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Abstract

One of the foremost requirements of corporate governance is transparency in the system, which ensures that individuals making decisions for and on behalf of a company do so in the best interest of the company and clearly avoid conflict of interest. It is the crux of fiduciary duty – the duty of loyalty and care towards the employer – that personal interest is sacrificed as compared to the employer's interest. Being on the right side of law is the goal but the line between legal and illegal is often hazy and changeable making it difficult for the practitioner to take any action and also for the judge to decide whether the line was breached or not. The paper deals with certain recent cases decided by higher courts in India and abroad on this issue.

Keywords

Corporate Governance, Fiduciary Duty, Care, Loyalty, Interpretation, Conflict of Interest

JEL Classification Codes

G34, K22, M14

Introduction

The top management of any company has to make important decisions for the company, and as the company – an inanimate body – cannot make the decisions on its own, it has to be done by individuals, or, a group of individuals, who make decisions in the interest of the company. Very often, these decisions are strategic and may involve huge sums of money. The individuals, usually called as the directors of the company, keep the interest of the company – which includes the promoters, shareholders, managers, etc. – in mind while acting for and on behalf of the company.

The role of these individuals cannot be taken by any robot or a computer or any other machine, it has to be performed by a human being. Each individual while performing the same role may conduct himself or herself in a different manner, as each person is expected to exercise discretion while making decisions. Discretion has to be exercised taking into account most of the factors which are known, and some of the information which could be gathered with little effort, and also some information which any person at a higher level of seniority is expected to seek and try all proper and legal methods to get it. Failure to do any such thing may be termed as dereliction of duty – fiduciary in nature – which means primarily the duty to take care and the duty of loyalty.

It is easier said than done. The duty of loyalty and the duty to take care have to be understood and interpreted in the context in which any of the persons has made the decision, and that

shall have a bearing on the judgement to be pronounced as to whether the person had exercised discretion or not; and also whether reasonable care had been exercised or not. It is not simple to understand and define the term "reasonable", and with fast changing circumstances, and at times the company facing certain exigency, or simply forced to make a paradigm shift due to dramatic change in the business and legal environment, a director in the company might have decided in a particular manner – which might be clear-cut deviation from the standard practices and the norms established in the company – but has to be judged on the basis of the norms of corporate governance, whether standard practices or legal requirements, which interestingly, are dynamic and not static.

When disputes raise their ugly head and allegations are made against the top-notch officials of a company, many a time, the matters reach the doors of courts to be resolved, and with the passage of time it is increasingly becoming difficult for the courts to apply the age-old concepts of fiduciary duty – duty of care and loyalty – to scrutinise the matter and make a judgement. The legislative tools do not provide much help as there is lack of objectivity, or one can say there is always an element of subjectivity involved, if not complete lack of objectivity, making it extremely difficult for the top management to comprehend the nuances and apply them in practical life. It, in fact, serves hardly any purpose to provide guidelines, or prepare a list of dos and don'ts for the simple reason that discretion cannot be taken away from a manager at any level, and truly speaking, the higher one goes in the hierarchy in an organisation, the higher the level of discretion involved.

Fiduciary: Meaning and Import

In *Martin's* case in 2012, which dealt with the issue of *benami* transactions, the Supreme Court went into great details of the idea of fiduciary, its meaning, and its interpretation made by different courts. *Benami* transaction is defined in section 2(a) of the The Benami Transactions (Prohibition) Act 1988, and is as follows:

> *"2(a) "Benami transaction" means any transaction in which property is transferred to one person for a consideration paid or provided by another person."*

The Supreme Court cited about fiduciary from several sources; and the following portion is worth reproducing:

> *"The expression "fiduciary capacity" has not been defined in the 1988 Act or any other Statute for that matter. And yet there is no gainsaying that the same is an expression of known legal significance, the import whereof may be briefly examined at this stage.*
>
> *The term "Fiduciary" has been explained by Corpus Juris Secundum as under:*
>
> > *"A general definition of the word which is sufficiently comprehensive to embrace all cases cannot well be given. The term is derived from the civil, or Roman Law. It connotes the idea of trust or confidence, contemplates good faith, rather than legal obligation, as the basis of the transaction, refers to the integrity, the fidelity, of the party trusted, rather than his credit or ability, and has been held to apply to all persons who occupy a position of peculiar confidence toward others, and to include those informal relations which exist*

> *whenever one party trusts and relies on another, as well as technical fiduciary relations.*
>
> *The word 'fiduciary', as a noun, means one who holds a thing in trust for another, a trustee, a person holding the character of a trustee, or a character analogous to that of a trustee with respect to the trust and confidence involved in it and the scrupulous good faith and condor which it requires; a person having the duty, created by his undertaking, to act primarily for another's benefit in matters connected with such undertaking. Also more specifically, in a statute, a guardian, trustee, executor, administrator, receiver, conservator or any person acting in any fiduciary capacity for any person, trust or estate.""*[1]

Thus, the word fiduciary has to be given a broad interpretation. It is not very clearly defined in any of the statutes, however, there is a general sense of understanding about the word and the obligations of the parties in a fiduciary relationship. With this understanding, we may explore some of the recent decisions by courts in India and abroad.

Fiduciary Duty: Banks and Bankers

The bankers have a definite fiduciary duty towards the bank, that is a banking company, and as the bankers are dealing with money, it is quite obvious that not even a single penny can be left unaccounted. All decisions made by the bankers should be in the interest of the bank, and simple principles of fiduciary duty, which are applicable in any other employer-employee relationship, need to be followed to the fullest. Taking things for granted, working under the influence of any bigwig, lackadaisical attitude, carelessness, disloyalty, unreasonableness to the extent of being imprudent, and similar behaviour are not expected from bankers. The courts are flooded with cases related to banks and bankers, not only in India but in almost all the countries in the world. Let us go through a recent judgement by the Supreme Court of India.

State Bank of India v. National Housing Bank, [2] ***2013***

In the well-known, or rather notorious, case of the securities scam of 1992, in which the Big Bull, Harshad Mehta, played a major role; among several matters, one of the matters has been decided by the Supreme Court in July 2013, which appears to be more of a lament on the present state of banking, politics, government and the investigative system in India, than a judgement. Unfortunately, this judgement somehow brings out the sorry state of affairs and also the helplessness of the highest court of the land.

Just to recall the facts: National Housing bank wrote a cheque in the name of the State Bank of Saurashtra – later merged with the State Bank of India – for a sum of about Rs. 95 crores. Harshad Mehta, the bearer of this cheque – we are not going into as to how he got hold of the cheque – instructed orally the banker, the individual, handling business at the State Bank of

[1] Sri Marcel Martins v M. Printer & Others; Supreme Court of India; 27 April 2012; 2012 Indlaw SC 132; (2012) 5 SCC 342; AIR 2012 SC 1987

[2] State Bank of India Through General Manager v National Housing Bank and others; Supreme Court of India; Bench: J. Chelameswar, R. M. Lodha, Madan B. Lokur, JJ.; 2013 Indlaw SC 478; 31 July 2013

Saurashtra to prepare a banker's cheque/demand draft in the name of 'X' for a similar amount, which the bank happily did. Much later, when the National Housing bank checked its records, the vigilant bankers in that bank found that about Rs. 95 crores had been paid to the State Bank of Saurashtra for purchase of securities, but nowhere in the vault the securities could be found physically. In those days, physical hardcopies of securities used to change hands, unlike most of the business done electronically today. Those bankers raised an alarm and wrote a letter, giving reference to the bankers cheque handed over earlier, to the State Bank of Saurashtra to send the securities urgently. On the receipt of this letter, the individuals handling these matters at the State Bank of Saurashtra must have dug up all the records and found that another banker's cheque was issued on the instructions of Harshad Mehta.

The simple question, the National Housing bank asked was: who was Harshad Mehta in the entire transaction between the National Housing Bank and the State Bank of Saurashtra? Who gave Harshad Mehta the authority to transact on behalf of the National Housing Bank, and why did the State Bank of Saurashtra acted on the instructions of Harshad Mehta when the drawer of the cheque was the National Housing Bank, and there were no instructions given by the drawer to the drawee, State Bank of Saurashtra? Apparently the State bank of Saurashtra had no answer to this and a dispute arose between the two banks leading to litigation. Similar disputes had arisen between different banks – some public and some private – with almost same *modus operandi*.

In the instant case, the Supreme Court of India, understandably, noted that the dispute was between two public sector banks, and it was not in the interest of anyone, maybe the lawyers being the only exception, to continue with the exercise of resolving the dispute in an adversarial manner. Keeping this in mind, the court ordered the parties and the government to stick together and decide it amicably. Now, as it can be very clearly understood, individuals at all levels were involved. Some of them might have been extremely powerful and well-connected, both in political circles as well as in the corporate world. With the blessings of the political masters and bureaucratic bosses, it didn't become difficult to somehow abuse the highly labyrinthine legal procedure and blame the entire thing on the inordinate delay in the judicial process without identifying the individuals involved and pinpointing as to who was at fault. On the contrary, best efforts were made never to let this happen, which compelled the Supreme Court to lament and write the following words with deep pain and anguish:

> *"…No attempt appears to have been made by the Government to find out the truth as to (1) how the plaintiff Bank parted with a high denomination cheque and gave custody of the same to Harshad Mehta and (2) as to how the first defendant Bank paid the various amounts to the dictation of Harshad Mehta in the absence of any authorisation by the plaintiff Bank. Be that as it may, if really the Government believed that the judgment of the Special Court does not require any interference, nothing stopped the Government from directing both the Banks to withdraw their appeals before this Court. The whole exercise appears to be an eye wash; a thinly veiled scorn for the orders of this Court. The professed purpose of the Special Courts Act - the back drop of the scandal that shook the nation - and the manner in which the litigation was conducted coupled with the absolute indifference of the Government to get at the truth only demonstrates the duplicity with which Governments can act…."*[3]

[3] Last paragraphs of the SBI v. NHB judgment, SC, July 2013

It is interesting to note that the Special Court set up for this very purpose had held that the banks – practically the role to be performed by bankers, the individuals – had a definite fiduciary duty:

> *"Having received, encashed plaintiff's cheque without there being any transaction, the first defendant is now liable to refund the money on the basis of conversion, fiduciary obligation and moneys paid without intending to do so gratuitously."*[4]

The matters currently being litigated in the United States related to JP Morgan Chase, Bear Stearns, Citigroup, and other well-known names on the Wall Street are primarily related to issues of fiduciary duty and conflict of interest. It is no wonder that some of the best legal brains are engaged to argue these matters in the courts, which, at times, makes the things protracted and difficult for the judges to be resolved. In most of the cases related to banks, huge sums of money are involved with itself is one of the most important reasons for a long legal battle.

Fiduciary Duty: Company and Board of Directors

Anyone who is acting for and on behalf of a company must keep the interest of the company, which includes the interest of the shareholders, in mind, and as the paramount interest. It is, therefore, unthinkable, that any decision, particularly major decisions regarding what businesses shall be conducted by the company, can be made without following the due process, which surely includes the consent of the shareholders and the Board of Directors. In the Birla v. Lodha case, allegations were made that the Chairman acted without consulting the Board. A bit of background is helpful.

Birla v. Lodha

Priyamvada Birla, widow of famous industrialist M P Birla, passed away in 2004. In her will she wrote her entire estate worth more than Rs. 5000 crores – must be worth more than Rs. 20,000 crores after almost 10 years – to her chartered accountant R. S. Lodha. This move of hers undoubtedly stunned the family, which, expectedly, came together – despite all the differences – to contest it in a court of law. The matter was fought in the Calcutta High Court, where it saw several twists and turns with a number of judges seeking recusal from that matter, on the ground that at some point of time in their career as a lawyer, which most of the judges are before being elevated to the Bench, each one of them had some connection with either of the Birla companies. The fact of the matter is that as the case was bitterly contested and sensitive enough with extremely serious questions of law involved topped with dollops of emotions – affection, love, bitterness, hate, revenge, etc. – it appeared to be an easier option to opt out from the process of making a decision, if at all possible on one pretext or the other. Propriety also demanded that anyone who had a direct linkage, either with the persons involved, or, the companies involved, for which those persons had been working in whatever capacity, should have refrained from sitting on the bench. Fallout of such big and unprecedented matters is often a dozen other matters litigated in different forums.

One such matter is regarding the control of the company – Birla Corporation Limited – by R S Lodha's son, Harshvardhan Lodha, who stepped into the shoes of his father when he passed away in 2008, and who had stepped into the shoes of Priyamvada Devi Birla after her death

[4] Cited from the order of the Special Court in the SBI v. NHB judgment of July 2013

in 2004. Through different legal mechanisms, Priyamvada Devi Birla had control over voting rights of more than 60% shares of the company. Using this power, Harshvardhan Lodha allegedly made several decisions for the company – for instance, venturing into new businesses like the money market without a collective decision making by the shareholders, by changing the object of the company, and also doing business with entities controlled by his family and friends, and making them benefit in a direct or indirect manner. The minority shareholders of the company brought the matter to the Company Law Board (CLB), which was later heard by the Calcutta High Court in appeal. The High Court cited a couple of paragraphs from the CLB judgement, and the relevant ones related to fiduciary duty are as follows:

> *"…It has been observed by the CLB in paragraph 74 of the judgment:*
>
> *"74. The CLB cannot shut its eyes to the flagrant violation of the provisions of S. 17 and the fraudulent manner in which those who are under fiduciary duties having breached the same by not letting the shareholders know whether the company is "to commence" this business in future or it has already been going on since 2008 or so, the proposed Postal Ballot Notice has failed to disclose the interest of the Directors through whose concern the proposed business is allegedly having been done through the concerns which are allegedly the family concerns of the Director(s) specifically R-2 in this matter. Expertise or no expertise, surplus funds or long term borrowings, the management of the R-1 company has proceeded blindly or deliberately to tread the paths which are unknown, to get lost in the wilderness and that too appears to be advantageous to a few being at the helm of affairs. There is no way that such act of the mismanagement can be allowed to reach a logical conclusion which certainly shall be disastrous for the R-1 company whose interest is paramount to the CLB.""*[5]

For the purpose of understanding the nature of fiduciary duty, it would be useful to have a look at the above cited paragraph from the CLB judgement which mentions about *'those who are under fiduciary duties…'* It is unimaginable that major decisions could be made independently by the Managing Director, or the Chairman of a company, without consulting the Board of Directors and taking the consent of the shareholders. In cases of certain exigency, the individual in certain position to make a decision may do that, but it is essential that at the earliest possible opportunity the decision needs to be ratified by the Board of Directors, according to the articles of association of the company and the legal provisions of the companies law as applicable to that particular company.

For high-profile matters like Birla vs. Lodha, it is quite obvious that the losing party is not going to call it quits at the High Court level, and hence the final battle is going to be fought in the Supreme Court of India. It is only a question of time when the matter reaches the Supreme Court and the interpretation is given by the highest court regarding the fiduciary duty, particularly the necessity of informing the stakeholders and taking their consent for extremely important matters.

Discretion, Subjectivity and Risk

[5] Birla Corporation Limited v. Harshvardhan Lodha and others; Calcutta High Court; Bench: Aniruddha Bose, J; 2013 Indlaw CAL 294; 2013 (3) CalLT 61; 10 May 2013

These discussions lay pronounced emphasis on 'subjectivity' of decision-making and the exercise of 'discretion' by individuals at the helm of affairs, especially when a tactical move is required to be made within a short period of time which doesn't give the luxury of consultation and approval. However, it is fascinating to note that what those situations which demand that type of decision-making are also subjective in nature and depend on the particular individual involved. It is quite possible that individual A is highly risk-averse, circumspect, and doesn't want to jump into decision making, whereas individual B may be of those types who don't believe in looking before they leap. It's a difficult situation for the judges to draw the line as to whether A or B has conformed to the norms of complying with fiduciary duty because both of them might have made the decision in the interest of the company, without any conflict of interest, and as the best thing which could have been done in the given scenario.

Fiduciary Duty: Confidentiality and Right to Information

Of late, the Right to Information Act, 2005 has gained tremendous importance in India, and interestingly has been the reason for interpreting the world 'fiduciary' by the Supreme Court of India as this word finds mention in the act under a particular section, 8(1)(e), which provides an exemption from disclosure if the parties are in a fiduciary relationship, however, the exemption is not valid if the scale tips in favour of public interest. It reads as follows:

> *"8 (1) Notwithstanding anything contained in this Act, there shall be no obligation to give any citizen,—*
> …
> *(e) information available to a person in his fiduciary relationship, unless the competent authority is satisfied that the larger public interest warrants the disclosure of such information;"*

Bihar and CBSE cases

One such case is that of *Bihar Public Service Commission (Bihar)*, wherein the important question was whether the confidentiality of the examiners could be retained by the Commission or it was bound legally to disclose in the interest of public at large. To answer it, the Supreme Court went into analysing the issue whether the relationship between the examiners and the examinee came under the ambit of fiduciary relationship or not. The Supreme Court followed an earlier decision in the case of *CBSE*, wherein it was said that such a relationship did not fall under the category of fiduciary relationship, however, the Supreme Court held in the *Bihar* case that disclosing the names of the examiners would not serve any public interest, rather it would not be in the interest of the public to disclose the name of the examiners as they might be threatened by the candidates are not been successful at the public service examination. The relevant paragraph from the *CBSE* case is as follows:

> *"… the words "information available to a person in his fiduciary relationship" are used in S. 8(1)(e) of the RTI Act in its normal and well-recognised sense, that is, to refer to persons who act in a fiduciary capacity, with reference to a specific beneficiary or beneficiaries who are to be expected to be protected or benefited by the Actions of the fiduciary-a trustee with reference to the beneficiary of the trust, a guardian with reference to a minor/physically infirm/ mentally challenged, a parent with reference to a child, a lawyer or a chartered accountant with reference to a client, a doctor or nurse with reference to a patient, an agent with reference to a*

> *principal, a partner with reference to another partner, a Director of a company with reference to a shareholder, an executor with reference to a legatee, a Receiver with reference to the parties to a lis, an employer with reference to the confidential information relating to the employee, and an employee with reference to business dealings/transaction of the employer. We do not find that kind of fiduciary relationship between the examining body and the examinee, with reference to the evaluated answer books, that come into the custody of the examining body."*[6]

In the *Bihar* case, the Supreme Court expanded the understanding of fiduciary a little further and stated:

> *"The term 'fiduciary' refers to a person having a duty to act for the benefit of another, showing good faith and candour, where such other person reposes trust and special confidence in the person owing or discharging the duty. The term 'fiduciary relationship' is used to describe a situation or transaction where one person places complete confidence in another person in regard to his affairs, business or transactions…. it is a statutory exemption which must operate as a rule and only in exceptional cases would disclosure be permitted, that too, for reasons to be recorded demonstrating satisfaction to the test of larger public interest. It will not be in consonance with the spirit of these provisions, if in a mechanical manner, directions are passed by the appropriate authority to disclose information which may be protected in terms of the above provisions. All information which has come to the notice of or on record of a person holding fiduciary relationship with another and but for such capacity, such information would not have been provided to that authority, would normally need to be protected and would not be open to disclosure keeping the higher standards of integrity and confidentiality of such relationship. Such exemption would be available to such authority or department."*[7]

The *Bihar* case lays emphasis on the fact that any such information which is provided to a person in a position of authority should be deemed to be fiduciary nature if that information would not have been provided to the person concerned had he not been holding that position of authority. Along with this necessary test, it is also important that the person in the fiduciary relationship must act honestly in the interest of the other party.

Fiduciary Duty and Power of Attorney

A power of attorney is a special form of contract, in which a principal appoints an agent either for one transaction or a number of transactions or for any other purpose. The agent acts on behalf of the principal and in case it is the relationship between a donor and a donee, where the donee is supposed to act in the interest of the donor, it goes without saying that the donee shall not make any decision in his own interest. The agent acts in a fiduciary capacity. The Supreme Court of India cited a passage from a 2005 judgement in a recent judgement pronounced in 2012, and it is as follows:

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[6] Central Board of Secondary Education and another v Aditya Bandopadhyay and others; Supreme Court of India; 9 August 2011; 2011 Indlaw SC 590; (2011) 8 SCC 497, paragraph 34 from Indlaw citation

[7] Bihar Public Service Commission v Saiyed Hussain Abbas Rizwi and another; Supreme Court of India; 13 December 2012; 2012 Indlaw SC 550; 2012(12) SCALE 525; [2012] 11 S.C.R. 1032

> *"The donee in exercise of his power under such power of attorney only acts in place of the donor subject of course to the powers granted to him by reason thereof. He cannot use the power of attorney for his own benefit. He acts in a fiduciary capacity. Any act of infidelity or breach of trust is a matter between the donor and the donee."*[8]

No new interpretation has been given by the Supreme Court, however, it is a vindication of the fact that whatever the understanding regarding the relationship between the donor and the donee, and the fiduciary responsibility of the donee is, has not been diluted. It has been reiterated by the Supreme Court that any person who is acting in a fiduciary capacity must do so to the best of his ability and understanding.

Fiduciary Duty and Role of the State

The State, as defined in article 12 of the Constitution, has a fiduciary relationship while acting for and on behalf of the People of India, to whom the country belongs. Of late, there have been issues related to disinvestment, licenses, contracts, etc. where individuals acting for the State, which in turn, has been bestowed with the responsibility of acting in good faith for the People of India, either did not follow the procedure or did not avoid conflict of interest. Emphasising on this fact that the State acts as a fiduciary, the Supreme Court observed:

> *"In the 2G Case, 2012 Indlaw SC 29, two concepts namely, "public trust doctrine" and "trusteeship" have been adverted to, which were also relied upon by learned counsel for CPIL, in defence of the argument that the State holds natural resources in a fiduciary relationship with the people. As far as "trusteeship" is concerned, there is no cavil that the State holds all natural resources as a trustee of the public and must deal with them in a manner that is consistent with the nature of such a trust."*[9]

This is an extremely important matter where the interest of the People of India is paramount and political masters and bureaucrats making decisions for the people of India cannot be permitted, particularly in a welfare state, which India fortunately is, to short-change the country for their own personal gains.

Fiduciary Duty, Fraud, and the Dominant Party

Some of the factors which vitiate a contract are fraud, misrepresentation or undue influence, and the relationship of principal and agent, with fiduciary duty cast on the agent to act in the interest of the principal, in one way or another, is a contract, maybe of a special type. It has been held by the Supreme Court of India in a case in 2003, which is being cited in a recent

[8] State of Rajasthan v. Basant Nahata, (2005) 12 SCC 77, cited in The Church Of Christ Charitable Trust & Educational Charitable Society, Represented By Its Chairman v M/S Ponniamman Educational Trust Represented By Its Chairperson/Managing Trustee, Supreme Court of India, 3 July 2012, Civil Appeal no . 4841 of 2012 (Arising out of SLP (C) No.30632 of 2011)

[9] Special Reference No.1 of 2012; Advisory Jurisdiction of the Supreme Court of India; related to telecom licenses; President's Reference of April 12, 2012; 2012 Indlaw SC 321; (2012) 10 SCC 1; post cancellation of 2G licences in Centre for Public Interest Litigation and others v. Union of India and others; February 2, 2012; 2012 Indlaw SC 29; (2012) 3 SCC 1; AIR 2012 SC 1002

case in 2013, that the burden of proving the absence of any such factors is on the dominating party. The relevant portion is as follows:

> *"…it was held that when fraud, misrepresentation or undue influence is alleged by a party in a suit, normally, the burden is on him to prove such fraud, undue influence or misrepresentation. But, when a person is in a fiduciary relationship with another and the latter is in a position of active confidence the burden of proving the absence of fraud, misrepresentation or undue influence is upon the person in the dominating position, he has to prove that there was fair play in the transaction and that the apparent is the real, in other words that the transaction is genuine and bona fide. In such a case the burden of proving the good faith of the transaction is thrown upon the dominant party, that is to say, the party who is in a position of active confidence. The instant case is required to be exercised in the light of the aforesaid settled proposition of law."*[10]

Fiduciary Duty and Minor's Interest

A Guardian making decisions for a minor is expected to make decisions in the interest of the minor. The relationship between the Guardian and the mind is that of trust, and, is, therefore, fiduciary in nature. In 2013 case, the Supreme Court of India observed:

> *"Once a person is appointed by the Court to be a Guardian of the property of ward, he is bound to deal with the property as carefully as a man of ordinary prudence would deal with it, if it were his own property. He is bound to do all acts for the protection and benefit of the property. A Guardian appointed by Court cannot deal with the property by way of sale, mortgage, charge or lease without the permission of Court and against the interest of minor….It is well settled law that a Guardian stands in a fiduciary relation to his ward and he is not supposed to make any profit out of his office. On being appointed as Guardian of the property of minor, he is to act as a trustee and he cannot be permitted to gain any personal profit availing himself of his position and such action of the Guardian while dealing with the property against the interest of ward would be voidable in the eye of law."*[11]

Is *scienter* or intention necessary?

A question which arises is: whether one is looking at the intention, or the action? It takes the discussion to an interesting level where one has to find out whether an element of fraud or a guilty mind is necessary for the breach of fiduciary duty, or even in the absence of any criminal intent, simply on the basis of action taken – which may be due to negligence, misinformation, mistake, or any other unintentional reason – it should be deemed to be in breach of fiduciary duty? In other words, is *scienter* necessary for a fiduciary duty to be breached? *Scienter* means the knowledge, or an allegation in a pleading that a thing has been

[10] Krishna Mohan Kul @ Nani Charan Kul v. Pratima Maity; AIR 2003 SC 4351; 2003 Indlaw SC 729; cited in Joseph John Peter Sandy v. Veronica Thomas Rajkumar; Supreme Court of India; 12 March 2013; 2013 Indlaw SC 133; (2013) 3 SCC 801; AIR 2013 SC 2028

[11] Sudish Prasad & Others v. Babui Jonhia Alias Manorma Devi & Others; Supreme Court of India; 7 February 2013; Civil Appeal No. 1012 of 2013; 2013 Indlaw SC 74; 2013 (97) ALR 454; 2013 (2) AWC 1114; JT 2013 (2) SC 584; 2013(2) SCALE 280

done knowingly.[12] *Scienter* and intention are quite close, however, there are finer aspects of distinction between the two, which is not necessary to dwell into at this juncture. Suffice to say that the person accused of breaching the fiduciary duty had the knowledge of what he was doing, and, maybe, to add further, he intentionally did something. It was not as if it happened without his knowledge and intention, that is to say anything which might have happened accidentally or despite the best efforts of the person not to let it happen.

U.S. Supreme Court: The Bullock Case, 2013

A recent American case – *Bullock* – on this point is quite enlightening. A person established a trust for the benefit of his children and made one of his sons as the non-professional trustee of the trust. It goes without saying that the trustee has a fiduciary relationship with the trust and must make all the decisions, which are made, to the best of his ability, in the interest of the trust and the beneficiaries of the trust. This particular trustee borrowed funds from the trust a couple of times and always repaid with interest. Later, the siblings alleged breach of fiduciary duty without assigning any malicious intent. The US Supreme Court observed that it would have been easy to label the conduct wrongful had there been an issue involving bad faith, moral turpitude, or any other immoral conduct, but in the absence of any such identifiable conduct it is a bit difficult to conclude whether the conduct was wrongful or not. For the purpose of interpreting whether there was a breach of fiduciary duty or not, knowledge or intention can be concluded when the fiduciary knew that it was improper and also acted in a reckless manner which can be equated to intent under criminal law. The Supreme Court laid emphasis on what should be the level of the recklessness and cited from an earlier decision. The relevant portion is as follows:

> *"…We include as intentional not only conduct that the fiduciary knows is improper but also reckless conduct of the kind that the criminal law often treats as the equivalent. Thus, we include reckless conduct of the kind set forth in the Model Penal Code. Where actual knowledge of wrongdoing is lacking, we consider conduct as equivalent if the fiduciary "consciously disregards" (or is willfully blind to) "a substantial and unjustifiable risk" that his conduct will turn out to violate a fiduciary duty…That risk "must be of such a nature and degree that, considering the nature and purpose of the actor's conduct and the circumstances known to him, its disregard involves a gross deviation from the standard of conduct that a law-abiding person would observe in the actor's situation." … Ernst & Ernst v. Hochfelder, 425 U. S. 185, 194, n. 12 (1976) (defining scienter for securities law purposes as "a mental state embracing intent to deceive, manipulate, or defraud")."*[13]

The Court held while interpreting defalcation in relation to bankruptcy as including a culpable state of mind of the fiduciary:

> *"We hold that it includes a culpable state of mind requirement akin to that which accompanies application of the other terms in the same statutory phrase. We describe that state of mind as one involving knowledge of, or gross recklessness in respect to, the improper nature of the relevant fiduciary behavior."*[14]

Thus, in the absence of intention, mere knowledge may be deemed to be equivalent to intention, if the person was legally duty-bound to act, or not to act, or to act in a different

[12] Osborn's Concise Law Dictionary, Seventh Edition by Roger Bird, Universal Law Publishing Co. Pvt. Ltd., Delhi, 1997

[13] Bullock v. Bankchampaign, N. A.; U.S. Supreme Court, No. 11-1518; May 13, 2013

[14] Opening paragraph of *Bullock* case, 2013

manner, as per the facts and circumstances of the case. But, in the absence of either of the two, intention or knowledge, it could not be said to be breach of fiduciary duty.

Fiduciary Duty: Mistake or Error of Judgment

What shall be the scenario in case the fiduciary neither intentionally nor with knowledge acted in a manner which could be at least alleged, if not finally interpreted, as breach of fiduciary duty? The fiduciary, as any other person, is expected to act in a reasonable and prudent manner, and while making decisions in its role as a fiduciary, the person is to be given the benefit of doubt of making any mistake, as any other normal human being may make. However, gross negligence, or, not taking into consideration what must have been considered, or considering those issues which need not have been considered, while making a decision, may be interpreted to mean breach of fiduciary duty.

Hastings Bass Rule

Of late, the British Supreme Court decided two matters jointly on this issue. The cases pertained to the scope of what is known as the *Hastings Bass rule*, a principle enunciated by the Court of Appeal (Civil Division) in 1974. In brief, it said that a transaction done by a trustee in furtherance of his fiduciary duty may be set aside, if he did not consider things which he should have considered, or considered things which he should not have considered. The relevant paragraph from the judgement is as follows:

> *"To sum up the preceding observations, in our judgment, where by the terms of a trust (as under section 32) a trustee is given a discretion as to some matter under which he acts in good faith, the court should not interfere with his action notwithstanding that it does not have the full effect which he intended, unless (1) what he has achieved is unauthorised by the power conferred upon him, or (2) it is clear that he would not have acted as he did (a) had he not taken into account considerations which he should not have taken into account, or (b) had he not failed to take into account considerations which he ought to have taken into account."*[15]

U.K. Supreme Court: Futter and Pitt cases, 2013

The Supreme Court has narrowed the scope of the Hastings Bass rule, which was earlier understood to have a fairly wide scope. The court was hearing two matters – *Futter* and *Pitt* – together.[16] In the *Futter* case, on the basis of legal advice the trustees, in the fiduciary capacity, made certain transactions which resulted into a tax liability as the advice was incorrect. The trustees sought nullifying the transactions on the basis of *Hastings Bass* principle. In the *Pitt* case, on the basis of legal advice a trust was established for the sake of saving taxes, however, later on, it was found that tax liability could not be avoided, and the trustees moved the court on the basis of the *Hastings Bass* rule, or on the ground of unilateral mistake, to set the trust aside. The Supreme Court ruled that the *Hastings Bass* principle

[15] Hastings-Bass (Deceased), Re; Also known as: Hastings-Bass Trustees v Inland Revenue Commissioners; Court of Appeal (Civil Division); 14 March 1974; [1975] Ch. 25; [1974] 2 W.L.R. 904; [1974] 2 All E.R. 193

[16] Pitt and another v Holt and another; with Futter and another v Futter and others; Supreme Court; 9 May 2013; [2013] UKSC 26; [2013] 2 W.L.R. 1200

could not be applied to either of the two cases, however, the trust was set aside in the latter case on the ground of unilateral mistake.

While deciding the cases, the Supreme Court laid down some rules regarding the principle – the trustees should not act outside the scope of their discretionary power; if they have acted within their discretionary powers, consideration of irrelevant matters, or non-consideration of relevant matters must be serious enough to amount to a breach of fiduciary duty, which obviously brings into subjectivity in the decision-making process. The trustee is not expected to be tested as per the highest possible standards; the standards followed by a reasonable and prudent person would suffice to be used as the measuring rod. One of the most interesting aspects of this rule is that the trustees may like to move the court to set aside one of the decisions they have made due to their incompetence, which appears to be most unreasonable and illogical. Therefore, the court opined that it would be proper for the beneficiaries to move the court, rather than the trustees themselves. It makes sense. One should not be allowed to take advantage of one's own incompetence, or carelessness, or gross negligence. The court, expectedly, ruled that it would be a safe defence for the trustees if they take sound professional advice from reasonably good professionals.

Problems and Suggestions

Changing trends all over the world regarding the understanding of the term fiduciary, and various interpretations by courts create a lot of problems. Some of these are discussed hereinafter with certain suggestions to take care of them.

1. Precise meaning

The dynamic nature of law poses the problem as the meaning of the word – fiduciary – might have been understood by businesspersons and laypersons for ages, however, precise meaning is not easily comprehensible. There is a difference in the meaning in simple English language, and when the word has to be interpreted in a legal sense, and that too in the context of a specific law. It is, therefore, quite vital that the terms fiduciary, fiduciary duty, fiduciary relationship, fiduciary capacity, and other related terms are defined in the specific laws with as much clarity as possible. It is agreed that the legislature cannot foresee the future and take care of all the possibilities which might happen, but at the same time, it is not desirable that the terms are left at the discretion of the judicial officers for interpretation, which typically takes place post-event. Thus, a lot of things can be taken care of, and uncertainty eliminated to a large extent, if these terms are properly defined in the respective statutes. The discretion will always remain with the judges to interpret terms, according to the changed scenario.

2. Changing roles and expectations

A person acting in a fiduciary capacity may not be doing it with very clearly defined responsibilities and tasks to be done, and also not with a clear-cut understanding of what he's supposed to do and what he's not supposed to do. In most real life situations, there is hardly a well-defined dividing line, which becomes even more blurred and difficult to be identified with the role of the person in a fiduciary relationship changing with the passage of time, which also results in a change in the expectations from that person. It is quite obvious that with such changing roles and expectations, the rationale for making a decision, either this way or that way, may also change, and, at times, in a dramatic manner. With these twists in the tale, to understand and identify whether a person has performed his fiduciary duty or not,

becomes a bit difficult, and any judicial officer is not expected to ignore the changes, both in the role and expectations. It is suggested that the judicial officers need to be sensitised so that the changed scenario, often to take care of an exigency, is taken into consideration. It may require a little bit of training, which essentially is to prepare the officers to take a holistic view of the situation and then make the decision accordingly by applying legal principles, statutes, and precedents.

3. Physical Act and Guilty Mind

One issue which has always been troubling the courts is about the guilty mind, something which is essential in criminal law, as *mens rea,* for anyone to be held liable, but in civil matters, particularly in white-collar crimes, which could have serious economic repercussions, the issue of guilty mind may not always be pertinent, primarily in matters where the accused was expected to have done some work so as to keep himself updated; that is, the higher the person in a hierarchy, the higher the duty to apprise himself of the relevant things and be proactive in his approach in problem-solving, and still better, not to allow problems to raise their ugly heads. With this level of high expectation from the people at higher levels in an organisation, mere absence of a guilty mind may not always absolve them if they have performed a physical act resulting in breach of fiduciary duty. Thus, the suggestion is that the higher the level of fiduciary in any organisation, or the higher the level of fiduciary duty in any other relationship, the greater is the need to make such persons aware of the gravity of their responsibility and the seriousness of their actions. It can be no one's case that people at that level did not understand as to what was expected from them, and hence they acted in a particular manner, and that’s why they need not be held liable. Therefore, to be abundantly cautious, it is desirable that these individuals are told explicitly about the fiduciary duty and what proactive measures are expected from them.

4. Discretion and Arbitrariness

No person acting in a fiduciary capacity is expected to act in an arbitrary manner. He or she is expected to exercise discretion and act in the best possible manner so that all decisions are made in the interest of the principal. At times it becomes a matter of debate as to whether the decision made by an individual was discretionary in nature or arbitrary. Benefit of doubt needs to be given to the person making the decision, but after a reasonable limit that individual has to take responsibility of the decisions made and own up in case any arbitrariness has crept in. While there are issues of exercising discretion, there are difficult situations when the individual does not specifically understand the gravity of the situation, even when he has been told explicitly and has been provided training for that purpose, should the decision be made leniently in favour of the person while taking into account the conduct of the person? It is suggested that such situations have to be dealt with in a deft and mature manner after considering the relevant facts and circumstances of the case. It would be difficult to have set guidelines and parameters for decision making, but certain basic framework for the understanding of discretionary power and arbitrariness can certainly be helpful. This framework can either be provided by the legislature, or by the judicial pronouncements, or both. However, it is practical that a summary of a number of these judicial pronouncements is made available so that contradictory views do not confuse a fiduciary while trying to understand as to his outer periphery – the dividing line between legal and illegal – for making decisions.

5. Conflict of Interest

This is one of the most ticklish issues in a fiduciary relationship, and particularly in organisational matters when an individual is acting for and on behalf of a corporate entity. A number of decisions are to be made for the organisation in which the fiduciary might either be a party, or maybe directly or indirectly affected. In such a scenario, it becomes awfully difficult to avoid that decision-making, and the doctrine of necessity is triggered, which legitimates and justifies the fiduciary to make such decisions in the interest of the organisation without any direct conflict of interest which is obviously known to the fiduciary, or should be known to the fiduciary with reasonable effort expected to be put in by him. Beyond a point it is not at all possible to make any decision which may not have any remote and indirect impact on the fiduciary, as it can be proved by the 'chaos theory' or 'butterfly effect' that every action will have an impact sometime, somewhere on someone. Thus, it is suggested that the fiduciary should be made aware of the fact that he should avoid situations of at least direct conflict of interest; a conflict between the interests of the principal and his own interest, which necessarily must always be secondary vis-à-vis principal's interest, and to a large extent the indirect conflict of interest in situations, which could be anticipated.

6. What's there for me?

This is an obvious question, which often comes to the mind of the fiduciary while making decisions for the principal, particularly where heavy sums of money, or matters of manifest importance are involved. In an ideal situation, it should not matter if the decision to be made is about a single penny or lacs of crores of rupees – for instance, in a problem for primary school children, two plus three apples, or two plus three billion dollars, shall always be five apples and five billion dollars respectively – as theoretically speaking, the decision has to be made by applying a certain principle, but practically, we do understand that the higher the stakes, the greater the possibility of greed and temptation taking over the virtues of honesty and duty. It is, therefore, extremely important and practically realistic that individuals in such positions of fiduciary responsibility must be rewarded handsomely, whether in the shape of salary, bonus, perquisites, retirement benefits, etc. However, there is a caveat: beyond a reasonable limit, no person can be rewarded; there is no end to greed, and the principal must be extremely careful of such persons, and sever the relationship with such a persona at the right moment, before it's too late.

7. Litigation and the role of courts

Once a matter is taken to a court of law for resolution of a dispute, it is not at all certain as to for how much time the matter will remain in the judicial process, from the lowest court to the highest court. Cases with heavy sums of money involved, or very important issues involved, are almost sure to reach to the highest court of the land. With a number of appeals available at each and every level in the judiciary, it becomes a nightmare to navigate through the difficult judicial terrain, even with the help of the best possible lawyers, and taking deep pockets for granted. It is suggested that in case of a dispute regarding fiduciary relationship, specially the interpretation of the term fiduciary, both the parties must try to sit together and reach a settlement. It is not at all desirable to skip this step and jump onto the litigation train. Many a time, it is possible to resolve the matter satisfactorily, maybe not to the fullest satisfaction of both the parties, but as the next best alternative to a high level of satisfaction of both the parties, in a practical manner, taking into account putting in a lot of time, effort and money in litigation, and still living in a state of glorious uncertainty, not to talk of losing out on numerous business opportunities.

Conclusion

In the absence of legislative clarity and certainty, the courts are trying to do their best to interpret the word fiduciary and other related terms in the present context, however, this entire exercise leaves a lot to be desired as whatever the courts do is only after the event has taken place. Ensuring predictability requires that the situation, various scenarios, and consequences in each of these scenarios are very well documented and known to the people in the fiduciary relationship so that they are not taken by surprise and they can plan well prior to taking the plunge. With more and more laws being enacted by the legislature, particularly in the economic and commercial domain, which have a remarkable impact on business, it is quite logical and justified that the people in general are made aware of the idea of fiduciary duty, to which they would be bound in case of entering into any such relationship. Contracts do matter, however, everything related to fiduciary duty cannot be written as contractual clauses, and, it is not even desirable to do so. There would always be a gap between what the legislature has enacted, and what has been interpreted by the judiciary with the changing times, and this must be made perceptible to any reasonable and prudent person who is willing to perform a fiduciary duty.