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Equitable Compensation for Breach of Fiduciary Duty in Scotland: A Comment on *Kidd v Paull & Williamsons LLP*

In *Robert Gordon Kidd v Paull & Williamsons LLP, Burness Paull LLP*,¹ the Outer House of the Court of Session examined the circumstances in which equitable compensation for loss resulting from breach of fiduciary duty is available in Scots law. The fiduciary, a firm of solicitors, breached its fiduciary duty of undivided loyalty by taking on two clients with opposing interests, and by failing to address the conflict through disclosure and informed consent. While the existence and breach of fiduciary duty were not contested, the parties differed on the correct approach to determining the amount of equitable compensation, causality and contributory negligence. After canvassing the relevant authorities, the court refused the pursuer’s motion for summary judgment in respect to the contested matters, which were left to be determined after proof.

This case comment focuses on the but-for test that the court applied in order to determine the elements required for granting equitable compensation for breach of fiduciary duty. It will be argued that the court seems to have conflated the no-conflict fiduciary duty with the contractual duty of disclosure of conflicts of interest and advice that existed between parties.

**A. THE FACTS**

Robert Gordon Kidd (“RGK”) was the sole shareholder of ITS Tubular Services Ltd (“ITS”), a Scottish company specialising in supply of drilling equipment to the oil industry worldwide.² He held full executive control of the company and its subsidiaries. In 2007, RGK decided to step down from management and sell his stake in the ITS group. To make his business more attractive to potential buyers, he appointed Jeff Corray and Scott Milen as directors of ITS.³ The two directors started looking for potential buyers, but their initial efforts were unsuccessful. In October 2008, they received three expressions of interest.⁴ In

¹[2017] CSOH 16 (hereafter “*Kidd*”).
² Ibid, para 1.
³ Ibid, para 3.
⁴ Ibid, paras 4-5.
January 2009, only one of the potential acquirers, Lime Rock Partners (“Lime Rock”), submitted an indicative proposal.5

Corey and Milen retained Paull & Williamsons (“PW”), a firm of solicitors, to act in connection with the proposed share sale. The PW partner primarily responsible for carrying out the directors’ instructions was Scott Allan.6 Unknown to RGK, Lime Rock was an existing client of PW. The PW partner with primary responsibility for Lime Rock was not Allan, but Kenneth Gordon, one of his colleagues.7 On 26 January 2009, Allan wrote a letter of engagement addressed to RGK and ITS. PW undertook to draft a due diligence report on the ITS group, for the purposes of the Lime Rock transaction. The letter stated expressly that PW had an obligation not to act for two or more clients whose interests are in actual or potential conflict. PW undertook to inform RGK and ITS of any such conflict promptly, and to require them to seek independent legal advice.8 On 24 February 2009, the business of PW was transferred to Paull & Williamsons LLP (“PW LLP”). In December 2012 PW LLP merged with Burness LLP, forming Burness Paull LLP (“BP LLP”).9

The Lime Rock transaction was finalised in September 2009. RGK sold one third of his stake in exchange of 10 million USD. Lime Rock undertook to invest in ITS a further 45 million USD. In exchange, RGK agreed to give up control of the board and his casting vote at board meetings.10 Subsequently, ITS ran into financial difficulties, due to, among other causes, mismanagement and breach of bank covenants. ITS went into administration and was sold as a going concern. RGK received nothing from the sale proceeds.11

RGK sued PW LLP and BP LLP jointly and severally, claiming that he incurred a loss of 210 million USD as a direct consequence of the manner in which the Lime Rock transaction was structured. He claimed that PW LLP were guilty of breach of contract, negligence, breach of fiduciary duty and fraudulent misrepresentation.12 Regarding the breach of contract and negligence claims, RGK averred that PW LLP failed to advise him on the practical effect of the transaction entered into and its foreseeable risks (i.e. loss of executive control over the ITS board), and failed to recognise and address the conflict of interests.

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5 Ibid, para 6.
6 Ibid, para 7.
7 Ibid, para 11.
8 Ibid, para 7.
9 Ibid, para 1.
10 Ibid, para 8.
11 Ibid, para 9.
12 Ibid, para 2.
between RGK’s best interests, on the one hand, and those of ITS and the ITS directors who instructed PW LLP on RGK’s behalf, on the other hand. Had he received the advice he was entitled to, RGK argued, he would not have proceeded with the Lime Rock deal and would not have sustained the loss.\textsuperscript{13} Regarding the second claim, RGK averred that the defenders were guilty of knowing and deliberate breach of fiduciary duty, by failing to disclose that they were acting, formally or informally, for Lime Rock in the ITS deal.\textsuperscript{14} The defenders admitted that, by acting for two clients with conflicting interests without proper disclosure they breached their fiduciary duties.\textsuperscript{15} They denied, however, that they had acted dishonestly or fraudulently.\textsuperscript{16} They also denied that there was a relevant causal link between the breach of fiduciary duty and RGK’s alleged loss.\textsuperscript{17} RGK moved for summary decree in respect of the breach of fiduciary duty and fraudulent misrepresentation claims, and the defenders moved for dismissal of the action.\textsuperscript{18}

**B. THE COURT DECISION**

The Court rejected RGK’s claim of fraudulent misrepresentation for two main reasons. First, Lord Tyre held that the alleged fraudulent misrepresentation of the PW LLP partner who was directly involved in the fiduciary conflict of interest cannot be treated, as a matter of partnership law, as a fraud of the LLP itself.\textsuperscript{19} Secondly, the claim failed because RGK did not aver that PW LLP’s express representation that it will not act in conflict of interest was given with the intention to induce RGK to enter into the Lime Rock transaction.\textsuperscript{20} Regarding the claims of breach of contract and negligence, however, the court refused the defenders’ motion to dismiss them as irrelevant.\textsuperscript{21}

The breach of fiduciary duty claim was analysed in significantly more detail, and therefore will be the focal point of this case comment. The court accepted RGK’s motion for summary decree as regards the existence of a fiduciary duty breach (which the defendants did

\textsuperscript{13} Ibid, para 10.
\textsuperscript{14} Ibid, paras 11-12.
\textsuperscript{15} Ibid, para 13.
\textsuperscript{16} Ibid.
\textsuperscript{17} Ibid, para 47.
\textsuperscript{18} Ibid, para 2.
\textsuperscript{19} Ibid, para 31.
\textsuperscript{20} Ibid, para 33.
\textsuperscript{21} Ibid, para 75.
not contest), but refused summary decree for the other aspects of the fiduciary duty claim.\textsuperscript{22} Next, Lord Tyre proceeded to a detailed evaluation of the requirements for granting equitable compensation for breach of fiduciary duty. He focused on the existence of this remedy in Scots law, the conditions for establishing a causal link between breach of duty and loss, and the availability of the defence of contributory negligence. In deciding on these matters, the court relied on \textit{AIB Group (UK) plc v Mark Redler & Co},\textsuperscript{23} \textit{Target Holdings Ltd v Redfens},\textsuperscript{24} and \textit{Canson Enterprises Ltd v Boughton & Co}.\textsuperscript{25} Lord Tyre held that the \textit{AIB-Target-Canson} approach is compatible with the Scots law of fiduciary duties.\textsuperscript{26} Consequently, when a Scottish court finds that equitable compensation is the appropriate remedy for breach of fiduciary duty, the measure of such compensation is what is required to put the beneficiary in the position he would have been in, but for the breach. The loss compensated must flow directly from the breach. Although foreseeability is not relevant, the link between breach and loss must be sufficiently direct. Moreover, the actions of the beneficiary or of third persons may be relevant for determining the existence of the causal link or the amount of the compensation.

\section*{C. ANALYSIS}

As Lord Tyre acknowledged, \textit{Kidd} was the first opportunity that the Court of Session had to consider the correct approach to be adopted in assessing compensation recoverable as a consequence of a breach of fiduciary duty in Scots law.\textsuperscript{27} Lord Tyre surveyed the most relevant English and Canadian decisions on equitable compensation for breach of custodial duties by trustees (\textit{AIB} and \textit{Target}) and breach of fiduciary duties by non-custodial fiduciaries (\textit{Canson}). He concluded, correctly, that the test for determining the causal link between breach of duty and loss, as well as the amount of compensation, requires determining the position the beneficiary would have been in, had the fiduciary duty been performed as undertaken (but for the breach).\textsuperscript{28} Once breach of fiduciary duty is established, the test places on the fiduciary the onus of proof that the beneficiary would have suffered the

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\textsuperscript{22} Ibid, para 76.
\textsuperscript{24} [1996] AC 421 (“Target”).
\textsuperscript{25} [1991] 3 SCR 534 (“Canson”).
\textsuperscript{26} \textit{Kidd}, paras 45-46.
\textsuperscript{27} Ibid, para 40.
\textsuperscript{28} Ibid, para 46.
\end{flushleft}
same loss regardless of the breach.\textsuperscript{29} A fiduciary will not escape liability by merely speculating about what might have happened, as opposed to proving it on the balance of probabilities.\textsuperscript{30}

A precise understanding of the fiduciary duty that was breached is the logical starting point of the evaluation of the applicable remedial regime.\textsuperscript{31} Without a clear understanding of the content of this duty, it is impossible to determine the position the pursuer would have been in but for the breach.\textsuperscript{32} The court held that the relevant breach of fiduciary duty was PW LLP’s failure properly to disclose its conflict of interest. In other words, the relevant question was “what would have occurred if the first defender had avoided committing a breach of fiduciary duty by timeous disclosure of the existence of its conflict of interest”.\textsuperscript{33} With respect, it is submitted that this is not the main relevant question for the purpose of the breach of fiduciary duty claim.

Scots law has long recognised that trustees, agents, solicitors and others owe fiduciary duties to their principals.\textsuperscript{34} Although the precise nature and content of such duties remain somewhat controversial, it is firmly established that not all duties arising from a fiduciary relationship are fiduciary duties. Many duties arise from express or implied contract terms, and are contractual, as opposed to fiduciary, duties.\textsuperscript{35} It is also established that fiduciaries are bound by strict duties against conflicts of interest. The no-conflict duty is traditionally formulated as a prohibition on a fiduciary from “entering”, “putting himself”, or “placing himself” into a position where his interests are in conflict with his duty and, indirectly, with

\textsuperscript{29} Ibid, para 50.
\textsuperscript{31} Sarah Worthington, “Four Questions on Fiduciaries” (2016) 2 Canadian Journal of Comparative and Contemporary Law 723 at 757.
\textsuperscript{32} \textit{AIB}, para 76 per Lord Toulson, and paras 92-93 per Lord Reed; see also \textit{Bank of New Zealand v New Zealand Guardian Trust Co Ltd} [1999] 1 NZLR 664 (CA) at 686, per Tipping J.
\textsuperscript{33} Kidd, para 48.
\textsuperscript{34} See generally Laura Macgregor, \textit{The Law of Agency in Scotland} (W. Green, 2013), Ch 6.
\textsuperscript{35} Ibid, 116 (discussing the difference between contractual and fiduciary duties of agents).
\textsuperscript{36} \textit{Aberdeen Railway Co v Blaikie Brothers} (1854) 1 Macq 461 at 471-472; \textit{William Henderson v The Huntington Copper and Sulphur Company} (1877) 5 R (HL) 1 at 7; \textit{Regal (Hastings) Ltd v Gulliver and Others} [1942] 1 All ER 378 at 381.
\textsuperscript{38} \textit{Cherry's Trustees v Patrick} (1911) 2 SLT 313 at 314.
the beneficiary’s interests.\textsuperscript{39} Furthermore, the law of fiduciary duties in Scotland and across the common law recognises that the conflict between fiduciary duties owed to different beneficiaries is a particular instance of the broader no-conflict requirement.\textsuperscript{40} The interest-duty and duty-duty forms of conflict of interest serve the same purpose: preventing the risk of improper exercise of judgment,\textsuperscript{41} or of improper exercise of non-fiduciary duties.\textsuperscript{42} The language used to describe the two kinds of conflict is similar: a fiduciary must not \textit{place himself or act} in a conflict situation.\textsuperscript{43} The breach arises automatically in both cases from the fiduciary placing himself in a position where the duty to one beneficiary is in actual or potential conflict with his interest or with the duty to the other beneficiary.\textsuperscript{44} In both instances of conflict of interest, a fiduciary may avoid liability by disclosing the conflict situation and seeking informed consent from all relevant beneficiaries.\textsuperscript{45}

Disclosure and informed consent are generally regarded as mechanisms by which a fiduciary may avoid liability, rather than distinct fiduciary duties that are triggered once a conflict situation is created.\textsuperscript{46} A relatively recent current of thought argues that fiduciaries have a distinct duty to disclose their wrongdoing, including entering into a conflict of interest. The most prominent court statement in this regard is in \textit{Item Software (UK) Ltd v. Fassihi},\textsuperscript{47} where Arden LJ held that directors have a duty to disclose their misconduct, which is a manifestation of their overarching fiduciary duty of loyalty.\textsuperscript{48} This approach has been heavily criticised. Opponents argued that a fiduciary duty to disclose wrongdoing expands fiduciary

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\textsuperscript{39} See also \textit{Huntington Copper and Sulphur Co Ltd v Henderson} (1877) 4 R 294 at 299 per Lord Young.


\textsuperscript{42} Matthew Conaglen, “Fiduciary Regulation of Conflicts between Duties” (2009) 125 Law Quarterly Review 111 at 125.


\textsuperscript{44} \textit{Bristol and West Building Society v Mothew} [1998] Ch 1 at 18-19; \textit{Bristol and West Building Society v Fancy & Jackson} [1997] 4 All ER 582 at 614.


\textsuperscript{46} Ibid, 155.

\textsuperscript{47} [2004] EWCA (Civ) 1244.

\textsuperscript{48} Ibid, paras 42-43.
duties beyond realistic bounds,⁴⁹ conflates the mechanism for curing a conflict with the no-conflict duty itself,⁵⁰ and is inconsistent with the general freedom from self-incrimination.⁵¹ Scots law seems to reject a fiduciary duty of disclosure for company directors. In 
\textit{Commonwealth Oil & Gas Company Ltd. v Baxter},⁵² the Lord President and Lord Nimmo Smith⁵³ rejected the suggestion that fiduciary duties are proscriptive and expressed reservations regarding the applicability of \textit{Item Software} in Scotland. Lionel Smith has proposed a more sophisticated explanation of why a fiduciary duty of disclosure exists.

According to his theory, within the sphere of fiduciary management, the fiduciary acts on behalf of and for the benefit of the beneficiary. Consequently, the beneficiary is legally entitled to everything arising from the sphere of fiduciary management. This creates a primary fiduciary duty of disclosure of relevant information. When a conflict of interest arises, failure to disclose it is a breach of a duty in the strict sense. Any loss caused by that breach should be recoverable as equitable compensation.⁵⁴ This approach has a strong theoretical appeal. Nevertheless, it is submitted, respectfully, that a duty to disclose everything that may reasonably be considered relevant to the sphere of fiduciary management, including the fiduciary’s own wrongdoing, seems too broad. There is a degree of difficulty in determining when such duty is triggered and whether it depends on the fiduciary’s subjective assessment of what is in the interests of the beneficiary to know.

Returning to the \textit{Kidd} scenario, it appears that, in light on the arguments above, the relevant fiduciary obligation that PW LLP breached was the duty not to place themselves in a duty-duty conflict by accepting both Lime Rock and RGK as clients. PW LLP had a duty of disclosure and advice, but that was a contractual duty of disclosure, not a fiduciary one. The difference is potentially significant, because the two liability regimes may lead to different monetary awards. Consequently, for the purpose of determining causation in the breach of fiduciary duty claim, the but-for test required the court to determine what course of action RGK would have taken, had PW LLP refrained from acting as his solicitor in the Lime Rock

⁴⁹ Alan Berg, “Fiduciary Duties: A Director's Duty to Disclose His Own Misconduct” (2005) 121 Law Quarterly Review 213 at 220.
⁵² 2009 SLT 1123.
⁵³ Ibid, 1127 and 1138 respectively.
transaction. The Court, instead, reasoned that the relevant fiduciary duty was the contractual duty to disclose the conflict and to advise the client to seek independent legal advice, and held that the test for causation requires an evaluation of what RGK would have done if he had received independent advice and abandoned the Lime Rock transaction. It is submitted, respectfully, that the latter test is relevant for determining the loss from breach of contract, not for the fiduciary duty claim. The relevance, if any, of the distinction between the two types of claim in Kidd remains to be determined after proof. From a theoretical perspective, however, it is desirable that courts display greater caution when dealing with overlapping claims of breach of contract and breach of fiduciary duty. The fiduciary law theory is beset with controversies, especially as regards the proscriptive versus prescriptive content of fiduciary duties. It is hoped that courts will play a positive role in dispelling some of these uncertainties.

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