

Zhang, C. (2018) The limits of fiduciary duties in business organizations: the evidence from limited partnerships in the US and UK. *European Company Law*, 15(3), pp. 83-89.

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Deposited on: 09 September 2019

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**The Limits of Fiduciary Duties in Business Organizations:  
the Evidence from Limited Partnerships in the US and UK**

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**Abstract**

*The development of fiduciary duty regime in the commercial law in Anglo-American countries has experienced more than one hundred years. Although fiduciary duty rules have been widely applied in business organizations for enhancing investor protection, the connotation and practice of fiduciary duties in modern commercial world are being changed dramatically during the recent decades. This article aims at exploring the functions and limits of fiduciary duties in business organization laws by carrying out detailed research on the institutional evolution of fiduciary duties in the limited partnership laws of the United States and United Kingdom. By both theoretical and practical analysis of fiduciary duties, this article emphasizes that any legal technique has its limits and boundary and the institutional advantages of fiduciary law can be well realized by alternative institutional arrangements; and any abuse of using fiduciary law in business organizations will decrease efficiency, and the legal transplantation of fiduciary law may also be costly in the destination countries outside common law jurisdiction.*

**1 Introduction**

The fiduciary duty regime is regarded by common-law scholars as an efficient and effective legal institution for cutting transaction costs in organized business activities, since the case-by-case practice of the courts can flexibly fill the gap between the market participants and then save the contractual costs of negotiating in commercial enterprises.<sup>1</sup> However, any legal institution has its own limits. In other words, the fiduciary duty as a practical legal technique for protecting

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<sup>1</sup> See Frank H. Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1991) 90-108.

investors also has its limitation and any abuse of fiduciary law in business organizations may also be inefficient.

This article aims to explore the limits and boundary of fiduciary duties in business organization laws by reviewing and analyzing its evolution in the reform of limited partnership legislation of the United States (US) and the United Kingdom (UK). In the second section of this article, the economic functions of fiduciary duties will be examined briefly; the following section will discuss the basic principle and evolution of fiduciary duties in the limited partnerships of the US and UK, by which the changing attitude towards managing partners' duties can be displayed. Based on the above theoretical discussion of fiduciary duties and practical study on the limited partnership laws in the US and UK, this article will point out the limitation of fiduciary duties in the context of transaction cost economics and its practical implication.

## **2 Fiduciary Duty as Default Rules: the Economic Functions**

Based on the contractual theory of the firm, the governance rules of the firm mainly depend on the agreement between the parties.<sup>2</sup> Theoretically, contractual parties can optimize the governance structure by drafting specific contractual provisions, by which all circumstances will be predicted and stipulated in contracts. In fact, it is impossible to predict all the contingencies in future and even if it were possible, the costs of drafting such contracts would be insufferable; that is to say, the contract of the firm would be incomplete. In such circumstances, the primary issues that need to be considered is how to deal with the uncertainty generated from the incompleteness of firms' contracts.

As a response to the uncertainties, two main approaches may be useful. The first is that the legislators are expected to draft more detailed statutes to provide solutions for the parties in the market in advance. However, aside from the problematic feasibility, owing to the complexity and volatility of business in modern society, over-detailed legislation may seriously weaken the

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<sup>2</sup> See details of the contractual theory of the firm: Henry N. Butler, 'The Contractual Theory of the Corporation' (1989) 11 (4) George Mason University Law Review 99.

legislative flexibility and adaptability in real commercial world. Additionally, no matter how accurate the written laws can be, it is difficult to avoid the vagueness of definition in the statutes. For example, different parties may have different understandings of the same term in a law; or a given circumstance may lie out the definition provided by the present legislation;<sup>3</sup> in other words, it is obvious that pursuing the completeness of legislation is not efficient.

The second approach to addressing the uncertainties in commercial law is external intervention and remedies. In the context of common law jurisdictions, fiduciary duties as default rules developed by the judiciary play an underlying role in dealing with the uncertainty in business law. In general, the fiduciary duty is one of the core concepts in business organizations of the Anglo-American jurisdiction. Although the fiduciary duties generally can be summarized as the duty of care and duty of loyalty which are imposed on persons such as the director in the company, the trustee of the trust fund or the managing partner in a partnership, the precise meaning of the fiduciary duties might not be understood correctly without a reference to the voluminous case law.

From an economic point of view, the fiduciary duty system plays a role as a gap-filler for reducing or correcting the uncertainties in incomplete contracts, in which the contractual parties can spend more time on issues for their own specific needs and leave the broader issues to the court.<sup>4</sup> Moreover, judicial sanctions against a manager's breach of fiduciary duties also convince the parties of the firms that the external pressure of fiduciary duties is able to supervise the managers effectively to perform properly.<sup>5</sup> In summary, the application of fiduciary duties has provided a flexible and costless way to extend the freedom of participants in transactions and to improve economic efficiency of business organizations.

### **3 The Fiduciary Duty of General Partners in Limited Partnerships of the United States**

Generally speaking, the fiduciary duties of a general partner in a limited partnership of the US

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<sup>3</sup> Iain G. MacNeil, 'Uncertainty in Commercial Law' (2009) 13 *Edinburgh Law Review* 68, 76.

<sup>4</sup> Iain G. MacNeil, 'Company Law Rules: An Assessment from the Perspective of Incomplete Contract Theory' (2001) 1 (1) *Journal of Corporate Law Studies* 107, 119.

<sup>5</sup> Easterbrook and Fischel (n 1) 92.

means that the law refrains general partners (GPs) from 1) appropriating any limited partnership's opportunities for his/her own sakes and 2) competing with the limited partnership he/she is managing and 3) dealing with the limited partnership's any business on behalf of another party with an adverse interest and 4) exceeding the authority granted to him/her in the partnership agreement to dispose the limited partnership's property. In practice, however, the connotation of the above rules has been changed through ages.

### ***The Highest Standard of Loyalty: Cardozo's Principle***

In the history of the US partnership law, the basic principle of the fiduciary duties of a managing partner initially emerged from *Meinhard v Salmon* (1928), a case appealed to New York Appeal Court. Salmon, the defendant obtained a twenty-year lease on a building owned by a third party, and the parties agreed to change the building from a hotel to shops. In order to finance the venture, Salmon entered into a joint venture, in which Meinhard would provide the investment capital, Salmon would manage the business, and the profit would be shared between them. When the lease was about to run out, the property owner approached the defendant to offer him an opportunity to lease a much larger real estate, including the current building. By the end of the joint venture, Salmon entered into a new lease between himself and the owner without informing the plaintiff.<sup>6</sup> Then Meinhard sued Salmon for the breach of the venture agreement and finally won the lawsuit in New York Appeal Court.

In the majority opinion of the court, Cardozo J *held* that co-venturers (partners) '*owe to one another, while the enterprise continues, the duty of finest loyalty*'.<sup>7</sup> What's more, in most cases of joint ventures or business partnerships, co-operation is mainly based on the high level mutual faith among each partner, therefore, judge Cardozo further decided that '*not honesty alone, but the punctilio of an honor the most sensitive is then the standard of behaviour*'.<sup>8</sup> Therefore, partnerships or joint ventures are much more closed and private-trust-based than other business organizations. Any individual partner mustn't take advantages of opportunities or interest without

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<sup>6</sup> *Meinhard v Salmon*, 249 N.Y. 458, 463-4, 164 N.E. 545 (1928).

<sup>7</sup> *Ibid.*

<sup>8</sup> *Ibid.*

informing other partners, even though the above duties may not be clearly expressed in a partnership agreement.

Judge Cardozo's opinion affects profoundly, hereafter, for more than half a century in the US courts, hundreds of the cases regarding the fiduciary duties in partnership law cited Cardozo's opinion as the reason for judgement. As a result, in the US partnership law cases, a breach of fiduciary duty can occur by something less than fraud or intentional bad faith.<sup>9</sup>

### ***The Equitable Duty of General Partners of Limited Partnerships***

Ever since Cardozo's decision was popularly accepted in the US courts, the case law of partnerships, especially US laws of limited partnerships have been developed in the direction of imposing strict equitable duty of loyalty on managing partners. In the Delaware case, *Boxer v. Husky Oil Co.*(1981),<sup>10</sup> Husky Exploration Limited (HE.Ltd) was a limited partnership that invested in oil and mineral resources. Pursuant to the Partnership Agreement, Husky Petroleum Corporation (HP.Co), the general partner (GP) was granted an option to purchase the interests of all the limited partners (LPs), the GP was entitled to assign the option to another. By the expiry date of the limited partnership agreement, the GP assigned the interests of two investments of the limited partnership to Husky Oil Company (HO.Co), the controlling shareholder of the HP.Co, in the values of \$10m and \$78480 respectively. However, such two deals was considered by the LPs as extremely unfair. The plaintiffs filed to the Court of Chancery of Delaware and alleged that the GP had breached its fiduciary duty to the LPs by standing on both sides of the transactions.<sup>11</sup>

The primary dispute in this case was that if the remedy was full by the statutes, whether a lawsuit regarding fiduciary duties can be accepted by the Court of Chancery. Although the Delaware Code<sup>12</sup> excludes the equitable jurisdiction of a case in which sufficient remedy can be satisfied by other statutes such as contract law, or common law. Nevertheless, the court held that:

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<sup>9</sup> Robert Thompson, 'The Story of Meinhard v. Salmon and Fiduciary Duty's Punctilio' (October 16, 2008) Vanderbilt Public Law Research Paper No. 08-44.

<sup>10</sup> *Boxer v. Husky Oil Co.*, 429 A.2d 995, 997 (Del. Ch. 1981).

<sup>11</sup> *Ibid.*

<sup>12</sup> Del.C. § 342 stipulates that '*The Court of Chancery shall not have jurisdiction to determine any*

*‘The statute, 10 Del.C. § 342, being a mere declaration of the ancient rule of equity, neither grants nor divests equity of any jurisdiction ..... the Court of Chancery has historically entertained suits seeking an accounting by fiduciaries and the General Assembly has not enacted any statute transferring that jurisdiction to another court, therefore this Court has jurisdiction over this matter’.*

It is intriguing that although the damages can be recovered by contract law, the US court insisted to impose fiduciary duty on GPs of limited partnerships, which has obviously displayed a strict attitude towards the obligations of the GP in limited partnerships.

### ***Restricting the Fiduciary Duty: the Reforms of the US Partnership Legislations***

Although fiduciary duties in trust law and corporation law are still statutory, in terms of limited partnership law, the US legislators have permitted the parties of limited partnerships to restrict or modify fiduciary duties of managing partners. Delaware Revised Uniform Limited Partnership Act 2000 ("DRULPA") establishes a model to cope with this issue, however, this also arouses ongoing debates pertaining to the fiduciary duty in the US partnership law.

In the appealed case *Gotham Partners v. Hallwood Partners* (2002),<sup>13</sup> Gotham Partners was the largest LP in the limited partnership Hallwood Partners L.P.. In accordance with the limited partnership agreement, Hallwood Realty Corporation, the sole GP was obliged to manage the business under the ‘*entire fairness standard*’ which required fair dealing and fair prices<sup>14</sup> when the GP transacts the limited partnership units or assets with any third party. In a given transaction, however, the GP transferred 23.4% of limited partnership units to its owner, Hallwood Group Incorporated (HGI) in an inadequate price and eventually enhanced HGI’s control over the limited partnership. Hence, Gotham Partners claimed to the Court of Chancery that the general partner has

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*matter wherein sufficient remedy may be had by common law, or statute, before any other court or jurisdiction of this State’.*

<sup>13</sup> *Gotham Partners v. Hallwood Partners*, 817 A.2d 160 (Del. 2002).

<sup>14</sup> *Ibid.*

breached its fiduciary duty.<sup>15</sup> The court decided that there was no doubt that the GP has breached the contractual fiduciary duty, however, pursuant to Section 17-1101(d) (2) of the DRULPA<sup>16</sup>, the fiduciary duty has been moved to an obligation under contract law, rather than equitable rules. Therefore, the Court of Chancery was unable to offer any equitable remedy to the plaintiff. Gotham Partners then appealed to the Supreme Court of Delaware.

The Supreme Court of Delaware reversed the trial court's decision with the reason that although Section 17-1101(d) (2) of the DRULPA gives contractual freedom to the partners of limited partnerships: *'There is no mention in, or elsewhere in DRULPA.....that a limited partnership agreement may eliminate the fiduciary duties or liabilities of a general partner'*,<sup>17</sup> the equitable remedy therefore, should be applicable to this case.

This leading case in limited partnership law shows that the US court firstly articulated that the fiduciary duty of GPs in limited partnerships is unshakable and irremovable. Even if the revised law of limited partnerships of the US allows parties to modify the duties of GPs, in consideration of the close personal co-operation between GPs and LPs, there is no reason to construe that the statute has eliminated the equitable fiduciary duty of managing partners.

The problem is that though the US case law has the discretion to affirm that fiduciary duty should not be eliminated from law of limited partnerships, however, the written legislation doesn't exactly clarify it. What's more, the issue that in what degree the parties are allowed to modify or even waive fiduciary duties by creating contractual provisions of limited partnership agreements, was sparked by private equity limited partnership funds in the US during the recent decade.

### ***Blackstone L.P.: Eliminating Fiduciary Duty on GPs?***

The Delaware General Assembly amended the law of limited partnerships in 2004 and clearly

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<sup>15</sup> Ibid.

<sup>16</sup> Section 17-1101(d) (2) of the DRULPA states: *'the partner's or other person's duties and liabilities may be expanded or restricted by provisions in the partnership agreement'*.

<sup>17</sup> Ibid.



permitted partners to contractually eliminate any partners' fiduciary duty in limited partnership agreements.<sup>18</sup> Private equity (PE) is a 'private club' for big-money players who are commonly sophisticated and qualified institutional investors, hence the activities of PE funds are out of regulatory preview. As a typical closed-end investment fund, the liquidity in PE funds is inadequate, going to public will substantially expand the way of assembling capitals for PE firms. As a basic legal principle in corporation law and securities regulation, directors must assume fiduciary duty to public companies, similarly, for protecting public investors, any listed firms must satisfy the strict ongoing disclosure and transparency requirements. As to listed limited partnerships, unexpectedly, the managers' fiduciary duty can be fully eliminated by limited partnership agreement (LPA), as a consequence, however, limited partners may be exposed to higher opportunistic risk in fund management.

In practice, Blackstone Group Inc. as one of the leading private equity tycoons in the world, may illustrate some important changes in practice of limited partnership law. For instance, Section 7 of the Blackstone Amended and Restated Agreement of Limited Partnership (June 2007)<sup>19</sup> displays how general partners in a listed PE limited partnership can considerably eschew the bind of fiduciary duty under the existing Delaware LP law:

Firstly, the duty of loyalty has been eliminated by the Blackstone LPA. The s7.1(a) evidently entitles the GP '*full power and authority to do all the things .....in its sole discretion*'<sup>20</sup> and s7.9 (b) further makes a wide range of justification to give GP powerful 'sole discretion'.<sup>21</sup> The

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<sup>18</sup> See Section 17-1101(d)(2)(d), Ch17, Title 6 of the Revised Delaware Code.

<sup>19</sup> Details and full text of Blackstone's Agreement which has been approved by SEC is available at: [http://www.sec.gov/Archives/edgar/data/1393818/000104746907005223/a2178627zex-3\\_1.htm](http://www.sec.gov/Archives/edgar/data/1393818/000104746907005223/a2178627zex-3_1.htm).

Hereinafter, the 'Blackstone LPA'

<sup>20</sup> Ibid.s7.1(a).

<sup>21</sup> Ibid.s7.9(b). It was stated that '*the General Partner, ..... is permitted to or required to make a decision in its "sole discretion" ..... shall be entitled to consider only such interests and factors as it desires, including its own interests, and shall have no duty or obligation (fiduciary or otherwise) to give any consideration to any interest of or factors affecting the Partnership or the Partners, and shall not be subject to any other or different standards imposed by this Agreement, any other agreement contemplated hereby, under the Delaware Limited Partnership Act or under any other law, rule or regulation or in equity. Whenever in this Agreement or any other agreement contemplated hereby or*

problem is that such a provision has publicly asserted that the GP in a public LP can not only fully exclude any LPs' intervention but also make any decisions by considering the interests including GP's own stake, whereas there is no restriction requiring the GP to give a priority to the interests of limited partners in decision-making. At the same time, s7.5(c) of the Blackstone LPA clearly states that '*the doctrine of corporate opportunity or other analogous doctrine shall not apply to any such Indemnitee* ',<sup>22</sup> which denies the principle established by Cadorzo J and then gives a leeway to letting the GP appropriate the opportunity for its own sake.

Secondly, in the situation of mergers, the Blackstone LPA also vests the GP a full power to make investment decisions without fiduciary duty to the limited partners. For example, s14.2 of the Blackstone LPA stipulates that:

*'.....merger, consolidation or other business combination of the Partnership pursuant to this Article XIV requires the prior consent of the General Partner, ..... the General Partner shall have no duty or obligation to consent to any merger, consolidation or other business combination of the Partnership .....may decline to do so free of any duty (including any fiduciary duty) or obligation whatsoever to the Partnership'*.<sup>23</sup>

It can be believed that in deciding a vital transaction, such as mergers and acquisitions, the interests of LPs may be threatened by opportunism and the fate of the limited partnership might be exclusively determined by the GP.

Finally, the Blackstone LPA also entitles a modification power to waive the fiduciary duty of the

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*otherwise the General Partner is permitted to or required to make a decision in its "good faith" then for purposes of this Agreement, the General Partner, or any of its Affiliates that cause it to make any such decision, shall be conclusively presumed to be acting in good faith if such Person or Persons subjectively believe(s) that the decision made or not made is in the best interests of the Partnership'.*

<sup>22</sup> Ibid., s7.5(c). According to s1.1 Definitions, *Indemnitees* include the General Partner, departing GPs, affiliates of GPs or any members, officers, directors, employees, agents, trustees of the General Partner. The *General Partner* refers to Blackstone Group Management L.L.C, a Delaware LLC, who is the general partner of the Blackstone Group L.P.

<sup>23</sup> Ibid., s14.2.

GP to the investors. In accordance with s7.9 (e) of this agreement, the GP is not imposed fiduciary duty to the limited partnership and all LPs bound by this agreement are agreed to replace such kind of duties or liabilities of the GP.<sup>24</sup> This provision has an effect that the investors who agree to sign the LPA must voluntarily waive its equitable remedy. In current trends of PE industry of the Wall Street, such a radical and aggressive challenge to fiduciary principles has been adopted by an increasing number of PE firms in the US.<sup>25</sup>

#### **4 The Fiduciary Duties of General Partners of Limited Partnerships in the United Kingdom**

Generally speaking, the main connotation of duty of loyalty in partnership law is the good faith principle. Although the Partnership Act 1890 of the UK provides that the duties and rights of partners in a partnership can be freely determined and revised by the consent of all the partners, the basic rule of duty of good faith regulating the partners' conducts in partnerships has been developed in case law and the application of any rules waiving the duty of loyalty in partnership agreement was void.<sup>26</sup>

Firstly, duty of loyalty means that the equal use and access to the partnership's information and records between the partners is required. In the cases, *Floydd v Cheney*(1970)<sup>27</sup> and *Finlayson v Turnbull*(No.1,1997)<sup>28</sup>, the leaving or resigned partners exclusively occupied the confidential

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<sup>24</sup> Ibid., s7.9 (e). it is provided as follows: '*Except as expressly set forth in this Agreement, to the fullest extent permitted by law, neither the General Partner nor any other Indemnatee shall have any duties or liabilities, including fiduciary duties, to the Partnership, any Limited Partner or any other Person bound by this Agreement, and the provisions of this Agreement, to the extent that they restrict or otherwise modify or eliminate the duties and liabilities, including fiduciary duties, of the General Partner or any other Indemnatee otherwise existing at law or in equity, are agreed by the Partners to replace such other duties and liabilities of the General Partner or such other Indemnatee*'.

<sup>25</sup> In fact, Blackstone is only one of the listed PE partnerships, during 2006-2007, several PE and hedge fund tycoons such as KKR&Co.L.P. and GLG Partners also went public in NYSE. In May 2012, Carlyle Group.L.P., another leading PE firm, was listed in Nasdaq with an offer amount of \$0.67billion. Available at:

<http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aStPTvZ7Eef8&refer=home> and <http://www.nasdaq.com/markets/ipos/company/carlyle-group-lp-863136-68088>.

<sup>26</sup> Geoffrey Morse, *Partnership Law* (7<sup>th</sup> edn OUP 2010) 161-162.

<sup>27</sup> *Floydd v Cheney*, [1970] Ch. 602.

<sup>28</sup> *Finlayson v Turnbull*, 1997 S.L.T. 613.

information of the partnerships' business for opening and operating their own business in future. It was decided that in a partnership enterprise, the fiduciary duty prohibits any partners from appropriating the files or documentations which include the business information belonging to the partnership. The important point is that even though in professional partnerships, like solicitors firms, each individual case or project is handled by appointed lawyer(s), however, the high level trust relationship between partners does not allow any partner to exclusively control the information of the businesses; in other words, no matter which partner control the partnership business, the commercial opportunities in each business are equally owned by the partnership.

In the second place, the duty of loyalty also indicates that the managing partners who substantially handled the business must disclose all related information to the copartners, especially in the circumstance where one partner purchases the partnership interest of another. In the English case *Law v Law* (1905)<sup>29</sup>, the two Laws, William Law & James Law were the co-partners of a partnership in Yorkshire since 1874, latterly, the former moved to live in London and gradually participated little in the partnership's business. In March 1900, William decided to transfer his interest to James and retire from the partnership, then he accepted the offer from James which proposed the transaction in the price of £21000 without any investigation of the account of the enterprise. The consideration was paid to the vendor in the form of installment in July 1900 and 1901. However, short after the second-half payment, William recognized that there were a series of assets weren't told to him but known to James only, which meant that the price of William's share was undervalued. William filed an action against James for compensation in 1901.

The defendant admitted that there were some other assets under the name of the partnership, however, he denied that these assets were never unduly concealed to the plaintiff and contributed to the unfair payment to William, because this private transaction should be carried out in the principle of freedom of contract and William didn't make any effort to investigate the account, business records or any other certificates of the assets and securities of the partnership, the duty of due diligence should be exercised by plaintiff himself, but there was no duty of disclosure on the

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<sup>29</sup> *Law v Law*, [1905] 1 Ch. 140.

defendant. Finally, the court held that, the freedom of contract principle should not be the principal rule in the transaction between the copartners due to the particularly close relationship between the co-partners<sup>30</sup>.

From this case we can see that in British partnership law, the managing partner or the partners who know more information of the business shoulder the duty of disclosing all the related information to the co-partners, in other words, the fiduciary relationship between the partners has substantially restricted the application of freedom of contract.

The other requirement imposed on partners is the prohibition of conflicts of interest between the private profit and the sake of the partnership business. This aspect of partners' fiduciary duty has positioned each partner as a trustee to the beneficiaries in a trust.<sup>31</sup> One leading case illustrating this point is *Bentley v Craven*(1853)<sup>32</sup>, the two parties and two others were the partners of a sugar refinery in Southampton, Craven the defendant was the managing partner of the firm who had sophisticated skills to purchase sugar at a discount price. However, Craven bought the sugar at discount price, then sold it to the firm at market price and made speculative profit for himself. Latterly, the dealing was discovered by the co-partners and Bentley represented the partnership sued the Craven to the court claiming the unjust profit from these transactions.

The dispute is that the dealings were traded in a market price rather than an unreasonably high price, in other words, the co-partners didn't suffer any unacceptable loss or cost from the transactions. So, should the conduct of Craven be deemed as a breach of fiduciary duty? The verdict asserted that although the managing partner in this case didn't cause extra cost to the partnership and it was also likely that if the same deals were handled by other partners whose commercial skills and knowledge were quite ordinary, the trade might be contracted at the same market price or even higher, however, Craven has still violated the fiduciary duty.<sup>33</sup>

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<sup>30</sup> Ibid.

<sup>31</sup> Morse (n 26) 166-167.

<sup>32</sup> *Bentley v Craven*, (1853) 18 Beav 75.

<sup>33</sup> Ibid.

According to above judicial practice, the defendant's speculative profit was ordered to return to the co-partners. And the importance of this case was also pointed by the court: in a partnership, if the managing partner(s) realize a benefit from his/her excellent skills or efforts and expect to make extra bonus from the transactions, he or she must account for it to the co-partners. The fiduciary law doesn't allow the agent to conceal the facts of the deals managed by him/her, neither can the agent make private or secret profit from the deals without any statement to the copartners.

In British fiduciary law, the misusing or appropriating the business opportunities belonging to the principals are also deemed as a breach of duty of loyalty. The leading cases such as *Boardman v Phipps*(1967), *Regal (Hastings) Ltd v. Gulliver*(1967) and *Industrial Development Consultants Ltd v Cooley*(1972)<sup>34</sup> in the field of commercial law have established a rule that any agents (e.g trustees, directors) who are able to acquire business information or privately approach the dealers, should not 1) put himself in the conflict position to the principal's interest and make profit by using the information neither 2) compete with the principals to use the opportunities for personal interests. This equitable rule was regarded as inexorable and the agent's profit must be returned to the principals, no matter the agent is bona fide or not. In other words, the agent cannot obtain extra profit from the dealing, unless it is approved by the principals. Although the practical rule of this was developed and summarized from above cases in corporate law and trust law, there seems little reason why this rule can be rejected in partnership law. The partners of partnerships are prohibited to use the opportunities of the enterprise to make private profit without the consent of co-partners.

In terms of venture capital limited partnerships, however, the similar trend that loosening the fiduciary duties in the law of business organizations also exist in the modern partnership law of UK. For instance, although there are fewer judicial practices clearly permitting the full waiver of fiduciary duties via the drafting of contractual terms, the scope of fiduciary duties, which can be modified by contractual terms, has been a basic principle.<sup>35</sup> Specifically, in consideration of the high costs involved in both the contracting and judicial practices of fiduciary duties, the rigid

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<sup>34</sup> [1967] 2 AC 46, [1967] 2 AC 134 and [1972] 1 WLR 443.

<sup>35</sup> *Kelly v Cooper* [1993] AC 205.

fiduciary duties of general partners in the UK's venture capital funds have been criticized, and it is argued that alternative mechanisms such as reputation<sup>36</sup> and contractual adjustment<sup>37</sup> have been playing an important role in preventing opportunism.

## **5 The Limits of Fiduciary Duties in Business Organizations: Practical Implications**

### ***The Uncertainty in Application of Fiduciary Duties***

Although the fiduciary duty regime as the default rules can save on transaction costs by allocating a part of the legislating power to the judicial system, which can make negotiation among the parties of the firm more efficient, every legal institution is a double-edged sword, the fiduciary duty rules of commercial organizations still have inherent shortcomings. Taking the securities investment fund (such as unit trusts in the UK or mutual funds in the US) as an example, the duty of care requires the trustees to manage the trust assets prudently and professionally in the interests of beneficiaries exclusively. In the instance where a loss occurs and beneficiaries or investors file a lawsuit, it may be too difficult for a judge to decide whether or not a specific investment decision was reasonable. Moreover, owing to the time-consuming process of judicial review, even though the court provides adequate remedies for investors, the loss in specific investments involving stock market indexes, for instance, or financial derivatives, may still be exacerbated before the eventual adjudication.

Furthermore, imposing strict fiduciary duties on some given business organizations may decrease the advantages of such given investment entities; for instance, in a family partnership, the

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<sup>36</sup> Joseph A. MaCahery and Erik P.M. Vermeulen, 'Limited Partnership Reform in the United Kingdom: A Competitive, Venture Capital Oriented Business Form' (2004) 5 European Business Organization Law Review 79, 82.

<sup>37</sup> A recent case decided by the High Court of Justice has shown that the duties of the general partner in a limited partnership can be narrowed down by contractual provisions in a limited partnership agreement (LPA), as the extent of fiduciary duties varies from case to case in the particular consideration of the current business of the partnership. *Inversiones Frieira SL v Colyzeo Investors II LP* [2012] EWHC 1450.

over-strict fiduciary duty may undermine kinship and trust between family members.<sup>38</sup> In terms of the limited partnership, in a general sense, limited partners do not manage the firm, which justifies the strict fiduciary burden on general partners. Because of the existence of unlimited liability on the general partners, however, the costs and benefits of the managing partners' fiduciary duties should still be balanced. Specifically, limited partnerships are usually used in risky investments, the flexibility of decision-making is essential for successful investment. In sum, the liability mechanism and governance structure within the limited partnership can be more efficient than the fiduciary duty system. As shown in this article, the case law of the US and UK have permitted the waiver of fiduciary duty in PE limited partnerships.

In addition, the judicial attitudes towards directors' fiduciary duty provisions included in the articles of association in public corporations also still differ in different regions. The US courts, for example, tend to regard public corporations as 'public contracts'.<sup>39</sup> Therefore, the waiver of fiduciary duties as freedom to contract may be restricted or invalidated by judicial review.<sup>40</sup> As for the UK law, though the Companies Act 2006 (CA2006) does not allow any provisions amending directors' liability in the articles of association,<sup>41</sup> directors' liabilities in certain circumstances may be mitigated or waived by judicial discretion on a case-by-case basis.<sup>42</sup>

### ***The Barrier to the Legal Transplantation of Fiduciary Duties***

Aside from the uncertainties in judicial interpretation, the legal transplantation of fiduciary duty regime across jurisdictions is also problematic. Some comparativists have stated that so far in

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<sup>38</sup> Larry E. Ribstein, 'Fiduciary Duties and Limited Partnership Agreements' (2004) 37 Suffolk University Law Review 927, 942; Ethan J. Leib, 'Friends as Fiduciaries' (2009) 86 (3) Washington University Law Review 665, 700–701.

<sup>39</sup> Tamar Frankel, 'What Default Rules Teach Us About Corporations: What Understanding Corporations Teaches Us About Default Rules' (2006) 33 Florida State University Law Review 697, 713–718.

<sup>40</sup> Ibid.

<sup>41</sup> CA2006, s 232 (1).

<sup>42</sup> *Re Brazilian Rubber Plantations and Estates, Ltd* [1911] 1 Ch 425; *Re City Equitable Fire Insurance Co* [1925] Ch 407; *Barings plc (in Liquidation) and Another v Coopers & Lybrand (a Firm and Others)* [2003] EWHC 1319 (Ch).



transitional economies, the legal reforms brought about by the authorities were mainly focused on the written laws in European or US legal systems, while reforms of the judicial system was still unsatisfactory.<sup>43</sup> Even though the judicial practices were introduced in some emerging markets, the limited experience in coping with decision-making in business organizations (e.g., Poland)<sup>44</sup> and politically driven adjudications (e.g., Russia)<sup>45</sup> can hardly provide adequate protection for investors.

What's more, the primary function of fiduciary duties in business law is providing flexible and efficient protection for investors, whereas in some transitional jurisdictions the functions of commercial laws are not protective but more political.<sup>46</sup> The over-dependence on transplanting the fiduciary duties in other jurisdictions may cause high social costs and the protective functions of fiduciary laws may be substantially weakened. It is obvious that the costs of any legal transplantation would not be nil, thus a mixture of indigenous or alternative solutions may be more efficient to the same legal problem in a given society and the convergence or divergence in legal transplantation is determined by the competition between different regimes.<sup>47</sup> In a nutshell, the limitations of the uncertainty and impracticality of fiduciary duties may lead to alternative legal reforms as more cost-efficient and favorable solutions to agency problems in a given jurisdiction out of the common-law world.

## 6 Conclusion

The role of fiduciary duties in business organization laws is significant, but also is changing through time. The evolution of the law of limited partnerships in the US and UK provides a useful

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<sup>43</sup> Katharina Pistor and Chenggang Xu, 'Fiduciary Duty in Transitional Civil Law Jurisdictions: Lessons from the Incomplete Law Theory' (2002) ECGI Working Paper Series in Law No. 01/2002.

<sup>44</sup> Ibid.

<sup>45</sup> Katharina Pistor and Chenggang Xu, 'Beyond Law Enforcement: Governing Financial Markets in China and Russia' in Janos Kornai and Susan Rose-Ackerman (eds), *Building a Trustworthy State: Problems of Post-Socialist Transition* (Palgrave 2004) 167-190.

<sup>46</sup> In this regard, see detailed analysis of legal transplantation in Russia and China from Curtis J. Milhaupt and Katharina Pistor, *Law & Capitalism: What Corporate Crisis Reveal About Legal Systems and Economic Development Around the World* (The University of Chicago Press 2008) 173-195.

<sup>47</sup> Ugo Mattei, 'Efficiency in Legal Transplants: An Essay in Comparative Law and Economics' (1994) 3 *International Review of Law and Economics* 3, 15-16, 18-19.

and practical evidence showing how the economic function of fiduciary duty regime can be well performed by other legal arrangements, such as personal liability of the managing person or close trusteeship between contractual parties. Such a trend in business organization law also suggests that the protective effect of fiduciary duties is not a free lunch and that the judicial and regulatory enforcement of fiduciary duties in various forms of business organizations will cost huge social resources. Therefore, it should be borne in mind that fiduciary duty as a judicial technique or external protection for investors also has its own limits. Any abuse of using fiduciary law in practice may lead to inefficiency. The gross efficiency in any form of enterprise cannot be reached, unless a balance between internal protection mechanism and external protection mechanism for investors is struck.