to another but they do not address the essential conflict of duty that the bank has placed itself in. (See B. Rider and T.M. Ashe (eds), *The Fiduciary, the Insider and the Conflict* (1995) Sweet & Maxwell and in particular *Australian Securities and Investments Commission v. Citigroup Global Markets Australia Pty Ltd* (2007) FCA 963.)

The concept of fiduciary obligation was authoritatively set out by Millet LJ in *Bristol and West Building Society v. Mothew* (1998) 1 Ch 1 at 118). The learned judge stated *'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…*' Therefore company directors in their dealings with the company, partners in dealing with each other, an agent in dealing with his principal, a trustee in dealing with his beneficiary, a public official in regard to his office and a professional adviser in dealing with his client would all be included. It is also probable that an employee in his dealings with his employer would also be covered. While employees are not generally considered to be fiduciaries. (But note that employees who in senior management positions act on behalf of a company, may well be considered to owe fiduciary obligations much the same as the company's directors, see *Canadian Aero Services Ltd v. O'Malley* (1973) 40 DLR (3d) 771 and 381. 2), they are within a duty of fidelity which has much in common with the obligations cast upon a fiduciary. An employee is 'trusted' by his employer not to make use of the employer's property or premises for the employee's benefit. It is important to note, however, that unlike an ordinary fiduciary relationship, the obligations, albeit different, flow both ways.

While it is certain that those in a position of stewardship or a fiduciary relationship must not subordinate, without a clear mandate, the interests of the person for whom they act or serve to their own, it is unclear how conflicting duties might be resolved. For example, would a trustee be under a duty to use inside information that he learnt by virtue of some other relationship for the benefit of the trust? It might be less easy for him to excuse himself when the information in his possession indicates that the trust will suffer a serious loss unless he takes action. Indeed, it has been said that a stockbroker may be under a duty to ensure that privileged information that he possesses does not work to the disadvantage of his client. (See G Cooper and B Cridlan, *The Law of Procedure of the Stock Exchange* (1971, Butterworths) p.104. But see the comment of Lord Browne-Wilkinson in Kelly v. Cooper (1993) AC 205, *'stockbrokers … cannot be contractually bound to disclose to their private clients inside information disclosed to the brokers in confidence by a company for which they also act'*. To what extent it could be argued that a broker may come under a duty to search out such information or act upon information of a positive quality which results in profits rather than the avoidance of an otherwise certain loss is rather more debatable.

Although it is true that the trust is a creature of the common law, other systems of law impose obligations on individuals not too dissimilar to those under discussion. For example, in civil law jurisdictions, agents and those operating under mandate might well be held to duties of good faith and care which would give rise to issues not unrelated to those discussed above. (See in particular C. Nakajima, *Conflicts of Interest and Duty*, 1999, Kluwer.) The misuse of privileged information and opportunity would also be condemned under Islamic law. (See generally B. Rider and C. Nakajima, Chapter 18 in *Islamic Finance*, S. Archer and R. Karim (eds), 2007, Wiley.) In most common law jurisdictions, it is generally thought that liability under the fiduciary law is, in large measure, strict. Thus, if a person in a fiduciary position does take an unauthorised benefit from his position, then he should be held accountable whatever his state of mind. While such a draconian approach might be appropriate in the case of trustees in the strict sense, there are many situations involving those in a fiduciary or analogous position where the courts have considered that proof of lack of probity is a material factor. (See, for example, *Royal Brunei Airlines Sdn Bhd v. Philip Tan Kok Ming* (1995) 2 AC 378.)

In the business and financial world, those in a fiduciary position will, it seems, be allowed to enter into situations where there is a possible and even, on occasion, real conflict of duties, provided they act with integrity. On the other hand, where there is a conflict between a duty to another and the self-interest of a fiduciary, the courts will be far more prepared to examine what has in fact taken place. Self-interest has been considered to be almost presumptive of abuse. The greater the degree of self-interest or benefit, the stronger will be the inference of corruption. On the other hand, it must be recognised that even in the case of conflict of duties, an intermediary will often expect to receive a benefit, be it in terms of commission or simply the retention of a business relationship. Consequently, it will rarely be the case that there is absolutely no element of self-interest in the equation.

Let us turn to a rule that is perhaps even clearer in its articulation than the 'no conflict rule'. Those in a fiduciary relationship must not derive from their position, or rather by virtue of the relationship, a 'secret profit.' Perhaps the most authoritative exposition of the rule is that of Lord Russell of Killowen in *Regal (Hastings) Ltd v. Gulliver* (1942) 1 All ER 378. *"The rule of equity which insists on those, who by the use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of bona fides; or upon such questions or considerations as whether the profit would or should otherwise have gone to the plaintiff, or whether the profiteer was under a duty to obtain the source of the profit for the plaintiff, or whether he took a risk or acted as he did for the benefit of the plaintiff, or whether the plaintiff has in fact been damaged or benefited by his action. The liability arises from the mere fact of the profit having, in the stated circumstances, been made. The profiteer, however, honest and well intentioned, cannot escape the risk of being called to account"*. In other words, any calculable benefit that comes into their possession that has not been expressly approved or permitted by the principal must be handed over to the principal. (See for a dramatic example of this also Roskill J. in *Industrial Development Consultants Ltd v. Cooley* (1972) 2 All ER 162 and *Bhullar v. Bhullar* (2003) 2 BCLC 241.) This is an important rule of stewardship and is a core principle in any system of good governance. It strikes at the very root of self-dealing.

After much debate as to the appropriateness of codification the new English Companies Act following in the traditions of many other Commonwealth countries has achieved a partial codification. (See generally B. Butcher, *Directors' Duties – A new millennium a new approach?* (2000) Kluwer and B. Rider, Y. Tajima and F. Macmillan, Commercial Law in a Global Context (1998) Kluwer.) Section 175(1) of the English Companies Act 2006 provides that "a director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company". It is made clear in section 175(7) that the 'no conflict rule' applies also to conflicts of duties. It has been argued that all the relevant fiduciary obligations are based on this fundamental principle. Consequently, the obligation to account for secret profits is but a manifestation of this strict obligation of loyalty. This is, however, an over simplification. (See for example, *Bhullar v. Bhullar* (2003) 3 BCLC 241 and in *Plus Group Ltd v. Pyke* (2002) 2 BCLC 201.) Indeed, it is clear even in the context of directors' duties that there are at least three relatively distinct, albeit often related, situations. This is underlined by the fact that Section 175(3) states that the duty set out in Section 175(1) "does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company". Self dealing in such transactions, on the part of a director is governed by a specific set of rules relating to disclosure, control and approval.

The common law imposed a very strict obligation on directors. Lord Cranworth LC in *Aberdeen Railway v. Blaikie* (1854) 2 Eq Rep 1281 stated *'it is a rule of universal application that no one"* having duties of a fiduciary nature *"shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict with the interests of those whom he is bound to protect"* and *"so strictly is this principle adhered to that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into…"* To hold directors to the duties of a trustee was not practical or perhaps in many cases in the commercial interests of the company. Consequently, despite the strict law, the courts permitted directors to deal with their own companies provided the shareholders after full disclosure ratified what had occurred. Indeed, in case of prior authorization by the shareholders, it is arguable that the potential conflict is avoided. Indeed, the exigencies of business led to the Courts going somewhat further and accepted that provided adequate disclosure was made to an appropriate body, determined by the company's constitutional documents, which may be merely the board of directors, the so called 'universal' rule of Lord Cranworth was effectively avoided. Commercial practice and pragmatism went perhaps too far and since the Companies Act 1929 there has been a statutory obligation of disclosure to the board which cannot be excluded or modified by the articles of association. Section 177(1) of the Companies Act 2006 places a statutory obligation on a director who is 'in any way, directly or indirectly' interested in a proposed transaction or arrangement with his company to declare to the other directors the 'nature and extent' of the interest before the relevant arrangement is entered into. It is important to note that this obligation goes beyond contract and includes non-contractual arrangements. The purpose of this provision is to alert the

board to the existence of a conflict and therefore obligate it to address it in the interests of the company. It follows that changes in the nature and extent of the relevant interest must also be disclosed and recorded. While the scope of this obligation is wide in so far as it includes 'indirect' interests such as a shareholding in another company with which a transaction is proposed, Section 177(6)(a) provides that a director need not declare an interest 'if it cannot reasonably be regarded as likely to give rise to a conflict of interest'. Furthermore, he need not disclose any interest that his fellow directors are already aware of and 'the other directors are treated as aware of anything of which they ought reasonably to be aware under Section 177(6)(b). A similar obligation to disclose interests is imposed on directors and shadow directors by Section 182 in regard to existing transactions or arrangements. It should be noted that failure to disclose existing interests, usually upon appointment, is made a specific criminal offence under Section 183.

Section 180 of the Companies Act 2006 provides that compliance with the disclosure obligation means that the director will not be in breach of his duty to the company if the relevant transaction is then entered into. Compliance will also ensure that 'the transaction or arrangement is not liable to be set aside by virtue of any common law rule or equitable principle requiring the consent or approval of the members of the company (Section 180(1), note, however, 'this is without prejudice to any enactment, or provision of the company's constitution, requiring such consent or approval'). While Section 178(1) the Companies Act 2006 provides the consequences of breach of Section 177 are to be the same as under the corresponding common law or equitable rules (Section 178(2) provides 'the duties …are, accordingly, enforceable in the same way as any other fiduciary duty owed to a company by its directors) it should be noted that the imposition of a statutory obligation to disclose may well render the law of fraud relevant. A dishonest failure to disclose might well constitute the offence of fraud and connivance on the part of others might well amount to a conspiracy to defraud.

The English Companies Act 2006 as the previous legislation recognizes that there are certain situations where the temptation and consequent risks of self-dealing are of such significance that mere disclosure to the board is not enough. Consequently in regard to substantial property transactions (see sections 190 to 196) and loans to directors (Sections 197 et seq) and those connected with them (see Sections 252 to 254), and certain aspects of their service contracts (see Sections 188 and 189 and generally Part 10, Chapter 5) there must be full disclosure to the shareholders and a vote in general meeting. While of importance in promoting and ensuring the integrity of directors and in certain respects other insiders, we need not address these provision here in detail. The Act provides specific civil remedies, which while resembling the general law are specifically honed to deal with the involvement of persons connected with the director (see Sections 195 and 213).

The other two areas of liability that arguably flow from the general rule against conflict of interest, in the context of corporate law, relate to the misuse of corporate property, information and opportunities and the making of secret profits. Section 175(2) specifically refers to the misuse of information. It also refers to the exploitation of property and so called corporate opportunities. We have examined the liability that can arise where a person in a fiduciary relationship, without proper consent or approval, derives profit from the exploitation of information or property, including expectant property or receives a benefit from a third party. It has been argued that the strict obligations of stewardship should render any risk of a conflict of interest or duty unacceptable. However, in the case of directors who are in the commercial world, the law is less exacting. Section 175(4) in regard to the avoidance of conflicts of interest, in the context of exploiting information, property and opportunity, states 'the duty is not infringed if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest.' By the same token Section 176(4) in the context of outlawing benefits from third parties, provides 'this duty is not infringed if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest'. Consequently, theoretical and unrealistic conflicts actual as well as potential should not expose a director to the prospect of liability. (See generally *Island Export Finance Ltd v. Umunna* (1986) BCLC 460; *Framlington Group Plc v. Anderson* (1995) 1 BCLC 475 and *Ultraframe (UK) Ltd v. Fielding* (2005) EWHC 1638.)

The justification for the common law imposing such strict obligations on those who accept positions of trust is essentially pragmatic. The legal system cannot be expected to detect and monitor every transaction and therefore strict and pragmatic rules are required for the ordering of all dealings between the fiduciary and his principal and with third parties on matters in which the principal has a legitimate interest. The rule therefore requires all remuneration and benefits to be agreed and therefore strikes at self-dealing, abuse of position and the diversion of opportunities that in good conscience should have gone to the principal. The rule against taking unauthorised profits works reasonably well in the context of principal and agent, but when applied to the position of fiduciaries whose relationship is with a company, it gives rise to a number of difficulties. As the company is a separate legal person, this fiduciary obligation is owed directly to the company and to no other person. The statutory provisions in the English Companies Act 2006 do not change this. Consequently, if a director uses information that he obtains as a director to deal in the securities of another company, his liability to account for his profit is to his own company and not to the issuer in whose securities he has traded. When the insider remains involved in the management of the company, there are serious practical and occasionally legal difficulties in bringing him to account. It is his company that has the right to sue for breach of the duty of good faith and the more specific duties, such as those set out in the Companies Act Section 178(2) specifically provides 'the duties in those sections…are… enforceable in the same way as any other fiduciary duty owed to a company by its directors'. In practice, this will mean that the action is to be commenced by his colleagues on the board or in senior management. The possibilities for minority shareholders to intervene and bring an action on behalf of their company are in reality severely limited.

The law relating to the circumstances in which minority shareholders may maintain an action on behalf of their company in the face of opposition from the management and majority shareholders has over the years attracted a great deal of comment and discussion not least in Hong Kong. (Reference should be made to Rita Cheung Siu Wa, *Minority Shareholders' Rights and Protection in Hong Kong: A Comparative Study* (2007) Ph.D dissertation of the University of London, published in part in The Company Lawyer.) While the courts have been prepared to assist shareholders to bring derivative actions based on the company's cause of action against persons who have seemingly engaged in fraud and misappropriation of the company's property, there has been uncertainty as to what amounts to fraud and what can be regarded as corporate property. For example, some of the cases involving allegations of equitable fraud include misconduct, such as the taking of a secret profit, in circumstances where there is no dishonesty in the common law sense. (See *Armitage v. Nurse* (1998) Ch 241 at 252 where Millett LJ stated that equitable fraud included 'breach of fiduciary duty, undue influence, abuse of confidence, unconscionable bargains and fraud in powers'. See also for an early discussion of this B. Rider, 'Amiable Lunatics and the Rule in Foss v. Harbottle' (1978) Cambridge Law Journal 270.) In *Item Softwear (UK) Ltd v. Fassihi* (2005) 2 BCLC 91 it was held that a director is under a duty derived from his obligation of loyalty to disclose to his company his own wrongdoing even if it does not amount to fraudulent misconduct. (The dishonest failure to do this might well render the law of fraud relevant.) The courts have in deciding whether the alleged misconduct is such as to justify permitting minority shareholders to proceed, at possibly considerable expense to all concerned referred to indications of lack of good faith on the part of those responsible for the wrongdoing. Thus, attempts to hide what has occurred or frustrate the company itself proceeding, possibly by the wrongdoers or those associated with such using their votes as shareholders in general meeting, have been weighed in the balance but judges. The circumstances in which a minority shareholder may now assert a derivative action in both the United Kingdom and Hong Kong have been clarified, at least to some degree, in the recent legislation. While the new statutory provisions almost entirely reflect the pre-existing case law, the position of a minority shareholder is arguably made easier as a result of increased clarity and the endorsement in statute, of what might be considered the more robust approach to wrongdoer influence.

## The Limits of Stewardship?

When we contemplate the duty that a corporate fiduciary owes to his company not to take advantage of his position or, for that matter, information that comes to him by virtue of his privileged position, we must recognise the narrowness of the relationship within which this duty operates. Directors and other corporate fiduciaries owe their duties to the company and, as the company has a separate legal personality, only to that entity. They do not, as fiduciaries, owe duties to other, albeit related, enterprises, shareholders, creditors, employees or anyone else. Of course, if they step into another legal relationship, they might well find themselves owing duties directly to such persons as well as to their company. For example, as we shall see, there have been cases (see, for example, *Allen v. Hyatt* (1914) 30 TLR 444; *Briess v. Woolley* (1954) AC 333 and, in particular, *Peskin v. Anderson* (2001) 1 BCLC 372; *Stein v. Blake* (No 2) (1998) 1 All ER 724 at 727 and 729 (per Millett LJ) and *Gadsden v. Bennetto* (1913) 9 DLR 719 (Man)) where a director has stepped into a special relationship with one or more of the shareholders and by virtue of this has been held liable for taking advantage of privileged information in his dealings with them. Such cases, outside the United States, are, however, exceptional. It is important to remember that, while as a matter of good governance, directors are required to have regard to the interests of different constituencies, as a matter of law, their duties are owed to and are enforceable by their company. Thus, while members of the board both collectively and individually must act in what they consider to be the best interests of the company and in doing this they should consider the interests of all those 'represented' in the enterprise, their duties of stewardship are owed to the company. Consequently, the shareholders, individually or collectively as the providers of capital, have no right to sue on a claim based on an infraction of a duty owed to the company. The company's property is not theirs and it has been decided that even conduct on the part of directors which damages the share price does not give individual shareholders or the even the general body of shareholders the standing to sue (*Prudential Assurance Co v. Newman Industries Ltd (No 2)* (1982) Ch 204).

However, where a fiduciary relationship can be found, it is probable that the obligation of fair dealing will import a duty of full disclosure and probably also a duty of care. Where such a relationship exists between for example an insider and the person with whom he is dealing, it is likely that the law will provide a remedy. However, the fiduciary obligation must generally arise from a pre-existing fiduciary relationship as it is far less clear that such obligations can arise, other than in the most exceptional circumstances, by virtue of the transaction in question. While it is probable that directors, the classic insider, may be in a contractual relationship with shareholders of their company, this is not a fiduciary relationship so as to give rise to the fiduciary obligation of fair dealing. It follows that a director who deals with someone who becomes a shareholder by virtue of that very transaction is in no pre-existing relationship whether contractual or otherwise. The traditional attitude of English law, and for that matter all common law jurisdictions, is that a director owes his fiduciary duties to his company which is a separate legal person. He does not owe duties directly, or for that matter even indirectly, to the shareholders who also have no legal interest in the company's property. (The rule established by Swinfen-Eady J in *Percival v. Wright* (1902) 2 Ch 421 and see also Lord Lowry in *Kuwait Asia Bank v. National Mutual Life Nominees Ltd* (1990) BCLC 868 at 888.) In *Peskin v. Anderson* (2001) 1 BCLC 372, Mummery LJ observed, referring to *Percival v. Wright*, 'the apparently unqualified width of the ruling has, over the course of the last century, been subjected to increasing judicial, academic and professional critical comment; but few would doubt that, as a general rule, it is important for the well-being of a company (and of the wider commercial community) that directors are not overexposed to the risk of multiple legal actions by dissenting minority shareholders…' (But see *Re Chex Nico (Restaurants) Ltd* (1992) BCLC 192 and In *Re A Company* (1986) BCLC 382.) The rule that directors do not owe duties as directors to members of their company either individually or collectively has been criticized but it remains a cornerstone of company law.

On the other hand, whilst the courts are not generally receptive to arguments that they should discover new fiduciary relationships, they are prepared to reconsider the factual circumstances in which duties can arise and in particular take account of changes in social and perhaps moral views. Thus, the High Court of

New South Wales in *Glandon Pty Ltd v. Strata Consolidated Pty Ltd* (1993) 11 ACSR 543 expressed the view that as attitudes to insider dealing had changed since 1902, a court faced with the issue today might not be as unwilling as Swinfen-Eady J was to discover a fiduciary obligation. In practice, what the New South Wales court was alluding to was a long-established approach, namely the recognition that in special and exceptional circumstances the facts of a particular case might well persuade the court that an unusual fiduciary relationship arises on the particular facts of the case. Although there are a number of examples of the courts being prepared to find that, for example, directors have stepped outside their normal corporate relationship into a special relationship with their shareholders, or for that matter third parties, perhaps the most dramatic illustration is *Coleman v. Myers*. Although, at first instance, Mahon J was prepared to hold that *Percival v. Wright* was simply per incuriam and should not be followed in New Zealand, the Court of Appeal, while taking the view that Swinfen-Eady J had been correct on the facts before him, held there were circumstances which could, and did in the present case, justify the court in finding that a relationship of fair dealing, involving both a duty of good faith disclosure and also one of care, arose as a legitimate expectation on the particular facts. In this case, the closely held nature of the company, the exceptional materiality of the information in question, the dishonesty of the insiders and the fact that the relevant shareholders had, over a long period, come to rely upon their probity, all served to justify the implication of a fiduciary obligation of fair dealing.

The circumstances where an English court would be prepared to find a specific duty of disclosure to an existing shareholder, let alone a person buying into the issue for the first time, are not entirely clear. It is probable that the insider would have to be in possession of highly relevant and material information which the other party could not have obtained even with the exercise of diligence. Furthermore, the situation must, it would seem, be such as to raise, on the part of the person dealing with the insider, a reasonable expectation of fair dealing. The comment of Newberger J in *Peskin v. Anderson* (2000) 2 BCLC 1 at 14 seeking to summarize the English law may well go too far. (See *Peskin v. Anderson* (2001) 1 BCLC 372 and in particular Mummery LJ at 378 and 383.) The Court of Appeal emphasised that the special circumstances must be such as to create essentially a 'fiduciary duty' of disclosure. Mere inequality of information cannot create a fiduciary relationship justifying fair dealing and disclosure. (See also *Platt v. Platt* (2001) 1 BCLC 698.) The learned judge observed: *'I am satisfied, both as a matter of principle and in light of the state of the authorities…, that Percival v Wright is good law in the sense that a director of a company has no general fiduciary duty to shareholders. However, I am also satisfied that, in appropriate and specific circumstances, a director can be under a fiduciary duty to a shareholder … So far as the authorities to which I have referred on this issue are concerned, the decisions … in which a duty was held to arise were cases where a director with special knowledge was buying the shares … for his own benefit from shareholders, where the director had special knowledge which he had obtained in his capacity as a director of the company, and which he did not impart to the shareholders, and where the special knowledge meant that he knew that he was paying a low price'*.

For a special relationship to develop giving rise to an obligation of fair dealing, it is most likely that the parties will be engaged in direct and personal negotiations. In the Court of Appeal in the Peskin case, it was emphasised that *'these duties may arise in special circumstances which replicate the salient features of well established categories of fiduciary relationships…those duties are, in general, attracted by and attached to a person who undertakes, or who, depending on all the circumstances, is treated as having assumed, responsibility to act on behalf of, or for the benefit of, another person'* ( *per* Mummery LJ (2001) 1 BCLC 372 at 397, see also *Stein v. Blake* (No 2) (1998) 1 All ER 724 at 729.) Even in those states in the United States that have developed the so-called 'special facts' doctrine. (See *Strong v. Repide* 213 US 419 1909) remedies, are in practical terms, confined to non-market transactions. It is also likely that in most cases the company will be closely held. Indeed, there are cases where the company resembles a partnership in which the courts have been prepared to view the relationship between shareholders and directors as analogous to that of partners bound by obligations of mutual good faith. (For example, *Ebrahimi v. Westbourne Galleries*

(1973) AC 360 and most recently *Oak Investment Partners XII LP v. Boughtwood* (2009) EWHC 176. See generally also B. Rider 'Partnership Law and its impact on Domestic Companies' (1979) *Cambridge Law Journal* 148.) We must also remember in our present discussion that the remedies available for a breach of the fiduciary's duty of loyalty are rather limited. Where the fiduciary allows another person to benefit in his place the law has been less robust but still imaginative.

## The Long Arm of Equity

On the other hand Judges have understandably been reluctant to stand by and see insiders facilitate the looting of their companies by others with whom there is often a fair suspicion that they are in cahoots. A series of recent decisions has underlined the significance of the constructive trust as a means of reaching out and imposing an essentially restitutory liability on those who receive the benefits of a breach of trust or who knowingly facilitate the breach. Whilst the principles are by no means new, the way in which the judges have applied them has been dynamic, while in the House of Lord's decision in *Westdeutsche Landesbank Girozentrale v. London Borough of Islington* (1996) AC 669, Lord Goff stated, 'it is not the function of your Lordships' house to write the agenda for the law of restitution, not even to identify the role of equitable proprietary claims in the part of the "law" has there been a burst of judicial activity in the area of intermeddlar liability'. In recent cases, the courts have fashioned a relatively effectively device to impose restitutory liability on those who, knowing the facts that amount to a breach of trust, knowingly participate in it or facilitate the laundering of the proceeds in circumstances where an ordinary person would consider what they have done, or perhaps not done or asked, is dishonest. The liability in such cases is not that of a constructive trustee in the conventional sense of the word; their liability is as an accomplice and the monetary liability that they are exposed to is to make restoration as if they were a constructive trustee. It is interesting that Lord Browne-Wilkinson in the Westdeutsche case observed that the distinction between the concept of remedial constructive trusts, as developed in US law and the traditional approach of the English law, remains, despite judicial ingenuity and the desire of judges, to make the 'crooks' pay. He pointed out that the essentially institutional constructive trust under English law arises by operation of law and that it is for the court merely to recognise and give effect to it and it is not open to the judge simply to impose such a device to afford a remedy which would not otherwise exist.

The view has been taken that before a trust can be found, it is necessary to identify property which can in the contemplation of the law be considered viable as trust property. In Lister v. Stubbs (1890) 45 Ch D 1 the Court of Appeal established the rule that a bribe, in so far as such involved only a personal obligation to account, could not be the basis of a tracing claim and was not susceptible to being regarded as trust property. Of course, there has always been a substantial grey area in company law in regard to what the textbooks refer to as the 'corporate opportunity' cases. In one or two Commonwealth cases, the courts have seemingly regarded the benefit of a contract which in fairness should have gone to a company, but which has been wrongfully diverted to another person, as a form of corporate property (*Cook v. Deeks* (1916) 1 AC 554; *Canadian Aero Service Ltd v. O'Malley* (1974) 40 DLR (3d) 371). As we have seen this discussion has had a role in deciding whether a minority shareholder should be able to bring a derivative action. Where there has been a misappropriation of corporate property the argument is that as the majority of shareholders cannot approve or ratify such conduct, a derivative action cannot be denied or frustrated.

In *A-G for Hong Kong v. Reid* (1994) 1 AC 498 the Privy Council, on an appeal from New Zealand, following the approach of the Court of Appeal of Singapore in *Sumitomo Bank Ltd v. Kartika Ratna Thahir* (1993) 1 SLR 735 opined that the rule in *Lister v. Stubbs* was inappropriate today. The Privy Council considered that on the basis that equity looks as done that which should be done, there was a sufficient basis in law for tracing into the proceeds of a bribe. Furthermore, their Lordships' comments and particularly those of Lord Templeman were wide enough to include the proceeds of a 'secret profit'. If the proceeds

of, for example, insider trading could be traced and be the basis of a constructive trust, the law in this area would be radically changed. For example, it would mean, as was in effect held by the High Court of Hong Kong in *Nanus Asia Inc v. Standard Chartered Bank* (1990) HKLR 396 that the proceeds of insider dealing could be traced into the hands of a recipient who took otherwise than as a bona fide purchaser without notice. It would also follow that accomplice liability could be imposed on those who facilitated the insider dealing provided they had the requisite degree of knowledge and were objectively speaking dishonest. It would also be arguable that in so far as the proceeds were the 'property' of the company, the exception to the rule in *Foss v. Harbottle*, placing beyond the reach of the majority of shareholders to ratify or excuse cases where there had been a misappropriation, would be available. While it has been assumed that the observations of, in particular, Lord Templeman in all probability were unintended to be applied broadly to all breaches of fiduciary duty resulting in unjust enrichment, recent cases have shown that some judges are willing to throw the net very widely. In *United Pan Europe Communications NV v. Deutsche Bank AG* (2000) 2 BCLC 461, the Court of Appeal had no difficulty in applying such reasoning to the misuse of confidential information obtained within a duty of loyalty and imposing a constructive trust on shares bought by the bank. With respect, however, in Reid, their Lordships clearly did not have these wider issues in mind when they showed so much determination in ensuring the unsavoury Warwick Reid should not be allowed to whisk his ill gotten gains, as Lord Templeman said, 'to some Shangri-La which hides bribes and other corrupt moneys in numbered bank accounts'. Indeed, this is one of the real problems in this area of the law. The judges, once they sniff fraud, are prepared to go some way in ensuring that the crook's ill gotten gains are taken away from him. They are not always too concerned with traditional compensatory, let alone restitutory, jurisprudence. In looking at some of the decisions, particularly those relating to directors' duties, it is important to remember that to a very real degree the end has justified the means and a search for all prevailing and entirely rational principles of restitution may well be a search in vain.

It is still probably the law that not all breaches of fiduciary duty are capable of giving rise to a constructive trust relationship. In *Nelson v. Rye* (1996) 2 All ER 186, Laddie J followed Lord Millett's view expressed extra-judicially in 'Bribes and Secret Commissions' published in (1993) *Restitution Law Review* 7. Lord Millett took the view that a constructive trust is appropriate when an agent receives property himself in circumstances where it should have gone to his principal. This is a principle which has long been recognised in the company law cases. The Australian High Court in *Warman International Ltd v. Dwyer* (1995) 128 ALR 201 also threw some light on this issue by distinguishing situations where a fiduciary benefits by use of his principal's property or an opportunity coming to him by virtue of acting for his principal where a constructive trust might be appropriate and other cases where he is merely guilty of a breach of his duty of loyalty. In the latter case, while there may well be an obligation to account for all or part of the 'secret profit', the more exacting relationship of a trustee may well be inappropriate. However, the Court of Appeal in *United Pan Europe NV* took the view that a constructive trust might be an appropriate remedy to deprive a fiduciary of his ill gotten gains when 'the conduct complained of falls within the scope of the fiduciary duty' to exhibit loyalty and it need not be shown that the profit resulted 'by virtue of his position'. Furthermore, the Court of Appeal did not accept that a constructive trust 'will only be granted where the applicant can trace into the property over which it is sought'. The remedy would depend upon the circumstances. Furthermore, in this context, it must also be remembered that the Privy Council has also shown a greater degree of flexibility in dealing with that old inflexible rule that a fiduciary should not place himself in a position where his interest and duties conflict. Disclosure with assent and contractual delimination of the scope of duties and expectations may well render what would otherwise be a conflict of interest nothing objectionable to the law (*New Zealand Netherlands Society Oranje v. Kuys* (1973) 2 All ER 1222; *Kelly v. Cooper* (1993) AC 205 and *Clarke Boyce v. Movat* (1994) 1 AC 428).

A further problem which has manifested itself is whether certain types of information can be considered to be a form of property, thereby bringing in the law relating to constructive trust and all this might entail. Of course there will be an informational aspect in most cases of self-dealing and abuse of position. The

law is unclear as to in which circumstances the courts will protect information of a confidential nature in a manner which is analogous to property. The Divisional Court has decided that confidential information is not property for the purposes of the law of theft in England (*Oxford v. Moss* (1978) 68 Cr App R 183). Whether such a view adequately takes account of the civil law and can in any case stand after the view expressed by the Privy Council in Attorney General for Hong Kong v. Reid remains open to serious doubt. In *Reid*, Lord Templeman certainly regarded the majority of their Lordships in *Boardman v. Phipps* (1967) 2 AC 46 as imposing a constructive trust on the defendants on the basis that they had misused confidential information. In *United Pan Europe NV* (2000) 2 BCLC 461 the Court of Appeal had no difficulty in considering a proprietary remedy, namely a constructive trust, might well be an appropriate remedy to improve on shares purchased by a fiduciary who had used confidential information. Indeed, Morritt LJ did not think it an issue whether the applicant could trace into the relevant property; what was at stake was depriving a fiduciary who had stepped into a conflict of interest of its 'secret profit'. Notwithstanding the uncertainty whether the principles relevant to the law relating to constructive trusts and the tracing remedy can be applied to all 'secret profits' and the misuse of information, it is useful to refer to a series of relatively new cases which imbue liability on those who receive the benefits or assist in the laundering of the proceeds of a breach of fiduciary duty.

## Dishonest Facilitators

The 'flood' of cases seeking to impose civil liability on those which might broadly be described as 'fiduciary facilitators' are based on a principle of law most clearly set out by Ungoed-Thomas J in *Selangor United Rubber Estates v. Craddock* (1968) 1 WLR 1555. In this case, the learned judge referred to an established principle of equity that where a person knowingly participates in another's breach of trust he will be regarded as standing in the same place as the trustee. There has been also considerable discussion as to the requisite state of knowledge for liability. The cases have indicated two basic standards, one requiring subjective knowledge and the other a rather more objective or constructive standard. It was thought that the distinction could be justified in terms of whether the third party who facilitates the breach of trust comes into possession of the relevant property or simply facilitates its control or attention by another. In the first case, a more objective standard was considered appropriate and knowledge of facts which would put a reasonable man on notice that something dishonest was afoot would be sufficient to justify liability akin to that of a trustee. On the other hand, where the participation of the third party does not extend to possession of the property, it was thought that the requisite degree of scienter should be actual knowledge. In the view of recent cases, it would seem that the question of knowledge is rather more bound up with the nature of liability that is being imposed. Where the third party does not come into possession of the trust property or its proceeds, then it is difficult to conceive of him as a constructive trustee or, for that matter, as having any status which would involve a proprietary nexus. The liability of such a person for participating in the breach of trust will be personal. In *Agip (Africa) Ltd v. Jackson* (1991) Ch 547 the Court of Appeal found no difficulty in regarding a chartered accountant who had facilitated laundering the proceeds of a fraud by incorporating companies and opening bank accounts in the names of these companies liable as if he were a constructive trustee and thereby holding him personally liable to restore the funds in question. Of course, in such cases, the liability is personal to the defendant and does not involve a proprietary liability. In this case, the court found that the person concerned had acted dishonestly. He knew of facts which in the circumstances made him suspicious, but he then deliberately refrained from making the enquiries which an honest man would have made and which would easily have uncovered the fraud. Although the cases do indicate varying qualities of knowledge, it would seem the better view today is that before a third party can be held liable as a facilitator, the court will have to be shown that he knew the facts or deliberately turned a blind eye and then acted with a lack of probity. In *Royal Brunei Airlines Sdn Bhd v. Philip Tan Kok Ming* (1995) 2 AC 378, the Privy Council handed down an opinion which does bring some clarity to this area of the law. The Privy Council emphasised that the liability of a person who assists or procures a breach of trust, but does not himself actually receive the property in question, is based on his dishonesty. The Privy Council considered

it matters not whether the trustee has himself been dishonest. Furthermore, the probity of the facilitator is to be judged by reference to the honesty of others. The test is whether he had acted in a way otherwise than an honest man would have in the circumstances. This would invariably involve conscious impropriety on the part of the facilitator, rather than mere negligence, let alone simple inadvertence. However, a person might well be considered to be acting dishonestly for the purpose of imposing liability where he recklessly disregarded the rights of others. The Privy Council underlined that in determining whether a facilitator had acted dishonestly, his actual knowledge at the relevant time had to be considered by the court and this was a subjective issue. What might have been known by a reasonable man in the position of the facilitator might be probative, but was not conclusive. Furthermore, the personal and professional attributes of the facilitator must also be considered in determining what he did and for what reason. The issue was further discussed in *Heinl v. Jyske Bank (Gibraltar) Ltd* (1999) 34 *LS Gaz R* 33. In this case, the judges used, as the basis of their reasoning, the judgment of Lord Nicholls in *Brunei* and concluded that it was not enough that on the whole of the information available to him he ought, as a reasonable man, to have inferred that there was a substantial probability that the funds originated from the bank in question, but that the inference had, indeed, been drawn. This clearly supports the idea that a high level of suspicion will be needed to incur liability in these cases. Another recent case bearing on the issue of liability in these circumstances is *A Bank v. A Ltd (Serious Fraud Office Interested Party (2000) Times*, 18 July.) This again saw the probability of liability of those who negligently participate in money laundering reduced as the court held that banks did not become constructive trustees merely because they entertained suspicions as to the provenance of money deposited with them. The level of dishonesty needed for dishonest assistance was not satisfied by a general suspicion; there needed to be substantial suspicion pertaining to the specific transaction with which they were involved for liability to be incurred. In *Twinsectra v. Yardle* (2002) All ER 377 the House of Lords endorsed the trend away from the imposition of liability on the basis of an essentially objective determination. Instead, referring to Lord Nicholls in Brunei their Lordships adopted what Lord Hoffman described as a combined test, having both a subjective and an objective element. Firstly, it must be shown that the defendant acted in a manner which reasonably honest people would not have. Secondly, it must be shown that the defendant actually appreciated that this conduct would be considered dishonest by other people.

There are situations where, to establish the requisite state of mind for liability under the civil and criminal law, it will be necessary to attribute knowledge from one person to another. When ever a body corporate is involved the question arises as to whose state of mind in the corporate hierarchy it is appropriate to attribute to the company. In *R v. Rozeik*, (1996) 1 BCLC 380 the Court of Appeal, referring to the earlier case of *El Ajou v. Dollar Land Holdings plc* (1994) 2 All ER 685 accepted that whether a company is fixed with the knowledge acquired by an employee or officer will depend on the circumstances and it is necessary to identify whether the individual in question has the requisite status and authority in relation to the particular act or omission. Therefore, it does not follow that information in the possession of even a relatively senior official will be attributed to the company if that employee is not empowered to act in relation to the transaction in question. On the other hand, as was dramatically illustrated in the House of Lord's decision in *Re Supply of Ready Mixed Concrete* (No 2), (1995) 1 AC 456 an employee who acts for the company within the scope of his employment, even if against the express instructions of his employer, may well bind the company as he is the company for the purpose of the transaction in question. A similar view was expressed by the Privy Council in *Meridian Global Funds Management Asia Ltd v. Securities Commission* (1995) 2 AC 500. As the decision of their Lordships in *Ready Mixed Concrete* clearly shows, a company may be liable to third parties or be guilty of the commission of an offence even though the relevant employee was acting dishonestly in breach of his contract of service or even against the interests of the company. In that case, the House of Lords accepted that the management had gone to considerable lengths to ensure compliance with their instructions, but once a transaction had been entered into by an employee who had the power to deliver on behalf of the company, such considerations went merely to the issue of mitigation. Whilst the Privy Council recognised in *Meridian Global Funds Management* that it is a matter of interpretation as to whether

a particular statute seeks to 'fashion a special rule of attribution for the particular substantive rule', both the Privy Council and the House of Lords were quite prepared to adopt this notion of 'merger' of minds in the case of restrictive trade practices law and securities regulation, given the discerned public policy in avoiding a result which might defeat the purpose of the legislature. Where the employee in question is perpetrating a fraud against his employer, then it is obviously inappropriate to take his knowledge of the fraud as being that of the victim company. This much is clear from *Re A-G's Reference (No 2 of 1982)* (1984) 2 All ER 216. See also generally Cheong-Ann Png, *Corporate Liability* (2001, Kluwer). In such situations, the employee cannot be both a party to the deception and represent the company for the purpose of it being deceived. When the company is the victim, the person or persons who may be taken to represent its state of mind may well differ from those whose state of mind will be attributed to the company in cases where it is the company that is charged with an offence. In *Rozeik*, the Court of Appeal thought that in this latter situation such persons are more likely to represent what Viscount Haldane called 'the directing mind and will of the corporation (*Lennard's Carrying Co Ltd v. Asiatic Petroleum Co Ltd (1915) AC 705*).

## Throwing the Net

Our discussion has so far focused on the directors of companies and in particular the issue of conflict of interest. Of course, in the context of financial service industry, for example, the range of fiduciary relationships is somewhat wider. There will be many individuals and companies that find themselves owing fiduciary obligations who are not in the position of directors. (See generally C. Nakajima and E. Sheffield, *Conflicts of Interest and Chinese Walls* (2002 Butterworths); B. Rider and T.M. Ashe (eds), *The Fiduciary, the Insider and the Conflict* (Sweet and Maxwell 1995) and C. Hollander and S. Salzedo, Conflicts of Interest (3rd Ed Sweet and Maxwell 2008).) The regulatory system has imposed obligations relating to the control and management of conflicts of interest and duty on persons who would not, in law be considered fiduciaries. It is also the case that the regulatory system and its rules have not always been in compliance with fiduciary law. (See generally *Law Commission, Fiduciary Duties and Regulatory Rules, A Consultation Paper (LC No 124) (1992) HMSO; Law Commission, Fiduciary Duties and Regulatory Rules, Report (LC No 236) (1995) HMSO* and B. Rider (Ed), *The Regulation of the British Securities Industry* (Oyez 1979) Ch 5) and certainly the reliance that some have placed on following industry practice and even regulatory guidance may as a matter of law be misplaced. There are numerous conceivable situations where conflicts of interest and duty may arise in the conduct of financial business. This is not the place to try and identify these let alone address them. It is also the case that the intervention of law on a much broader basis has made a considerable difference in resolving certain conflicts. For example, today it could not be sensibly argued that a stockbroker who learnt unpublished price sensitive information is under a duty to use it for the benefit of his client. (But note G Cooper and R Cridlan, *The Law and Procedure of the Stock Exchange* (Butterworths 1971) at page 104 and also see the allegations in *Briggs v. Gunner*, Chancery Division 16 January 1979.) The same would also be true of a trustee in the prudent management of the trust funds. (But see *Phipps v. Boardman* (1967) 2 AC 46 and B. Rider "The Fiduciary and the Frying Pan" (1978) *Conveyancer* 114.)

However, potential conflict issues may arise that have not been considered with as much thought. Today there is considerable interest in Shari'ah compliant investment services. Indeed, China has participated in the deliberations of the Islamic Financial Services Board and the Monetary Authority in Hong Kong is actively considering how best to facilitate development. None the less, Islamic law is in some respects rather vague in regard to stewardship. For example, the position of members of a shari'ah council advising financial institutions on issues of shari'ah compliance in regard to different products and funds may raise issues of conflict and handling of price sensitive information. It will not always be clear where fiduciaries operate in multiple functions or for different clients who is entitled to primacy and on what basis. The traditional rules of equity that give primacy in the discharge of a duty to those who are first in time — subject to issues of notice is not in the context of the realities of financial life practicable. (See for example *Anglo-*

*African Merchants Ltd v. Bayley* (1969) 1 All ER 421 and *North and South Trust Company v. Berkeley* (1971) 1 All ER 980.) Attempts to expand and apply rules based on simple conflicts between two principals, in the context of simple commercial transactions or agency agreements, have also proved inadequate for the task. Referring to the strict rules of confidentiality and no conflict developed, for example, in the practice of law tends to neglect the public policy issues that dictate exacting standards as a matter of justice, which are arguably inappropriate in the world of business. Reliance on so called 'Chinese walls' and other methods of segregating information, focus on liability attaching to the flow of information and knowledge rather than the issue of conflict of duty. (See for example *Financial Services in the UK, A new framework for investor protection, DTI* (1985) Cmnd 9432 HMSO para 7.4 *'the Government is not convinced that total reliance can be placed on Chinese Walls because they restrict flows of information and not the conflicts of interest themselves.'* See also *Dunford & Elliott Ltd v. Johson & firth Brown Ltd* (1977) 1 Lloyds law Reports 505 at Roskill LJ. at 515.) While the regulators and professions have attempted to deal with some of these issues, given the complexity of the issues and vested interests successive governments have been reluctant to resort to legislation and the matter has somewhat pragmatically been left largely in the hands of the courts.

## No Remedy, No Breach!

Before leaving the issue of fiduciary responsibility in cases of self-dealing and abuse it is important to recognize that the issue as to whether a cause of action exists is a different albeit in practice related issue, to whether an appropriate remedy is available. The Courts do not like to find themselves in a situation where they are powerless to provide a remedy which will give effect to their determination as to the merits of a matter. Of course, in many ways the common law has developed around the existence of remedies and perhaps historically the courts have not focused as much as they might have on the issue of rights as opposed to remedies. As we have seen it used to be said that damages were a common law remedy and could not be awarded for merely a breach of fiduciary duty. Of course, in many cases the breach of a fiduciary obligation will not stand alone and there may well be causes of action in tort and contract. While the award of damages is not traditionally a remedy of the Courts of Equity, Chancery Courts were prepared to make financial orders. For example, as we have seen a fiduciary who made a secret profit or received a bribe could be ordered to account for this and hand it over to his principal. In appropriate cases interest could be ordered or an account surcharged, and in cases of fraud this interest might be compounded. It was also possible in some situations to put the parties on terms. In other words, condition the award of an equitable remedy such as specific performance or rescission, by the undertaking of one party to make financial contribution to another. Section 50 of the Supreme Court Act 1981 provides that the English courts may award damages in addition to or in substitution for, an injunction or specific performance. It should be noted that it is only in regard to such a provision it is appropriate to speak in terms of equitable damages as opposed to equitable compensation. Equity is also able in certain cases to impose trusts and in effect charges on money and other property and demand that it be delivered up to those entitled to it. Consequently, it has never been the case that equity was powerless in regard to issues of financial compensation. Within many common law countries the merger of the common law and equitable jurisdictions, at least in the making of orders to facilitate the administration of justice, cases arose in which it was unclear whether an award of damages was being made by the judge wearing his common law or equitable hat. Many jurisdictions in effect allow their courts to award what passes for damages in cases of breach of fiduciary duty. In some cases this is pursuant to statutory provisions. It has been said, for example, by the Court of Appeal of New Zealand, that there is no difference in the rules of remoteness in the award of damages or compensation for breaches of, for instance, the common law duty of care or the fiduciaries obligation to exercise care and prudence. (See B. Rider "A Special Relationship on the Special facts" 41 *Modern Law Review* (1978) 585.) This is not the case, however, in every jurisdiction and the availability of a financial order in cases of a breach of fiduciary duty standing on its own, cannot be taken for granted.

The law of restitution has developed significantly over the last thirty years. It might be claimed with some accuracy that until the 1980s, the law of restitution was a best a rag bag of specific remedies, mostly of an equitable nature, that could be used only in very specific circumstances. While other common law jurisdictions and in particular Australia and New Zealand forged ahead the English courts showed rather more caution. We have already noted that there is, at least traditionally, no claim for damages in equity, albeit there is a reasonably expansive and perhaps ever expanding jurisdiction to award compensation. Where there is a trust and a misapplication of funds, whether capital or income, the beneficiary has an election to simply take over the investment into which the money has been placed or reject it. The trustee in breach is required to make good any depreciation in the value of the trust as a result of his breach. We have seen that he can be charged interest and surcharged. Where there is no trust, those to whom the fiduciary obligation is owed may seek equitable compensation. In English law it seems that the principles behind the Court's discretion to award equitable compensation, in terms of causation, remoteness and measure are the same as in damages claims. (See Lord Browne-Wilkinson in *Target Holdings Ltd v. Redferns* (1996) AC 421.) The object of any award is to place the trust or beneficiaries in the position, at the day of trial, they would have been in had the breach of duty not occurred. While this approach appears to be correct where the relevant breach of duty is essentially a common law duty, such as the duty to act with diligence or care, it has been authoritatively doubted whether it is appropriate where what is in issue is the breach of a purely fiduciary obligation. In such cases the obligation to make restoration occurs at the time of breach and the common law approach to causation is irrelevant. To hold otherwise would be to undermine the special obligations of a fiduciary. Where the beneficiary rejects a misapplication of funds, what has happened after the breach is irrelevant. The fiduciary is under an obligation to make good the trust or fund as it was at the time of breach. This approach was taken in a case of equitable fraud and the directors or a company had to make full restoration to the company and could not simply pay over the difference between the value of the unlawful dividend and the value of a lawful dividend that they could and would have in fact paid (*Bairstow v. Queen's Moat Houses plc* (2001) BCLC 531). In this case the Court of Appeal emphasized that they were stewards and had acted dishonestly. In another case involving an allegation of fraud in equity, the court held that the defendant 'is liable to restore the plaintiff to the situation he was in when the defendant did him wrong' much in the same way as the courts treat common law fraud (*Swindle v. Evans* (1997) 4 All ER 705). It is open to debate whether the basis for awarding equitable compensation is the breach of fiduciary duty – the obligation of stewardship, or the loss that is occasioned as a result of the wrongdoing. It is interesting that in the *Swindle v. Evans* Mummery LJ stated 'in considering the extent of liability for breach of fiduciary duty it is not always necessary to consider all the matters which may be relevant in determining' a claim based on negligence. Sir John observed *'Foreseeability and remoteness of damage are, in general, irrelevant to restitutionary remedies for breach of trust or breach of fiduciary duty. The liability is to make good the loss suffered by the beneficiary of the duty'* ((1997) 4 All ER 705). He added, however, that it is necessary to consider the issue of causation.

As we have seen in our discussion above one of the most important restitutory remedies is the imposition of a constructive trust on property or money. In so far as the imposition of a trust establishes a proprietary relationship between the relevant funds and those entitled, which can have significance in cases of insolvency, it is questionable whether at least in English law it is appropriate to regard the constructive trusts as remedial. It is a way of holding property. In other jurisdictions, while the proprietary nature is still present, it has been seen as rather more of a remedial than proprietary device. Where there is a misappropriation or wrongful disposal of trust property, then as we have seen, the property in which the money is invested may be subjected to the original trust or the beneficiaries may reject this and petition the court for equitable compensation. If they take the property, there may still be a claim for any shortfall. Fiduciaries as we have seen may also be liable for secret profits and other unauthorized benefits that they have received by virtue of their fiduciary position. In such cases it is said that the imposition of a trust on those benefits is a constructive trust. It is a new trust, whereas in the case of a misapplication, equity reaches out and brings the property that now represents the diverted funds as the original trust. Until

relatively recently, it was not clear whether all benefits obtained by virtue of a fiduciary relationship, could be subject to a constructive trust or traced. As we have seen, the cases appeared to distinguish between secret profits tainted because of lack of authority and the potential for conflict on the one hand and the receipt of a bribe on the other. In the case of a bribe there was merely a personal obligation to account. The Privy Council in *A-G for Hong Kong v. Reid*, as we have seen, disapproved of such a distinction and considered that applying one of the maxims of equity — equity looks as done that which should be done, a constructive trust could be recognized in regard to properties purchased with the proceeds of a bribe ((1994) 1 AC 498.) It is now the better view that any benefit obtained by virtue of a fiduciary office will be potentially traceable and subject to a constructive trust.

We have referred to the personal obligation of a fiduciary to account for secret profits and, indeed, any benefit that he receives in breach of his duty of loyalty to his principal. We have already seen that calling a fiduciary to account and demanding the disgorgement of profits that he has made by virtue of his fiduciary status, in no way depends upon establishing loss to the principal. It is enough that he has violated his fiduciary obligation. We have also seen in our discussion of the possible use of this restitutory remedy in cases of insider abuse that it only applies to profits and not the avoidance of losses. It is also probably limited to benefits that arise, directly or at least traceably in the hands of the fiduciary himself. While an account for profits is properly an equitable device, recent cases have indicated that a similar liability may be invoked in common law actions. In *Attorney-General v. Blake*, a former British spy profited from the publication of a book in breach of among other things his contract of employment with the British Government. The House of Lords recognized that there existed a power to call the defendant to account for his profits, as the Government *'had a legitimate interest in preventing the defendant's profit making activity and, hence, in depriving him of his profit'* ((2001) 1 AC 268). While the boundaries of this remedy are unclear, it is necessary to show that the normal action for contractual damages would not be adequate or fair. It should also be noted that the English courts have allowed the award of damages and in many cases an accounting of profits where there has been a misuse of confidential information and particularly intellectual property rights. (See *Seager v. Copydex* (No 2) (1969) 1 WLR 809 see also in regard to inside information *Dunford and Elliot Ltd v. Johnson & Firth Brown Ltd* (1977) 1 Lloyd's Rep 5050.)

## Fraud and the Abuse of Opportunity

Let us now examine the relevant law relating to fraud which has in practice played probably the most significant role in inhibiting self-dealing. The dividing line between the criminal and civil law with regard to fraudulent conduct has never been entirely clear in English law. Indeed, one of the earliest causes of action, that of deceit, involved considerations of almost a penal nature. Given the harm that allegations of dishonesty can cause to individuals, particularly if they are in business, the courts have always been concerned by way of procedure and proof to ensure as far as is practical that such allegations are not made and pursued wantonly. Therefore, as a matter of pleading in the civil law, averments of fraud must be specially pleaded with all the relevant facts establishing the specific averment set out. While there is a difference between the standard of proof in an ordinary criminal trial and one for fraud in the civil law, judges have often emphasised that as the seriousness of the allegation increases in criminal proceedings, the standard of proof that is required to be met will be more exacting. Therefore, in practice, there may not be a great deal of difference between the standards of proof required to establish fraud in the civil and criminal law, particularly when it is remembered that in most cases considerable reliance will need to be placed on documentary evidence. Where allegations of fraud or deliberate misconduct involving moral turpitude are made and persisted with in circumstances which the court considers unjustified, there will be serious cost implications for the plaintiff and on occasion judges have expressed their disapproval of counsel.

The issue of fraud may arise in the civil law in a number of ways. However, since *Paisley v. Freeman* (1789) 3 TLR 51 it has been the rule that if a person knowingly or recklessly, i.e. not caring whether it is

true or false, makes a statement to another with the intention that it shall be relied upon by that person, who in fact does rely on it and as a consequence suffers harm, then an action in deceit will be available. It is the need for the plaintiff to establish that the defendant acted with actual knowledge or could not care less whether what he said was true or not, which distinguishes liability in fraud from, for example, liability in the tort of negligence. (See *Derry v. Peek* (1889) 14 App Cas 337.) In the case of negligent misstatement, the defendant will be liable if an ordinary reasonable person would have known that what was said was untrue, i.e. the standard is objective. Where a person has been induced to enter into a contract as a result of a fraudulent misrepresentation, the law provides remedies or rescission and damages. While rescission may be a more attractive remedy in the case of investment transactions, it will not always be available. There is a strict rule which requires full restoration of property transferred under the relevant contract, i.e. the parties must be restored to their original position. It follows that if the victim of the fraud, rather than run the risk of a further, perhaps unrelated, diminution in the value of his securities, disposes of them, he will have lost his right to rescind. In *Smith New Court v. Scrimgeour Vickers* (1994) 4 All ER 225, Nourse LJ observed that, in the case of a fungible asset like quoted shares, the rule which requires restitution *in specie* is a hard one and in cases of fraud it was clear that the court had little sympathy with it, although in the circumstances it was not appropriate to depart from it. The rule works harshly, particularly in the case of an omission to disclose information which does not give rise to an independent cause of action for damages. (See *Banque Keysey Ullman v. Skandia* (1989) 2 All ER 952.) In an action for damages, the courts have been concerned to ensure that a fraudster takes no benefit from his fraud or the false circumstances that he has created. In Clark v. Urquhart, Stracey v. Urquhart (1930) AC 28 at 68, Lord Aitkin emphasised that the measure of damages is the 'actual damage directly flowing from the fraudulent inducement' and this includes consequential loss. (See *Doyle v. Olby (Ironmongers) Ltd* (1969) 2 All ER 119.) On the other hand, depreciations of the value of shares by market forces operating after the date of acquisition does not flow directly from the fraudulent inducement, but from the purchaser's decision to retain the shares and accept the hazards of the market rather than sell at once.

The historic relationship between causes based on deceit and in the tort of negligence has already been alluded to. As it is not necessary for a plaintiff in an action for damages to specify the particular tort which he is seeking to rely on for a remedy, provided he asserts and establishes the facts required for liability under at least one accepted cause of action, there may in practice be little lost in not alleging to being able to prove dishonesty, given the court's attitude to allegations of fraud. Apart from the desire to brand a person as a fraudster, it remains possible to obtain exemplary damages in cases of proven fraud and the statue of limitation may be more favorable, but in the majority of cases plaintiffs are well advised to refrain from specific averments of fraud. In the case of misrepresentation inducing a contract between the parties, the statutory remedies for negligent statements provided by the Misrepresentation Act 1967, S.2(1) are, in practical terms, superior to an action in tort. Under S. 2(1), the person responsible for the misrepresentation has the burden of establishing that he had reasonable grounds for believing and did in fact believe what he said to be true.

As we have seen, the issues of fraud may also be relevant in other actions such as conspiracy and under specific statutory provisions giving rise to a civil remedy. Equity follows the law and will not enforce a bargain that has been procured by fraud. Furthermore, the courts have developed a form of restitutionary liability for those who receive property transferred in breach of trust or who facilitate the laundering of such property with the requisite degree of dishonesty. (See *Agip (Africa) Ltd v. Jackson* (1992) 4 All ER 385 at 451; *El Ajou v. Dollar Land Holdings plc* (1993) 3 All ER 717 and *Royal Brunei Airlines Sdn Bhd v. Tan* (1995) 2 AC 378.) It must also be remembered that whilst there have been significant developments in the criminal law facilitating the taking and receipt of evidence from overseas, the civil law provides far greater weapons in obtaining evidence and discovery, in freezing funds and in enforcing orders of the court.

We will examine first a particularly interesting aspect to the law of fraud and one that has been of some relevance in the context of Hong Kong. (See for example the extended discussion of Section 3 of Prevention of Fraud (Investments) Ordinance in B. Rider 'The Regulation of Insider Trading in Hong Kong' (1975) 17 *Mal. L. Rev* 310 continued (1976) 18 *Mal. L. Rev* 157 and also B. Rider, *Report to the Attorney General of Hong Kong on the Investigation and Prosecution of Fraud and Corruption in Hong Kong: Proposals for Reform* (1978).) The early English law recognised that certain forms of conduct could undermine the efficient and fair operation of markets and there were common law offences, such as 'forestalling, regrating and cornering', as early as the eleventh century. These were later superseded by statutory offences and today survive, to some degree, within the offence of conspiracy to defraud. The English Courts have long taken a dim view of attempts to interfere in the proper workings of the markets. For example, in *Rubery v. Grant* (1872) 13 LR 443, Sir Robert Malins VC considered that to allege that a person was a member of a share rigging syndicate amounted to an allegation that they were dishonest. He added:

> *'going into the market pretending to buy shares by a person whom you put forward to buy them, who is not really buying them, but only pretending to buy them, in order that they may be quoted in the public papers as bearing a premium, which premium is never paid, is one of the most dishonest practices to which men can possibly resort'.*

The learned judge went on:

> *'there is a class of people who think it is a legitimate mode of making money, but if they would only examine it for a moment they would see that a more abominable fraud, and one more difficult of detection, cannot be found'.*

The first reported English case to be decided by the English courts, or at least reported, is that of *R v. De Berenger* (1814) 105 ER 536. This case involved one of the most audacious frauds ever perpetrated on a stock market. The United Kingdom had been at war with France for over two years and the price of British government stock was naturally depressed. The conspirators sought to raise the price of stock on the London Stock Exchange, enabling them to dump securities that they had already acquired, by spreading rumours that Napoleon had been killed and that peace was certain. The London Stock Exchange appointed a committee of inquiry which discovered the relevant facts. De Berenger and seven others were indicted of:

> *'unlawfully contriving by false reports, rumours, acts and contrivances, to induce the subjects of the King to believe that a peace would soon be made … thereby to occasion without any just or true cause a great increase and rise of the public government funds and the government securities of the Kingdom … with a wicked intention thereby to injure and aggrieve all the subjects of the King who should, on 21 February, purchase or buy any part or parts, share or shares of and in said public government funds and other government securities'.*

The defendants contended that seeking to raise the price of securities in the market was not of itself a crime and that there was no criminal conspiracy without some allegation that they had intended to cheat certain investors or cause harm to the government. Indeed, it was argued that it was in the government's interest that the price of its securities should be kept high.

The court, however, had little sympathy for such arguments and held that it was not necessary for the Crown to allege, let alone prove, that anyone had in fact been misled and injured. Both the means used, along with the object of the enterprise, were unlawful. The public had the right to expect that the market had not been interfered with by wrongful means. Lord Ellenborough stated:

> *'A public mischief is stated as the object of this conspiracy; the conspiracy is by false rumours to raise the price of the public funds and securities and the crime lies in the act of conspiracy and combination to effect that purpose and would have been complete although*

*it had not been pursued to its consequences, or the parties had not been able to carry it into effect. The purpose itself is mischievous, it strikes at the price of a vendible commodity in the market and if it gives a fictitious price, by means of false rumours, it is a fraud levelled against all the public, for it is against all such as may possibly have anything to do with the funds on that particular day. The excuse is that it was impossible that they should have known, and if it were possible, the multitude would be an excuse in point of law. But the statement is wholly unnecessary, the conspiracy being complete independently of any persons being purchasers. I have no doubt it must be so considered in law according to the cases'.*

The decision in De Berenger does not address directly, however, the issue as to whether it is an indictable conspiracy to interfere with the proper operation of the markets, not through the circulation of false rumours and information, but by a course of dealing. Under the ordinarylaw, it is possible to make a statement by word or by conduct, so as a matter of principle manipulative conduct could be regarded as constituting a false and misleading representation.Nonetheless, in *De Berenger*, one of the learned judges said:

*' … the raising or lowering the price of the public funds is not per se a crime. A man may have occasion to sell out a large sum, which may have the effect of depressing the price of stocks, or may buy in a large sum, and thereby raise the price on a particular day, and yet he will be guilty of no offence. But if a number of persons conspire by false rumours to raise the funds on a particular day, that is an offence and the offence is, not in raising the funds simply, but in conspiring by false rumours to raise them on that particular day'.*

In a subsequent civil case involving an action for rescission against a stockbroker who had agreed to purchase shares on the Stock Exchange on behalf of the plaintiff for the sole purpose of creating trading on the market at a premium in order to create the impression that there was a thriving market and thereby induce other investors to purchase, in denying rescission, the court expressed the view that the relevant agreement amounted to a criminal conspiracy to defraud the public (*Scott v. Brown, Doering, McNab & Co* (1892) 2 QB 724). The view was expressed by Lopes LJ that there is 'no substantial distinction between false rumours and false and fictitious acts'. On the other hand, it is also clear that not every concerted intervention into the market to hold a price will be considered manipulative. Furthermore on the English authorities there is a distinction between manipulation and what we describe today as stabilisation.

It is important to remember when considering these authorities that the law might not necessarily be the same in the case of a criminal and a civil conspiracy and different considerations apply as to whether the persons concerned are being prosecuted for a criminal offence, are seeking to enforce an agreement inter-party or are being sued before the civil courts by an innocent third party. Unfortunately, the judges, in categorising certain conduct as illegal, do not always observe these distinctions. It would seem that a conspiracy to influence the price of shares or other securities on a market by making false statements or by engaging in purposeful conduct, such as a series of transactions with the intention of misleading the market, will be a conspiracy at criminal law. Conspiracy to create a public mischief no longer exists in English law, but the facts in the relevant cases would fall within the scope of conspiracy to defraud today. Generally speaking, however, it would be appropriate for the prosecution to allege a statutory conspiracy to breach the FSMA 2000, S.397(1)(a), (b) or (c). Considerable discussion has taken place over the years as to the proper scope of conspiracy in the criminal law. The Law Commission's working party published a consultation document in 1973 in which it concluded that the crime of conspiracy should be confined to an agreement to commit a specific offence. In other words, the mere agreement to engage in a course of conduct, no matter how malicious, should not of itself constitute a crime, unless the conduct in question was itself a specific offence. The Law Commission took the view, however, that there were situations covered by the crime of conspiracy to defraud which might not be susceptible to this approach. (See

*Working Paper 50*, 'Inchoate Offences' and *Working Paper 56*, 'Conspiracy to Defraud'.) The Criminal Law Act 1977, section 1 enacted a statutory offence of conspiracy to replace the common law offence of conspiracy. This reflected the Law Commission's view that the crime of conspiracy should be limited to circumstances where the object of the agreement is to commit an act which would itself be a substantive offence already known to the criminal law. However, the Criminal Law Act 1977, Section 5(2) excepted the common law offence of conspiracy to defraud which remains outside section 1. Discussion has taken place as to whether conspiracy to defraud should remain an exception to the general rule. The Law Commission report 'Criminal Law: Conspiracy to Defraud' (1994 HMSO) takes the view that it still has a role to play. This is illustrated in *Adams v. R.* (1995) 1 WLR 52. The Privy Council was of the opinion that an agreement to conceal transactions with regard to which there was a fiduciary duty of disclosure, so that those responsible might avoid being called to account for their unauthorised profits, amounted to an indictable conspiracy to defraud.

## Fraud (by Representation or Conduct)

The early common law recognized the importance of punishing conduct that involved fraud and also providing those harmed by it, with recompense. However, in common with many other legal systems the law has had difficulty in determining exactly what is fraud. In the context of the civil one of the leading works on the subject *(Kerr on the Law of Fraud and Mistake) states 'It is not easy to give a definition of what constitutes fraud in the extensive signification in which the term is understood by the Civil Courts of Justice. The Courts have always avoided hampering themselves by defining or laying down as a general proposition what shall be held to constitute fraud. Fraud is infinite in variety. The fertility of man's invention in devising new schemes or fraud is so great, that the courts have always declined to define it… reserving to themselves the liberty to deal with it under whatever form it may present itself. Fraud, in the contemplation of a Civil Court of Justice, may be said to include properly all acts, omissions, and concealments which involve a breach of legal or equitable duty, trust or confidence, justly reposed, and are injurious to another, or by which an undue or unconscientious advantage is taken of another. All surprise, trick, cunning, dissembling and other unfair way that is used to cheat any one is considered fraud. Fraud in all cases implies a wilful act on the part of any one, whereby another is sought to be deprived, by illegal or inequitable means, of what he is entitled to."*

In the context of the criminal law there has been concern as to the fairness of such vagueness and in many countries attempts have been made to provide what passes for a definition. In reality most do little more than recite the ways in which the courts have identified something as fraudulent. Paradoxically, in Britain after much discussion and an extensive Fraud Review ordered by the Attorney General in July 2006, a new law was enacted which in many respects broadens the crime of 'fraud'. Judge Alan Wilkie QC, then one of the Law Commissioners of England and Wales in referring to an earlier report by the English and Welsh Law Commission on Fraud, published in July 2002, stated that the objectives of a new law should be "to make the law of fraud clearer and simpler… (and) as a result all concerned whether jurors, police, victims, defendants or lawyers, will be better placed to understand who has committed a crime and who has not". (See generally the *Fraud Report No 276, Law Commission; Law Commission, Legislating the Criminal Code: Fraud and Deception (Consultation paper No 155, 1999*.) In so far as the new Fraud Act 2006 bases liability on the concept of 'dishonesty' it remains to be seen whether there is any greater certainty. In the United Kingdom there is only one offence of fraud in this new Act. It may be committed in three broad ways under Section 1. Firstly, by a false representation (Section 2). Secondly, by failing to disclose information in regard to which there is a legal duty to disclose (Section 3) and thirdly, by abuse of a position in which one is expected to safeguard, or not to act against, the financial interests of another person (Section 4). The offence is committed if what is done is done dishonestly with a fraudulent intention. Thus, it is the state of mind that is the determinant factor in liability.

Dishonesty is a core and, indeed, protean concept, in fraud. Dishonesty is a question of fact, not law. Thus, the appropriate instruction, according to English law, to the jury is – where the prosecution has proved that what the defendant did, was dishonest by the ordinary standards of reasonable and honest people, must the defendant have realized that what he was doing would be regarded as dishonest by those standards? (See *R. v. Ghosh* 75 Cr App R 154.) It is important to note that it is for the jury to decide what the relevant standards of honest behavior are. Furthermore, in considering whether the defendant actually appreciated that what he was doing violated these standards, the jury must consider the defendant's own state of mind at the relevant time. The second element that must be established is that of fraudulent intent. In establishing that a fraud has been committed, it must be proved that in making the false representation, failing to disclose information, or abusing the position, the defendant intended to make a gain for himself, or for another, or to cause loss to another, or expose another to a risk of loss. It is important to note that the offence is complete if what is done is done with the requisite intention, the fact that a gain or loss occurred or did not, is irrelevant. It is the defendant's intention that is determinant. It is not without interest that the English Law Commission in its *Report on Fraud* (2002, para 7.53) stated that "fraud is essentially an economic crime, and we do not think the new offence should extend to conduct which has no financial dimension". Thus, gain or loss is stated in the Act only to apply to 'money or other property'. However, gain or loss does extend to a temporary gain or loss. There is no need for the defendant to intend to achieve a permanent gain or loss.

Establishing dishonesty to the satisfaction of the court has been said to be one of the main stumbling blocks to securing more convictions. Juries have been criticized for not having the expertise and understanding to properly understand the facts that are placed before them and on occasion a similar complaint has been made about judges. The complexity of information and in particular documents placed before the court is often perceived to be a significant hurdle in achieving the level of appreciation upon which a sound determination of the facts can be made. On the other hand in common law jurisdictions it is often said that once the jury or judge 'sniffs' the stench of dishonesty, it is not difficult to find it. Given that the determination as to what amounts to dishonest conduct is in most cases an issue for the jury, proof of intention is probably more problematic. It is important to distinguish the question as to what the defendant's intention was, from what his motive may have been. Generally speaking motive is an irrelevant issue in the determination of criminal liability. While it may be of significance, for other reasons such as classification, profiling and detection, motive is generally no concern of the court until sentencing. Intention is generally a straightforward issue, as a person intends something if he acts with the purpose of causing that result. Thus, juries will often be simply instructed to be sure that the defendant did the act, he intended.

Intent may, however, not always be so simple. In many systems of law, the courts distinguish between direct and indirect or oblique intent. Direct intent is as we have set out, that is where the consequence is desired and the defendant seeks to bring it about, or, at least strives to. Indirect intent is where the defendant realizes that the consequence is certain, or virtually certain, as result of what he does or does not do, but he does not in any positive sense desire it, and yet proceeds. Oblique intention would normally be sufficient for a determination that the defendant has the required fraudulent intention. Thus, a result is intended when it is the defendant's purpose to cause it, or though it is not the defendant's purpose to cause it, the result is a virtually certain consequence of the act or omission, and he knows that it is a virtually certain consequence. It is necessary, however, to distinguish intention from recklessness. If the defendant foresees a consequence as likely or even possible as a result of his actions and yet proceeds, and in the result that consequence does in fact occur, the defendant can be said to have caused the result recklessly. It is important to note that even a very high degree of foresight as to a given consequence is not the same thing, in law, as an intention. Nevertheless, if the jury accept that the defendant was virtually certain that a specific result would occur and it did, it would not be unreasonable for the jury to conclude that the defendant did in fact intend it.

The offence of fraud will be committed if the defendant, with the requisite mens rea, makes a false representation. The representation may be made by word or conduct, express or implied, in regard to any fact, including the state of mind of the person making the representation or another. It may also, unlike generally in the civil law, be a representation as to the law. It will be a false representation if it is untrue or misleading and the person responsible for the representation knows that it so. The Fraud Act also provides that a representation may be regarded as made if it, or anything implying it, is submitted in any form to any system or device designed to receive, convey or respond to communications, with or without human intervention. It should be noted that under the new English law the offence is based on the making of a misrepresentation by the defendant and not the deception of the victim. The focus for liability is the conduct of the defendant and not the effect of that on the mind of the victim.

Returning to the issue of what is a representation the experience of the English criminal law is based very much on the law of contract. A representation in the law of contract is a statement, by word or conduct, of material fact, made by one person to another during the negotiations leading up to contract, which was intended to be relied upon, and was in fact relied upon, but which was not intended to be a binding contractual term. Where that representation is false or misleading it is properly termed a misrepresentation. The state of a man's mind — is according to the law, as much a statement of fact as the state of a man's digestion. (*Edgington v. Fitzmaurice* (1885) 29 Ch.D. 459 at 483 per Bowen LJ and *British Airways Board v. Taylor* (1976) 1 All ER 65 at 68, *per* Lord Wilberforce.) It follows that a false statement as to one's current intention is a misrepresentation of fact. By the same token an assertion of belief in the existence of certain facts, even the likelihood of future events, may be a misrepresentation of the fact that the person making the statement actually had, at that time, such a belief.

Attributing legal responsibility for mere silence or in action, as we have seen, is always a problem in the law. Generally speaking there is no duty to disclose material facts and therefore mere silence cannot be considered to amount to a representation. There is no indication in the Fraud Act that the law has changed. Having said this, it has been argued that where an ordinary and honest person would consider it right to speak out, and such a person appreciating this, does not, then the very dishonesty of his conduct, might justify liability. The problem with this argument is that there is still no representation as such. It is highly doubtful whether dishonesty can itself create an obligation of disclosure. In the general law of contract, there are only three situations where silence may be regarded as tantamount to a representation. Firstly, where there is a half-truth. If only half the truth is told, and the result is misleading, then the civil law normally imposes on the person responsible for the half-truth an obligation to correct the false impression. Secondly, a representation that is true when made, but is later falsified by events or in some cases a change of intention, would normally require correction. This reflects the notion that a representation continues to operate as an inducement to contract until the contract is entered into. Thirdly there is a special class of contracts of utmost good faith — *uberrimae fide*. In these exceptional circumstances the law, by tradition, imposes an obligation to affirmatively disclose all material facts relating to the contract. Fiduciaries are under duty in dealing with their principals and beneficiaries to act in good faith and this, while not entirely accurately may be considered to be to all intents and purposes within the scope of the duty of *uberrimae fide*. However, in the case of fraud by persons in a fiduciary position it would probably be better to resort to the provisions in the English Fraud Act 2006 imposing liability for fraudulent taking advantage of ones special position. Indeed, it was partly because of the uncertainties as to the scope of the obligation to disclose in the course of fair dealing that justified the enactment of these specific provisions. Having said this, the dishonest failure to disclose information that should be disclosed, even on the basis of a fiduciary relationship, such as between a director and his company, may amount to a conspiracy to defraud.

For liability, the representation must be untrue or misleading. Under the English law it would seem that there might be liability in the criminal law for the making of an untrue statement, which the defendant,

does not know is untrue, but does appreciate might in the circumstances be misleading. Misleading, in this context, means less than wholly true and capable of an interpretation to the detriment of the victim. In the case of the criminal law, where it is not necessary, at least in the United Kingdom, to consider whether it actually influenced the mind of the person to whom it was addressed, issues of reliance are irrelevant. Of course, where what is said is so ridiculous no reasonable person would rely upon it, the jury or court may find the defendants conduct does not fail to meet the standards of ordinary and honest people. Of course, this is all rather subjective.

As we have pointed out, the reformed criminal law in the United Kingdom in regard to fraud has a different emphasis than in many other jurisdictions. One point that is worthy of note is that the United Kingdom law does not require proof of materiality. This is an important issue in many provisions relating to false statement in other countries. A good example in the US Federal law is section 1001 of Title 18 USC. This makes it a criminal offence to falsify, conceal or cover up by any trick, scheme or device a material fact, the making of any materially false, fictitious, or fraudulent statement or representation or making or using any false writing or document knowing that it contains any materially false, fictitious, or fraudulent statement or entry. In determining whether a false statement or concealment is material the US courts examine whether the statement has a natural tendency to influence, or be capable of influencing, the decision of the other party. It is not necessary to prove that the victim was actually influenced let alone the victim relied on it. The Supreme Court considers that the issue of materiality involves questions of both fact and law and should therefore be submitted to the jury.

Section 3 of the Fraud Act in the United Kingdom, provides that the offence of fraud may be established if a person dishonestly fails to disclose to another person information which he is under a legal duty to disclose, intending thereby to make a gain for himself or another, or to cause loss to another or to expose another to a risk of loss. We have already seen that generally the law does not place an obligation on a person, even during the negotiation of a contract, to disclose information that he appreciates would be material to the other party's decision. However, there are situations where by statute, contract, custom and fiduciary obligation a duty to disclose facts arises. We have already seen that in certain circumstances there may also be a duty to correct the misleading impression resulting from a half-truth or the falsification of a continuing representation. Where the person failing to disclose is not under a specific legal duty to disclose the relevant information, then it may still be possible to find liability, but based on the notion of an implied representation. We have already raised the issue of whether a mere moral obligation to disclose information should be enough to provide a basis for liability. It is important to remember that legal rules do not operate in isolation of each other and there is an interaction between the civil and criminal law. Generally speaking the civil law does not obligate persons to disclose information simply because it would be the right thing to do.

Before the enactment of the Fraud Act it has been claimed that English law did not recognize the offence of criminal breach of trust. The Fraud Act 2006 now specifically addresses this in section 4. A person will be guilty of fraud if he occupies a position in which he is expected to protect or safeguard, or at least not act against, the financial interest of another person and he dishonestly abuses that position, intending thereby to make a gain for himself or another, or to cause loss to another, or to expose another to a risk of loss. It is expressly provided that a person may be regarded as having abused his position even though his conduct consists of an omission rather than an affirmative act. The real issue revolves around who can properly be said to occupy a position where he is expected to safeguard, or not act against, the financial interests of another. It is clear that the formulation is wider than those in a conventional trust relationship, or for that matter fiduciary relationship. It is unclear whose expectation is relevant. Is it the expectation of the victim or a more objective determination? It is also unclear whether the expectation must be reasonable. It seems that it is the intention of the Government that this is a question of fact to be determined by the jury, in the same way as the issue of dishonesty.

As we have seen in our discussion of the fiduciary law in the past there have been problems with imposing criminal liability for diverting so called corporate opportunities and the taking of secret profits. As we have seen corporate opportunity is a contract or other advantageous arrangement that should in fairness have gone to a particular company, but which has been diverted by insiders, typically the directors, for their own personal benefit. The approach of the courts differs and may have rather more to do with the perceived integrity of what has occurred rather than any underlying jurisprudence. There are decisions which treat the opportunity as some kind of expectant property which in good conscience belongs to the company. Therefore, when directors divert it they are in effect stealing or at least misappropriating an asset that belongs to the company. Other courts have been reluctant to treat this as property and have simply sought to impose personal obligations based on conflict of interest on the relevant insiders. There are very few cases where it has ever been thought appropriate to consider a charge theft. Such conduct does, however, in most instances amount to a breach of trust. Directors are under an obligation to safeguard the financial interest of the company and the dishonest diversion or such opportunities would be an offence under the Fraud Act. We have also seen that those in a fiduciary position are forbidden from making a 'secret profit'. This is essentially a profit that arises in the course of the fiduciary obligation and which has not been specifically authorized or consented to, by the person to whom the fiduciary obligation is owed. In most legal systems, the secret profit is owed much in the same way as a debt to the principal, but is not owned by him. In other words, the taking of a secret profit does not involve the misappropriation of another person's property. Provided the taking of a secret profit is now dishonest, it may well amount to a criminal breach of trust.

The common law has not been eager to base liability on the unjust acquisition of wealth in circumstances where a specific wrong has not been committed. Indeed, there are cases in the English courts which affirm that describing something as unfair or even unjust does not of itself establish a cause of action or enable the court to intervene. Of course, where there is an obligation such as in a fiduciary relationship to act fairly the situation is different. The imposition of criminal liability for the acquisition of unexplained wealth, while controversial, is not as radical as some would suggest. Britain imposed in many of its territories and dominions. (See for example, Section 10 of the Prevention of Bribery Ordinance (Cap.201) Hong Kong) provisions relating to the acquisition of unexplained wealth particularly in the case of public officials. These have been adopted in other jurisdictions and now the United Nations Convention against Corruption 2006 urges all countries to enact such laws. Article 20, provides:

> *"Subject to its constitution and the fundamental principles of its legal system, each State Party shall consider adopting such legislative and other measures as may be necessary to establish as a criminal offence, when committed intentionally, illicit enrichment, that is a significant increase in the assets of a public official that he or she cannot reasonably explain in relation to his or her lawful income."*

It is important to remember that many officials are in a position in which they are expected to safeguard or not to act against the financial interests of another person, including the public at large or the state. Consequently, many cases of abuse of office would be potentially an offence under the Fraud Act 2006. In cases where a public official, without reasonable excuse or justification, willfully neglects to perform his public duty or willfully misconducts himself, to the extent that he abuses the public's trust in the office, he is guilty of the common law offence of misfeasance in public office (*Attorney General's Reference* (No 93 of 2003) (2004) 2 Cr App R 23). The collapse of the Bank of Credit and Commerce International (BCCI) led to allegations in Britain and elsewhere that the authorities and in particular the Bank of England had been 'willfully negligent' in their duty to protect depositors. Suits were brought alleging that the Bank of England and certain officers was guilty of the tort of misfeasance (*Three Rivers District Council v. Bank of England* (No 3) (2003) 2 AC 1). These actions failed in part because it could not be established that the Bank of England had acted with willfulness in the breach of its duties.

This paper has examined the existing law primarily in England and Wales relating to self-dealing and abuse in the context of those who are in a fiduciary relationship — a relationship of stewardship in which society recognizes an obligation of fair dealing and integrity. We have also looked at the way in which the criminal law, mainly in the area of fraud imposes liability for dishonest self-dealing. Perhaps, however, the most relevant area of law, at least conceptually, is that relating to the taking and giving of bribes. However, in Britain there has traditionally been little dependence on specific provisions relating to corruption and much more use has been made of the general criminal law and in particular fraud. Over the last two decades there has been growing concern both within and outside the United Kingdom that the law relating to bribery and in particular its enforcement is deficient and in some respects may not comply with Britain's various international treaty and convention obligations. This is not the place to enter into a discussion of these issues. Suffice it to say that the English Law Commission has over the years made a series of sensible proposals for the reform of the law, which in large measure give emphasis to the theme of this paper — stewardship (and a good deal more!) (See in particular, *Reforming Bribery, the Law Commission*, Law Com No 313, 19 November 2008 and *Reforming Bribery, A Consultation Paper, The Law Commission*, Consultation Paper No 185, 31 October 2007.)

As in other countries specific legislative concern has focused on those in public office. Section 1 of the Public Bodies Corrupt Practices Act 1889 provides that 'every person who shall by himself or by or in conjunction with any other person, corruptly solicit or receive, or agree to receive, for himself, or for any other person, any gift, loan, fee, reward or advantage whatever as an inducement to, or reward for, or otherwise on account of any member, officer, or servant of a public body…, doing or forbearing to do anything in respect of any matter or transaction whatsoever, actual or proposed, in which the said public body is concerned, shall be guilty of an offence'. It is further made an offence for any person 'by himself or by or in conjunction with any other person corruptly give, promise, or offer any such benefit as an inducement or reward to such person. Thus it is rendered a crime to take and to give an inducement, in such circumstances. It is only an offence if the bribe is given or offered to or solicited by a member, officer or servant of a 'public body'. While initially concerned with local government bodies, by the Prevention of Corruption Act 1916, it is extended to 'local and public authorities of all descriptions'. Thus, a body which has public or statutory duties to perform on behalf of the public will be a public body for the purposes of this offence. Having said this, there are areas of uncertainty. For example, while officials of a nationalized company would be caught those of a company in partial public ownership would not. It is also questionable as to whether members of the House of Commons are included. Since 2002 bodies in other jurisdictions performing an equivalent function to a body that would be properly considered to be a public body in the United Kingdom is also covered.

The scope of the offence in terms of benefit to be taken or given is extremely wide and includes 'any office, or dignity, and any forbearance to demand money or money's worth or valuable thing, and includes any aid, vote, consent, or influence, and also includes any promise or procurement of an agreement or endeavor to procure, or the holding out of any expectation of any gift, loan, fee, reward or advantage...'. The advantage must be given, solicited or offered, as an inducement to the members, officer or servant of a public body to do something or forbear from doing something in respect of a matter or transaction, actual or proposed, in which that public body is concerned, or as a reward for so doing, or otherwise on account of such. Thus a bribe may serve as a reward for past favors and an inducement to repeat them. However, a reward for past favors is sufficient for liability, even if there was no agreement in advance. The requirement that what is done be proved to be done 'corruptly' has causes difficulty. It is not necessary to show dishonesty as such. Under Section 2 of the Prevention of Corruption Act 1916 where in any proceedings it is proved that 'any money, gift, or other consideration has been paid or given to or received by a person in the employment of Her Majesty or any Government Department or a public body or from a person, or agent of a person, holding or seeking to obtain a contract from Her Majesty or (other public body)' the advantage 'shall be deemed to have been paid or given and received corruptly as such inducement or reward… unless the contrary is proved'. In *R. v. Brathwaite* (1983) 1 WLR 385, it was explained that 'the burden of

proof' in such circumstances 'descends on the shoulders of the defense'. It then becomes necessary for the defendant to show, on a balance of probabilities, that what was going on was not 'corrupt'. It is not without interest that the reversal of the burden of proof has been criticized as unnecessary in Britain by the law Commission (*Law Commission No 248* (1998)) on the basis that under the Criminal Justice and Public Order Act 1994 (Section 34) adverse inferences may be drawn from the failure of a defendant to explain certain circumstances in all cases.


The corruption of agents is addressed in Section 1 of the Prevention of Corruption Act 1906. This provides 'if any agent corruptly accepts or obtains, or agrees to accept or attempts to obtain, from any person, for himself or for any other person, any gift or consideration as an inducement or reward for doing or forbearing to do… any act in relation to his principal's affairs or business, or for showing or forbearing to show favor or favor to any person in relation to his principal's affairs or business…' he commits a crime. The section also provides for mirror liability for anyone who corruptly seeks to induce an agent in this manner. Thus, as in the case of public officials both the taker and giver of favors potentially commit a crime. Agents are defined to include 'any person employed by or acting for another; and the expression 'principal' includes an employer'. It is also made clear that a person serving under the Crown, any public body, or under any corporation, or local authority or board of guardians, is an agent. While in theory interesting legal issues might arise in regard to the scope of agency and whether if, for example, an employee acting outside his authority, is still an agent, in practice these have not arisen. The Anti-Terrorism, Crime and Security Act 2001 in Section 1(4) provides that for the purpose of determining whether a person is within the scope of this offence it is immaterial if the principal's affairs or business have no connection with the UK and are conducted outside the UK and the agent's functions have no connection with the UK and are carried out in a foreign country. We have already noted that this Act also extended the definition of public body to overseas public bodies.

Bribery of a public officer is a common law offence and the receipt of a bribe, as we have seen, by an official may well be the crime (and tort) of misconduct in public office. It is probable that the notion of public officer, in regard to the common law offence in England, is wider that the statutory provisions. The 2001 Act, also extended the scope of the common law offence making it clear that 'it is immaterial if the functions of the person who receives or is offered a reward have no connection with the UK and are carried out' outside the UK. The bribe must be proved to be intended to influence the officer's discharge of his public duties, by inducing him to act otherwise that what his duty would dictate. The Anti-Terrorism, Crime and Security Act 2001 in Section 109 provides that if a national of the UK or a body incorporated under the law of any part of the UK does anything in an country outside the UK and that act would, if done in the UK, constitute the crime of corruption, it will be so considered and proceedings may be taken in the UK. It is immaterial that what occurs is not a crime in the place it takes place. The crimes included within this 'long arm' provision include all that we have discussed above, including conspiracy, attempt or incitement to do so.

## Drawing the Strands Together

From our somewhat eclectic ramble around the English jurisprudence on self-dealing it is clear that the genius of the common law has never been logic. The judges often faced with the foul smell of corruption and other forms of self-dealing have often been prepared in a robust manner to pull and stretch principles, in particular found in equity, to achieve if not justice something resembling it. Indeed, the pragmatic approach of common law judges, while often regarded as a boon to commerce, has often left their civilian brothers perplexed and confused. While with or without the benefit of the United Nations Convention

against Corruption and the plethora of other international and regional initiatives, most countries today have reasonably comprehensive laws designed to inhibit and penalize acts of corruption, as history and, indeed, recent history so well shows us, perhaps the most significant damage to our fragile social and financial institutions occurs not as a direct result of activity that can easily be characterized as a substantive criminal offence. The real risks are rather more in the realm of a denial or abuse of — that time honored concept of stewardship. It is in the wealth of experience that is the common law that one, in the view of the author, best and most easily finds guidance. Judges over centuries have been faced with that most pervasive of human aspirations — greed and have on the whole done a good job in dealing with it. Indeed, in the many initiatives that have been launched in China particularly by the Communist Party (reference should be made to the excellent dissertation by Dr Ye Feng, *Combating Corruption: A Chinese Perspective*, Ph.D, University of London 30th August 2006), a similar sentiment is found. At the end of the day while the Supreme People's Procuratorate may or may not have spectacular successes in bringing prosecutions under the criminal law, in reality it is the work of local party officials and committees that have achieved results and good stewardship in the districts.

In this paper there has been little opportunity to address, other than in the context of accountability under the civil law, the vital issue of enforcement. In the author's view without effective and efficient enforcement the legal system can itself be brought into disrepute. Suffice it to point out that after a great deal of messing about in Britain, the former Director of Public Prosecutions and the former Director of the Serious Fraud Office have both recently called for a one agency approach in dealing with fraud and financially motivated crime, for much the same reasons as rehearsed in this paper. At the end of the day — almost inevitably traditional fraud and facilitative economic crimes such as corruption are but manifestations of a failure of good stewardship.

**Professor Barry RIDER**
**Jesus College**
**Cambridge**
**CB5 8BL**