The Employment Relationship and Fiduciary Obligations

Introduction

One of the current controversies concerning the law of the employment contract is whether the contract gives rise to a fiduciary relationship and, to the extent that it does not, whether it should.[1] The orthodox view is that entry into an employment contract, of itself, does not give rise to such a relationship.[2] A position recently confirmed so far as Scotland is concerned by Lord Glennie in *Samsung Semiconductor Europe v Docherty*.[3] There are though weighty dicta to the contrary; such as the opinion of Lord Jauncey in *Neary v Dean of Westminster*.[4] Again, in *Attorney- General v Blake,* Lord Woolf stated that `There is more than one category of fiduciary relationship, and the different categories possess different characteristics and attract different kinds of fiduciary obligation. The most important of these is the relationship of trust and confidence, which arises whenever one party undertakes to act in the interests of another or places himself in a position where he is obliged to act in the interests of another. The relationship between employer and employee is of this character. The core obligation of a fiduciary of this kind is the obligation of loyalty. The employer is entitled to the single-minded loyalty of his employee. The employee must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third party without the informed consent of his employer.'[5] Such dicta have the undoubted potential to form the basis for a judicial reformulation of the law. In addition, the prevailing orthodoxy notwithstanding, some commentators assert that classification of employees as fiduciaries would be a positive development which would enhance the content of the employment contract.[6]

As matters stand it is undoubtedly the case that, in some circumstances, the employee may come under fiduciary obligations. For instance, an employee should not accept a bribe and, in the event

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[1] See L.Clarke, `Mutual Trust and Confidence, Fiduciary Relationships and Duty of Disclosure', (1999) 30 ILJ 348. On the law in general see M.Conaglen, *Fiduciary Loyalty: Protecting the Due Performance of Non-Fiducary Duties* (Hart: 2010).
[2] *University of Nottingham v Fishel* [2000] IRLR 471.
[3] [2011] CSOH 32.
[4] [1999] IRLR 288.
[5] [1998] Ch. 439.
[6] Clarke (n 1) at 359.

that he does so, he will have to account for it to his employer.[7] An employee who is employed as an agent will, in the ordinary course of things, owe the normal fiduciary obligations inherent in that relationship such as the duty not to make secret profits. It also appears to be the case that, in some jurisdictions including England, some senior employees are regarded as fiduciaries.[8] The scope of the contractual obligations undertaken may impact on the extent to which fiduciary obligations are owed by the employee. The Australian case of *University of Western Australia v Gray* dealt with a claim that the contract contained an implied obligation to invent.[9] For a variety of reasons this was unsuccessful but had it been the employee would have become subject to fiduciary obligations. *Gray* reminds us of the employer's ability to increase the significance of such obligations by extending the scope of express contractual ones. Again, the corporate opportunity doctrine does not necessarily apply to employees given that they are not fiduciaries. However, it may be relevant depending upon what the employee is employed to do.[10] Where the employee's responsibilities include the procuring of business on the employer's behalf the doctrine will then be applicable. An employee engaged in a different capacity would though be perfectly entitled to divert a corporate opportunity: `the employee does not in general promise to give his employer the benefit of every opportunity falling within the scope of its business.'[11]

Scope for Confusion

It should be said that the fact that, from time to time, the employee may owe some fiduciary obligations may lead to the erroneous assumption that the employment relationship is fiduciary in nature. The emergence of the implied obligation of mutual trust and confidence, and in particular the manner in which it is expressed, may also serve to confuse. In *University of Nottingham v Fishel* Elias J referred to `the use of potentially ambiguous terminology in describing an employee's obligations, which use may prove a trap for the unwary. There are many cases which have recognised the existence of the employee's duty of good faith, or loyalty, or the mutual duty of trust and confidence- concepts which tend to shade into one another.'[12] The existence of the obligation of fidelity (a duty owed by all employees) further complicates things. In *CRC-Evans Canada Ltd v Pettifer* it was observed that that duty requires ` the employee to act in the best

[7] *Fishel* (n 2).

[8] *Shepherds Investment v Walters* [2007] IRLR 110.
[9] [2009] FCAFC 116.
[10] *Samsung* (n 3).
[11] *Fishel* (n 2) 485.
[12] *Fishel* (n 2) 483.

interests of his employer at all times. The employee shall not follow a course of action that harms or places at risk the interests of the employer.'[13] Expressed in such broad terms the obligation appears to be highly continuous to a fiduciary obligation; the obligation to ` to act in the best interests of his employer at all times' is particularly significant in this regard. However, it is not the case that the obligation of fidelity goes this far: ` the hallmark of a fiduciary duty is a requirement that a person pursues the interests of another at the expense of his own: but an employment relationship does not in itself require an employee to pursue his employer's interests at the expense of his own.'[14] Whilst the employee must further the employer's interests he need not do so exclusively and, for instance, is entitled to take limited steps by way of preparation (prior to his leaving the employment) to compete with the employer without falling foul of the obligation of fidelity.

Where Next?

There does appear to be some evidence that the obligations arising under the employment contract are moving closer to those owed by a fiduciary; the implied obligation of fidelity, for instance, may demand more by way of propriety where a senior employee is concerned.[15] More fundamentally, but perhaps questionably, some jurisdictions now hold that senior managers are fiduciaries. The way in which an employee's obligation of disclosure has evolved is also of relevance. An employee is not obliged to disclose his own misconduct whether that misconduct arises before the commencement of the employment relationship or during its existence; *Bell v Lever Bros* remains good law[16]. By way of contrast, fiduciaries `come under an open-ended, affirmative duty of disclosure.'[17] The *Bell* case has been distinguished in *Sybron Corp v Rochem* [18] where it was held that, in certain circumstances, an employee holding a managerial role may be under a duty to report the misconduct of fellow employees. Crucially, where such a duty arises the employee is still obliged to report even where he will incriminate himself. It is

[13] 1997 CanLII 14943 (AB QB**)** para 45. And see R. Flannigan, `The (Fiduciary) Duty of Fidelity', (2008) 124 LQR 274.
[14] *Lonmar Global Risks v West* [2011] IRLR 138 at 156.

[15] *Collidge v Freeport* [2007] EWHC 1216.

[16] [1932] AC 161.

[17] S. Deakin and G.S. Morris, *Labour Law, (2005)* 342. The extent of a director's duty of disclosure under Scot's law is unclear: *Commonwealth Oil & Gas v Baxter* 2009 SLT 1123.
[18] [1983] ICR 801.

submitted that the stance adopted in the *Sybron* case is well-founded. Such obligations may well be inherent in the role undertaken by the employee and hence essential to proper job performance. The circumstances relevant to determining whether a duty to report is owed will include the express contractual obligations of the employee and his role in the organisation[19]. It is also the case that the creation of the implied obligation of mutual trust and confidence may mean be that, in future, an obligation of disclosure will apply where one side possesses information that the other could not reasonably be expected to know and where the information would serve to protect the interests of the other side.[20] In any event, it is arguable that the emergence of a more extensive obligation of disclosure moves the employment contract a step closer to joining the ranks of fiduciary relationships.

Obligations Owed by Senior Management

As we have seen, it appears that those belonging to `senior management' are now viewed as fiduciaries in some jurisdictions and therefore constitute an exception to the general rule. Admittedly, there is no reason in principle why the common law obligations owed by employees should be the same irrespective of the role played by them or their place in the organisational hierarchy. Why should the obligations imposed by law as a consequence of entry into a contract of employment be the same in respect of both a member of the senior management team and a junior salesperson? Certainly in *Gray* the Australian Federal Court recognised that` while one type of term may quite appropriately be implied in a class of contract cast in very general terms, e.g. in a contract of employment the employee's duty to obey lawful and reasonable directions given by the employer that fall within the scope of the employment, ...another term may be of such a character as to be implied only into a recognisable sub-category of that larger class.' [21] Where disclosure is concerned we have already seen that an employee in a managerial position may come under a more extensive obligation than his colleagues; what is seen as incidental to the contract of employment may vary depending upon the employee's place in the structure of the organisation. The Canadian courts though have adopted a much more radical stance by extending the full range of fiduciary obligations to those who can be categorised as senior managers. In *Canadian Aero Service v O'Malley* the Supreme Court approved the view of Gower in his seminal work on Company Law[22] that fiduciary ` duties, except in so far as they depend on statutory provisions expressly limited to directors, are not so restricted but apply equally to

[19] *RBG Resources v Rastogi* [2002] EWHC 2782 (Ch).
[20] D. Brodie, *The Employment Contract*, (2005) 71.
[21] *Gray* (n 9) para 138.
[22] The sentence approved is repeated in the current edition: PL.Davies, *Gower and Davies' Principles of Modern Company Law* (8th ed) 486.

any officials of the company who are authorised to act on its behalf, and in particular to those acting in a senior managerial capacity.'[23] It is worthy of note that Gower did not cite any authority for this proposition and the current editor of Gower has felt compelled to insist that the employment relationship is not a fiduciary relationship `so that it would be inappropriate to apply the full range of director's duties to even senior employees.'[24] An individual affected by the `*O'Malley*` doctrine owes the full range of fiduciary duties; in *O'Malley* itself the application of the `corporate opportunity' doctrine restricted the capacity of the defendant from pursuing a number of business opportunities. In developing the law in that case the Supreme Court drew upon the moral code underpinning the law of fiduciary obligations: `loyalty, good faith and avoidance of a conflict of duty and self-interest.' Encompassing senior management officials within the class of those owing fiduciary obligations was `simply recognition of the degree of control which their positions give them in corporate operations, a control which rises above day-to-day accountability to owning shareholders and which comes under some scrutiny only at annual general or at special meetings.' The court appears to have been concerned that some senior employees had as much opportunity to influence the company's affairs as directors. Were they to abuse their powers then the risk posed to the company is of a similar magnitude. This rationale might be thought to mirror that which prompted the emergence of the concept of *de facto* directors.[25] This concept allows persons who can be regarded as having an involvement in the corporate governance of a company (but who have not been appointed as directors) to `be treated as directors for the purposes of statutory provisions relating to such matters as wrongful trading by, and disqualification of, directors'.[26] Guidance on the criteria to be used in identifying such a director was given by Jacob J in *Secretary of State for Trade and Industry v Tjolle*: `Those factors include at least whether or not there was a holding out by the company of the individual as a director, whether the individual used the title, whether the individual had proper information (e.g. management accounts) on which to base decisions, and whether the individual has to make major decisions and so on. Taking all these factors into account, one asks 'was this individual part of the corporate governing structure?' answering it as a kind of jury question.'[27] As a corollary of their participation in decisions going to the heart of the company's welfare *de facto* directors owe fiduciary duties. Some senior managers will undoubtedly be *de facto* directors.

[23] [1973] 40 DLR (3d) 371.
[24] Davies (n 22).

[25] Davies (n 22) at para 16-08.

[26] *Holland v Revenue and Customs* [2011] 1 All ER 430, para 54
[27] [1998] BCC 282 at 290.

Whatever the merits of the decision in *O'Malley*, the manner in which the law in Canada has evolved since then flags up several concerns and two points might be made in particular. First, it has proved very difficult to find a convincing basis upon which to distinguish between those who are senior managers and those who are not. Second, and not unrelated to the previous point, the range of employees who have been caught has been extensive. Deciding who can be categorised as a member of senior management has not proved to be at all straightforward. A voluminous body of case law has led to little progress in respect of either indicia or definition. On occasion judicial focus has been on the nature of the discretion possessed by the employee; employees being classified as fiduciaries where they `are in the position to unilaterally exercise their authority in a way that could affect their employer's legal and economic interests'[28]. This is less than helpful given that the range of employees who possess a degree of discretion is extensive; in a different context Lord Steyn noted that `there can be discretion even in the hammering of a nail'.[29] It might be said that any employee with any measure of discretion is in a position to impact upon the employer's interests; albeit that the likelihood of significant damage occurring will vary enormously. Some other Canadian decisions look to the degree of trust imposed as a guide to the position of the employee in the management hierarchy: `In general, the relationship becomes elevated to the fiduciary level when the employer reposes trust and confidence in the employee on a continual basis, relying upon the employee in reaching business decisions. It is the trust and reliance transferred by the employer which gives the employee the power, and in some cases, the discretion, to make business decisions, on the employer's behalf.'[30] Again though, particularly in a large organisation, a significant number of employees may be in this position and, in fact, the category of employees concerned has not been limited to those involved in formulating overall strategy. In *Anderson v Smyth and Kelly Customs Brokers v World Wide Customs Brokers*, for example, a manager responsible for the day-to-day operations of a company's regional office was found to be a fiduciary as he was in `a position of trust with attendant power to affect the economic interests of the appellant.'[31] The nature and significance of the decisions that the employee is entrusted to take must also be highly relevant if this factor is to serve as a test.[32] Is it only business decisions that might be expected to be taken by members of senior management that are determinative? If the answer to that question is yes then we are no further forward in our search for elucidation.

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[28] *Boehmer Box v Ellis Packaging*, 2007 CanLII 14619 (ON SC), para 45.

[29] *Gorringe v Calderdale MBC* [2004] 2 All ER 326, 331. Lord Steyn was quoting from Paul Craig, *Administrative Law*, 2003, 5th ed, 898.

[30] *Sure Grip Fasteners Ltd. v. All Grade Bolt and Chain Inc*. (1993) 45 C.C.E.L. 276 at 284.

[31] *Anderson, Smyth and Kelly Customs Brokers v World Wide Customs Brokers* [1996] 7 WWR 736, para 15.

[32] *Tree Savers International Ltd, v. Savoy* (1991), 81 Alta. L.R.(2d) 325, 328 (Q.B.), (affd. (1992), 120 A.R. 368.

Finding a means to determine the class of employees who are caught by the *O'Malley* doctrine has been hugely problematic. The underlying rationale has been lost sight of; courts do not ask whether the employee is in a position to control the business to a degree that is analogous to directors. The extensive case law has failed to produce effective criteria. Lack of clarity about what is meant by the term senior management has led to classification as a fiduciary being extended to employees who are not involved in corporate decision-making but whose role is simply important to the success of the company. On occasion in Canada it has sufficed that the employee could be viewed as `key personnel'; though the case law on who is key is difficult to reconcile.[33] The range of employees who are encompassed is though considerable. More significantly, the identification of the category of `key personnel' has served as a catalyst for the revision, and readjustment in favour of the employer, of existing obligations. In *Radd Precision v Lall* a sales manager, who had exclusive contact with customers and had access to the employer's confidential information about the customers, was viewed as a fiduciary.[34] It is clear that the defendant was not a decision-maker in the employer's organisation. The key to the decision seems to have been the fact that he had complete access to the customer list.[35] Of course the employee who has access to confidential information already undertakes obligations by virtue of his duty of fidelity. *Radd* suggests a perceived need to reconstitute the latter obligation on a more onerous basis. Adams J, in *CHS Air Conditioning v Environmental Air Systems,* pointed to one factor which he thought prompted courts to find that an employee stood in a fiduciary relationship with their employer: "where former employees exploit obviously and highly confidential information in a manner that strikes a court as grossly unfair, it is more likely that a fiduciary obligation will be found to exist or that the information will be treated as the equivalent to a trade secret." [36]Such an expansive approach to fiduciary obligations may be seen as unsatisfactory on policy grounds: `…the general interest of the public in free competition and the consideration that in general citizens should be free to pursue new opportunities, in my opinion, requires courts to exercise caution in imposing restrictive duties on former employees in less than clear circumstances. Generally speaking…the law favours the granting of freedom to individuals to pursue economic advantage through mobility in employment.[37] The employer's interests can be protected by the obtaining of a covenant and the employee's by judicial scrutiny thereof.

[33] See the various authorities listed in *Boehmers*, (n 24).
[34] 1996 CanLII 8173 (the proceedings were interlocutory).
[35] Other cases of this sort are referred to in *Boehmers* (n 24).

[36] 20 CCEL (2d) 123 , para 23.
[37] *Barton Insurance Brokers Ltd. v. Irwin*, (1999), 170 D.L.R. (4th) 69

O'Malley has been accepted as representing the law in England; it remains unclear what a Scottish court would decide.[38] There are no indications that the courts in the UK will find it any easier than their Canadian counterparts to articulate key indicia of seniority. *Crowson Fabrics v Rider*, for instance, approached the matter in a decidedly circular way: `Where an employee was not a director it was essential to look at his role and determine whether or not the nature of that role was sufficiently senior for the court to conclude that in addition to his normal duties as an employee he owed a fiduciary duty'.[39] The management structure adopted by a company may assist; for example, the existence of a senior management team. Other factors which may be relevant have been held to include the level of remuneration conferred, the degree of trust reposed and the extent to which the employee was involved in the formulation of company strategy.

I would suggest that all of this is problematic. The imposition of fiduciary obligations is a matter of consequence; not least because of the range of remedies that are opened up to the claimant. It should be clear when those obligations arise. The term `senior management' could not be more nebulous and carries different connotations in different organisations. Judicial elaboration has not been assisted by lack of attention to the reasoning that prompted the decision in *O'Malley*. If we assume, at least for the moment, that senior management should be regarded as fiduciaries there is much to be learned from the case law on *de facto* directors. There criteria have been developed which are consistent with and indicative of the underlying rationale. For instance, as already discussed, in *Tjolle* Jacob J indicated a number of factors that can be utilised to decide whether someone is a *de facto* director. The factors concerned are designed to elucidate whether the role adopted has sufficient connection with the running of the company to allow an affirmative response. They reflect the underlying rationale that what matters is control of company strategy and policy. They are specifically formulated to determine whether the individual concerned is part of "the corporate governing structure".[40] It must also be said that if the law on *de facto* directors succeeds in capturing such individuals it is not clear whether there is any justification for senior managers being held to owe fiduciary duties as well.

The Future

As we have seen, there are some indications that the contract of employment is taking on more of a

[38] *Crowson Fabrics v Rider* [2008] IRLR 288.
[39] *Crowson* (n 38) at
[40] *Tjolle* (n 27).

fiduciary flavour. However, I am far from convinced that they are particularly weighty. The most significant development has been the decision in *O'Malley* but the inclusion of senior management can be seen as an exception to the general rule; albeit one of uncertain ambit. Moreover, *O'Malley* may not represent the law of Scotland. The case law developments on disclosure are consistent with, and can be explained by, the contract of employment being influenced by notions of good faith to a greater extent than was previously the case. Indeed it is important to have regard to the key development and driver for change; i.e. the emergence of the implied obligation of mutual trust and confidence - a term which has become central to the content and values of the employment contract. One impact of the term may be that employees will be entitled to concern themselves less with the interests of the employer. This is however contingent upon the manner in which the courts resolve the tension between the mutual trust term and the obligation of fidelity. It should be said that the former term emerged from contemporary judicial thinking about the employment relationship whilst the latter is much longer established. The former term reflects `a `unitary' view of industrial relations in which common interest and partnership (and not conflict and subordination) are emphasised as features of the employment relationship.'[41]The way in which the resulting tension is resolved will have significant consequences for the extent of an employee's obligations. In the *Malik* case Lord Steyn observed that `the implied obligation as formulated is apt to cover the great diversity of situations in which a balance has to be struck between an employer's interest in managing his business as he sees fit and the employee's interest in not being unfairly and improperly exploited.'[42] The advent of the obligation of mutual trust and confidence means that the employment contract will have to be interpreted in a manner which takes account of the fact that the interests of employer and employee may legitimately diverge. The obligation requires that `each party must have regard to the interests of the other, but not that either must subjugate his interests to those of the other. '[43] The requirement that regard be had to the interests of both sides may appear difficult to reconcile with the conventional formulation of the obligation of fidelity which requires that the employee does not act contrary to the employer's interests. Having said that the articulation of the detailed requirements imposed under the umbrella of the obligation of fidelity also involves a balancing exercise (albeit implicitly) between the interests of the two sides. The case law on the legitimacy of preparatory acts of competition, prior to leaving employment, furnishes an example. I would suggest that the emergence of the obligation of mutual trust and confidence, given its explicit recognition of the employee's interests,

[41] B.W.Napier (1977), `Judical Attitudes towards the Employment Relationship - Some Recent Developments 6 ILJ 1 at 17.

[42] *Malik v BCCI* [1998] AC 20 at 46.
[43] *Fishel* (n 2) 483.

may require that the balance be struck somewhat differently in the future. This would allow for proper account to be taken of the employee's interests. Some of the older cases dealing with the obligation of fidelity may have been based on the erroneous view that the employment contract is fiduciary in nature requiring `that one party must exercise his powers for the benefit of another.'[44] The courts must determine how the implied obligations of mutual trust and confidence and fidelity should be read together; there is an obvious need for internal coherence within the body of law constituted by the implied terms of the contract of employment.

Over the last 30 years the judicial view of the nature of the employment contract has changed and, as a result, there have been significant changes to the content of the contract. Traditionally the employment contract would have been viewed as commercial in nature and therefore giving rise to a relationship which was not fiduciary: `fiduciary obligations are seldom present in dealings of experienced businessmen of similar bargaining strength acting at arm's length.'[45] Now we view the employment relationship differently; the common law no longer disregards the imbalance of power that is the hallmark of employment relations. In *Slaight Communications v Ron Davidson* the Canadian Supreme Court endorsed the following passage from Kahn-Freund's seminal work, Labour and the Law: 'The relation between an employer and an isolated employee or worker is typically a relation between a bearer of power and one who is not a bearer of power.'[46] `In a similar vein in *Malik v BCCI* it was said that `An employment contract creates a close personal relationship, where there is often a disparity of power between the parties. Frequently the employee is vulnerable'[47]. Recognition of the power imbalance and consequent vulnerability in employment relations is important in the current context and, in my opinion, makes it highly improbable that the employment relationship will move into the world of fiduciary relations. Fiduciary obligations exist to protect the vulnerable. In her influential judgment (though in fact dissenting) in *Frame v Smith* Wilson J stated that relationships in which a fiduciary obligation have been imposed possess three general characteristics; one of which is that the beneficiary is peculiarly

[44] *Fishel* (n 2) 483.

[45] *Frame v Smith* [1989] 1 SCR 1038 at para 63. In *ABK Limited v Foxwell* [2002] EWHC 9, para 73 it was said that `The importation of fiduciary duties into an essentially commercial relationship is something which may occasionally be done, [but] a great deal of caution needs to be exercised in doing it'. . In *Johnson v. Gore Wood* [2002] 2 AC 1 Lord Cooke referred to *Addis v Gramophone* [1909] AC 488 and observed that `In severely confining damages for wrongful dismissal, your Lordships' House of those days appears to have seen the relationship of employer and employee as no more than an ordinary commercial one. This is a world away from the concept now…'.

[46][1989] 1 SCR 1038.

[47] *Malik v Bank of Credit and Commerce International SA* [1998] A.C. 20 at 37.

vulnerable to or at the mercy of the fiduciary holding the discretion or power.[48] Vulnerability of this nature will often be present in a fiduciary relationship but viewing the employer as being at the mercy of the employee seems counterintuitive. Can it really be said that the employer is vulnerable? It is certainly the case that should the employee perform his obligations incompetently there is a risk to the employer's business. In that sense, as in all contracts, each party has a degree of vulnerability. However, the employer could hardly be said to be `peculiarly' vulnerable. Moreover, he has a number of devices at his disposal, such as imposing a restrictive covenant, which can be utilised to protect his interests. Recognition of the employee's vulnerability in the face of disparity in bargaining power prompts the question whether the employer should be held to owe fiduciary obligations to the employee. The answer is in fact no. Lord Steyn's treatment of divergent interests works both ways. Just as it serves to protect the employee from the unitary perspective which informed the obligation of fidelity it also allows the employer to have regard to interests other than those of the employee.[49]

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[48] *Frame* (n 45) at para 60. In the recent Supreme Court of Canada decision in *Alberta v Elder Advocates* 2011 SCC 24 at para 36 it was said that `for an *ad hoc* fiduciary duty to arise, the claimant must show, in addition to the vulnerability arising from the relationship as described by Wilson J. in *Frame:* (1) an undertaking by the alleged fiduciary to act in the best interests of the alleged beneficiary or beneficiaries; (2) a defined person or class of persons vulnerable to a fiduciary's control (the beneficiary or beneficiaries); and (3) a legal or substantial practical interest of the beneficiary or beneficiaries that stands to be adversely affected by the alleged fiduciary's exercise of discretion or control.'

[49] In any event, fiduciary obligations are less likely to arise in contracts where the obligations are reciprocal.