

Do Constructive Trusts Deter Disloyalty?

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ABSTRACT

Constructive trusts of disloyal fiduciary gain often are justified by the argument of deterrence. For there to be effective deterrence two conditions must be satisfied: first, potentially disloyal fiduciaries must be sufficiently informed, directly or indirectly, of the properties of the constructive trust; secondly, fiduciaries must respond by accurately weighing the costs/benefits of disloyalty and other options before choosing the option that maximises their self-interest. Typically one or both of these conditions will not be satisfied. Drawing upon insights from the behavioural sciences we find that fiduciaries contemplating disloyalty generally cannot be expected to be cognizant of the properties of the constructive trust therefore cannot be influenced by them. Even when known, such properties will not necessarily influence fiduciary behaviour due to the way well-informed fiduciaries are likely to perceive and process the risk their disloyalty will be detected. The deterrence gains generated by the recognition of a constructive trust therefore are likely to be negligible.

Keywords: constructive trusts – fiduciary loyalty – deterrence – behavioural economics

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1. INTRODUCTION

When a fiduciary's gain neither is subtracted from nor intercepted on its way to the principal, the appropriateness of constructive trust relief generally is debated on the understanding that 'the primary, if not the only, concern of the law.....is to deter deviation from duty'.¹ Disagreement emerges not over whether the constructive trust generates extra deterrence – so much is assumed – but over whether the extra deterrence generated is sufficient to justify a proprietary response given the potential impact on innocent third parties, particularly the fiduciary's unsecured creditors.²

The deterrence thesis compliments the prophylactic theory of fiduciary obligation articulated by Conaglen.³ The prophylactic rationale posits that the strict obligation of loyalty seeks to make harm to the principal less likely by requiring the fiduciary to avoid situations in which such harm is more likely to occur. The fiduciary's avoidance of situations in which harm is more likely to occur is secured by changing the fiduciary's calculations of the costs and benefits of acting in those situations. Conaglen thus observes the function of a disgorgement remedy for breach of fiduciary obligation 'is to deter fiduciaries from entering into such transactions in the first place, by seeking to remove any attraction that the transaction might hold'.⁴

The influence of deterrence thinking in extending the reach of the constructive trust is apparent in the cases. Decisions to recognise constructive trusts of bribes and secret commissions have been bolstered by reference to 'powerful policy reasons' for securing full disgorgement.⁵ And while a constructive trust was denied in *Sinclair*,⁶ Lord Neuberger MR, as he then was, accepted the recognition of a constructive trust turned on whether it was 'the only way of ensuring that those with fiduciary duties were dissuaded from breaching their duties'.⁷ His Lordship expressed the tentative conclusion that a

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¹ Peter Watts, 'Tyrrell v Bank of London: An Inside Look at an Inside Job' (2013) 129 LQR 526, 531. See also Anthony Duggan, 'Constructive Trusts From a Law and Economics Perspective' (2005) 55 UTLJ 217, 229-230; A Duggan, 'Gain-Based Remedies and the Place of Deterrence in the Law of Fiduciary Obligations' in Andrew Robertson & Hang Wu Tang (eds), *The Goals of Private Law* (Hart Publishing 2009) 365, 384; Emily Sherwin, 'Constructive Trusts in Bankruptcy' [1989] U Ill L Rev 297, 337-339. In extra judicial writings the issue tends to be addressed, as one might expect, primarily as an issue of legal principle, although the deterrent function of the constructive trust is nonetheless acknowledged: see Sir Terrence Etherton, 'The Legitimacy of Proprietary Relief' (2014) 2 Birkbeck L Rev 59, 75; Sir Peter Millett, 'Remedies: The Error in *Lister & Co v Stubbs*' in Peter Birks (ed), *Frontiers of Liability*, vol 2 (OUP 1994) 51, 56. See also Lord Peter Millett, 'Bribes and Secret Commissions Again' [2012] CLJ 583, 590.

² Craig Rotherham, 'Policy and Proprietary Remedies: Are We All Formalists Now?' (2012) 65 CLP 529, 534. Compare Peter Watts, 'Constructive Trusts and Insolvency' (2009) 3 J Eq 250, 280 (upon bankruptcy the 'deterrent purpose is spent' and there may be a case for subordinating the principal's claim to those of creditors who have suffered loss) and Anthony Duggan, 'Constructive Trusts' (n 1) 229-230, 247-248 (recognition of a constructive trust upon the fiduciary's bankruptcy is efficient from an *ex ante* perspective).

³ Matthew Conaglen, 'The Nature and Function of Fiduciary Loyalty' (2005) 121 LQR 452. On the difficulty of distinguishing prophylaxis and deterrence, see Lionel Smith, 'Deterrence, Prophylaxis and Punishment in Fiduciary Obligation' (2013) 7 J Eq 87.

⁴ Matthew Conaglen, *Fiduciary Loyalty: Protecting the Due Performance of Non-Fiduciary Duties* (Hart Publishing 2010) 80.

⁵ *Daraydan Holdings Ltd v Solland International Ltd* [2004] EWHC 622 (Ch), [2005] Ch 119 [86] (Collins J). See also *Dyson Technology Ltd v Curtis* [2010] EWHC 3289 (Ch), [189] (Grant J).

⁶ *Sinclair v Versailles Trade Finance (in administration)* [2011] EWCA Civ 347, [2012] Ch 453.

⁷ *Sinclair* (n 6) [53]. See also *FHR European Ventures v Mankarious* [2013] EWCA Civ 17, [2014] Ch 1 [116], where Sir Terrence Etherton C expressed the opinion that 'detering fraud and corruption' is one of the 'important issues of policy' requiring consideration.

personal claim for an account of profits is sufficiently dissuasive.⁸ However, in *FHR European Ventures* a unanimous seven member panel of the Supreme Court, which included Lord Neuberger PSC, reached the opposite conclusion. Holding that a secret commission received by an agent was held on constructive trust for the principal, the panel emphasised (1) the social costs of bribery and secret commissions;⁹ (2) the importance of removing all of the defendant's gains; and (3) the superior disgorgement potential of a proprietary claim over a personal claim.¹⁰ International and domestic measures to combat bribery and corruption,¹¹ the panel noted, indicate concern over such activities 'has never been greater than it is now' and suggest the civil law's response should 'be particularly stringent in relation to a claim against an agent who has received a bribe or secret commission'.¹²

Elsewhere in the Commonwealth courts have been emphatic about the deterrent role of proprietary claims.¹³ In *Lac Minerals*, for example, La Forest J opined the essence of fiduciary duty 'is its utility in the promotion and preservation of desired social behavior and institutions'¹⁴ and a constructive trust of fiduciary gain 'acts as a deterrent to the breach of duty'.¹⁵ More recently, in *Grimaldi* the Full Court of the Federal Court of Australia reasoned that '[t]o exclude the bribed fiduciary from the deterrent effect of the constructive trust is.....to make it unavailable in the very situations where deterrence is likely to be the most needed'.¹⁶ In combating 'the crudest form of fiduciary infidelity', it continued, 'the full range of equity's remedies and techniques (including tracing and following illicit gains) are important instruments of deterrence'.¹⁷

Of course, in Australia and Canada, unlike in England, the constructive trust is 'remedial' rather than 'institutional' in nature.¹⁸ Consequently, it will not be imposed if other remedies are more appropriate.¹⁹ Potentially unfair effects, particularly on innocent third parties, therefore may be avoided or ameliorated. Deterrence nonetheless remains the driver of the constructive trust absent

⁸ *Sinclair* (n 6) [53], [90].

⁹ References to the objectionable nature of the activity might hint at a retributive motive for the recognition of a constructive trust. Indeed, appeals both to retributive and deterrent considerations are not uncommon in this context: see *Soulos v Korkontzilas* [1997] 2 SCR 217, 227 (SC, Can); American Law Institute, *Restatement of Restitution (Third)* §3 cmt a, §43 cmts b & h (explaining disgorgement both in terms of retributive and prophylactic rationales). However, a retributive rationale requires a sanction to be proportionate to the gravity of the wrongdoing, as determined by such factors as the harm inflicted or risked and the wrongdoer's motives. A retributive rationale therefore is incapable of justifying a constructive trust in many instances, as where the profiting fiduciary causes his principal no loss and acts in good faith – for instance, the receipt of the commission in *Williams v Barton* [1927] 2 Ch 9 (Ch) – or where the principal acts in what he reasonably considers is in his principal's best interests, as in *Boardman v Phipps* [1967] 2 AC 46 (HL). In such instances the disgorgement sanction 'contains a penal element calculated to deter': *Boardman v Phipps* [1965] Ch 992 (CA) 1031 (Pearson LJ).

¹⁰ *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2015] AC 250 [1], [42], [44]. Similar points were made in *Attorney General for Hong Kong v Reid* [1994] 1 AC 324 (PC) 330-331, 338.

¹¹ OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions 1999, which implemented calls 'for effective measures to deter, prevent and combat the bribery of foreign public officials' (Preamble); United Nations Convention Against Corruption 2003, the main purpose of which is to 'promote and strengthen measures to prevent and combat corruption' (Art 1(a)); and the Bribery Act 2010, passed in response to concerns about the previously uncertain and fragmented legislative responses to bribery and to implement the UK's international obligations to curb bribery and corruption: see Law Commission, *Reforming Bribery* (Law Com No 313, 2008) paras 1.1, 2.01-2.34.

¹² *FHR European Ventures* (n 10) [42].

¹³ In addition to the cases discussed, see also *Lloyds Trust Company (Channel Islands) Ltd v Fragoso* [2013] JRC 211 (Jersey Royal Court), [28]; *Sumitomo Bank Ltd v Thahir Kartik Ratna* [1992] SLR (R) 638 (Sing HC) [216] (Lai Kew Chai J).

¹⁴ *Lac Minerals v International Corona Resources Ltd* [1989] 2 SCR 574 (Can SC), 672.

¹⁵ *Lac Minerals* (n 14) 673. See also *Soulos* (n 9) 235-236 (McLachlin J); *Strother v 3464920 Canada Inc* [2007] SCC 24, [2007] 2 SCR 177, [155]-[156] (McLachlin CJ).

¹⁶ *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6, [576].

¹⁷ *Grimaldi* (n 16) [576].

¹⁸ See generally, Andrew Hicks, 'Conceptualising the Constructive Trust' (2005) 56 NILQ 521. For rejection of the remedial constructive trust in UK courts, see *Re Polly Peck International plc (in administration)* [1998] 3 All ER 812 (CA) 830-831 (Nourse LJ); *Compagnie Commerciale Andre SA v Artibell Shipping Company Ltd* [2001] SC 653 (CSOH) [50] (Lord Macfadyen); *Sinclair* (n 6) [37]; *Crossco No 4 Unlimited v Jolan Ltd* [2011] EWCA Civ 1619, [2012] 2 All ER 754 [84] (Eherton LJ); *Bailey v Angove's Pty Ltd* [2016] UKSC 47, [27].

¹⁹ *Soulos* (n 9); *Farah Construction Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89, [200]; *John Alexander's Clubs Pty Ltd v White City Tennis Club Ltd* (2010) 241 CLR 1, [126]-[128]; *Grimaldi* (n 16) [582].

third party effects. Thus, in *Grimaldi* the Court expressed the opinion that, while a constructive trust of the proceeds of a profitably invested bribe will be denied where the fiduciary is insolvent,²⁰ outside insolvency a constructive trust ‘is likely to be awarded as a matter of course’.²¹ To deny a constructive trust in such circumstances would ‘create an incentive which should not be tolerated’.²²

The basic premise of the deterrence thesis is that the constructive trust possesses superior disgorgement properties relative to an account of profits. Its recognition therefore reduces the expected benefit of, and incentive for, disloyal behaviour. This assumes two behavioural conditions are satisfied. First, fiduciaries perceive and understand the implications for them of the disgorgement properties of the constructive trust. Secondly, fiduciaries use this information to undertake a cost-benefit analysis of disloyalty, and choose disloyalty only if it maximises their interests. That advocates of the deterrence thesis assume these conditions generally are satisfied is, perhaps, not surprising. The deterrence argument is economic in nature and classical economics – the brand of economics to which most people subscribe, even if only implicitly²³ – assumes actors rationally maximise their own self-interest.²⁴ Moreover, as one leading economist frankly concedes, ‘economic analysis of the behavioural effects of a legal rule generally begins with the assumption that the legal rule is clearly known not only to judges and other public officials but also to those subject to the legal rule’.²⁵

In recent years, however, mounting evidence from the behavioural sciences has shown that people’s behaviour frequently departs, in systematic and predictable ways, from that predicted by classical economics. Applying these insights this article finds that, far from being ‘important instruments of deterrence’,²⁶ the constructive trust and associated doctrines such as tracing are likely to generate little additional deterrence. In practice, the assumptions underpinning the deterrence thesis do not hold: a fiduciary contemplating disloyalty is unlikely to be aware of the disgorgement properties of the constructive trust (whether directly or indirectly) and, in the unlikely event that he is, he is likely to underweight or ignore them. This is not to say that a constructive trust never can influence fiduciary behaviour, but the conditions under which it is likely to do so are atypical.

The article is organised as follows. Section 2 identifies the marginal disgorgement benefits of the constructive trust, which are perhaps more modest than generally is assumed, and identifies the role of disgorgement in the standard economic theory of deterrence. Section 3 outlines key developments in the behavioural sciences which undermine the behavioural predictions of classical economics. Sections 4 and 5 develop these insights in greater detail. Section 4 identifies a number of biases which are likely to cause fiduciaries to perceive a low risk that disloyalty will be detected and explores the implications of low risk perception for deterrence. Section 5 examines the extent to which fiduciaries are likely to become informed about the legal consequences of disloyalty. It finds cognitive limitations, fiduciary information search strategies, and the external information environment will limit the fiduciary’s knowledge of the legal implications of disloyalty. While we can expect fiduciaries to cognize the basic notion that disloyal gain must be ‘given up’, fiduciaries are unlikely to be cognizant of the more complex properties of disgorgement, such as how the gain will be identified or quantified. Section 6 concludes.

²⁰ *Grimaldi* (n 16) [583] (noting a lien ‘may well be sufficient to achieve “practical justice” in the circumstances’).

²¹ *Grimaldi* (n 16) [583].

²² *Grimaldi* (n 16) [576].

²³ Cass Sunstein & Richard Thaler, *Nudge: Improving Decisions About Health, Wealth, and Happiness* (Yale University Press, 2008) 6 (noting that most people are committed to the idea that each of us ‘fits within the textbook picture of human beings offered by economists’).

²⁴ Richard Posner, *Economic Analysis of Law* (Kluwer, 9th edn 2014) §1.1; Robert Cooter & Thomas Ulen, *Law and Economics* (Berkeley Law Books, 6th edn 2016) 12-13.

²⁵ Louis Kornhauser, ‘The Economic Analysis of Law’ in Edward Zalta (ed), *The Stanford Encyclopedia of Philosophy* (Winter 2016 edn) <<https://plato.stanford.edu/archives/win2016/entries/legal-econanalysis/>>.

²⁶ *Grimaldi* (n 16).

2. CONSTRUCTIVE TRUST AND THE ECONOMICS OF DETERRENCE

(a) *The Marginal Disgorgement Benefits of the Constructive Trust*

The perceived importance of the constructive trust in deterring disloyalty rests on its superior disgorgement properties relative to a personal claim for an account of profits. As Duggan explains, '[f]or effective deterrence the remedy must capture all D's gains from the wrongdoing' and '[t]he only sure-fire way of extracting all D's gains is to impose a constructive trust'.²⁷ As will be discussed below, this perhaps overstate the point a little. Nevertheless, a constructive trust may enhance disgorgement as a result of three proprietary aspects: (1) the principal's power to invoke the tracing process; (2) the principal's power to call for the trust property to be transferred *in specie*; and (3) the enforcement advantages that follow from the recognition of a proprietary claim.

(i) Tracing

A constructive trust provides a gateway to the tracing process, which allows the principal to recover secondary profits derived from the investment of the initial gain.²⁸ By contrast, it sometimes is assumed that an account of profits will not reach beyond the value of the gain initially received in breach of fiduciary obligation.²⁹ For some, any extension of personal rights and remedies to capture secondary profits risks blurring important conceptual boundaries that should remain clearly delineated.³⁰

Tracing is not, however, designed to effect disgorgement of wrongful gain.³¹ To effect perfect disgorgement a wrongdoer must be stripped of all of the wealth he would not have acquired 'but for' the wrong. Tracing tends to involve transactional rather than causal inquiries. Penner makes the point neatly: 'tracing tracks the transactions a person makes with the property rights at his disposal; it does not track increases in wealth that are causally dependent on prior increases in wealth'.³² Since it is possible to generate wealth by utilising an initial gain without leaving a transactional trail, claims against traceable proceeds 'are not in any way a substitute for gain stripping as a matter of principle, and they are a very poor facsimile in practice'.³³

It is, moreover, incorrect to assume that a purely personal disgorgement claim that reaches secondary profits cannot be developed. An account of profits functions to identify the profit made by a wrongdoer as a result of the commission of a wrong. The value of wrongfully acquired profit is identified by a 'but for' test of causation subject to an appropriate remoteness principle.³⁴ Usually the remoteness principle limits recovery to benefits arising directly from the commission of a wrong, but in the context of a profiting fiduciary the principle must be weaker and permit recovery of profits

²⁷ Duggan, 'Constructive Trusts' (n 1) 229.

²⁸ *FHR* (n 10) [1], [44]; *Reid* (n 10) 331, 336; Lord Peter Millett, 'Bribes and Secret Commissions' (n 1) 590.

²⁹ *Reid* (n 10) 336; Lord Millett, 'Bribes and Secret Commissions' (n 1) 590; Roy Goode, 'Proprietary Liability for Secret Profits – A Reply' (2011) 127 LQR 493, 495. The view derives some support from the comments of Lindley LJ in *Lister & Co v Stubbs* (1890) 45 Ch D 1 (CA) 15 (rejecting the notion that an agent in receipt of a secret commission might be compelled to account 'for all the profits which he might have made by embarking in trade with it' since this would confound ownership with obligation). The view of Lindley LJ has been long supported by Goode: see Roy Goode, 'Property and Unjust Enrichment' in Andrew Burrows (ed), *Essays on the Law of Restitution* (1991) 215, 242 (noting *Lister* was correctly decided because it does not 'allow P to recover by way of personal action a sum measured as if his claim did have a proprietary base'). See also Roy Goode, 'Ownership and Obligation in Commercial Transactions' (1987) 103 LQR 433, 441-444. The perceived limitation of a personal claim may explain why a declaration of constructive trust was sought in *Boardman* (n 9); see Andrew Hicks, 'Proprietary Relief in *Boardman v Phipps*' (2014) 65 NILQ 1, 10-12.

³⁰ *Lister* (n 29); Goode, 'Property and Unjust Enrichment' (n 29).

³¹ See Sarah Worthington, 'Fiduciary Duties and Proprietary Remedies: Addressing the Failure of Equitable Formulae' (2013) 72 CLJ 720, 740-742.

³² James Penner, 'The Difficult Doctrinal Basis for the Fiduciary's Proprietary Liability to Account for Bribes' (2012) 18 T & T 1000, 1006.

³³ Penner (n 32) 1006.

³⁴ Graham Virgo, 'Restitutionary Remedies for Wrongs: Causation and Remoteness' in Charles Rickett (ed), *Justifying Private Law Remedies* (Hart Publishing 2008) 301, 307-310.

arising indirectly from the breach, from the application of the initial gain.³⁵ If the driver of doctrine in this area is deterrence, and if deterrence makes it imperative to strip a fiduciary of all gains attributable to a breach of fiduciary obligation, relaxation of the usual remoteness rules to capture ‘but for’ wealth is both logical and necessary. Moreover, a causal inquiry coupled with an appropriate remoteness rule would be a more principled method of measuring the fiduciary’s gain than transactional link tracing. It also would have the advantage of being less disruptive to third parties than a proprietary claim.³⁶

Indeed, such a flexible personal disgorgement remedy may exist already. In *Sinclair* Lord Neuberger MR expressed the view, albeit tentatively, that a purely personal disgorgement claim is ‘sufficiently flexible’ to allow recovery of gains causally linked to a breach of fiduciary obligation.³⁷ The object of an account in this context, as Morritt LJ emphasised in *Deutsche Bank*, ‘is to ensure that the defaulting fiduciary does not retain the profit’.³⁸ More recently, the Court of Appeal emphasised the flexibility of an account when accepting that an accessory will be liable to disgorge profits flowing from dishonestly assisting in a breach of fiduciary obligation so long as there is a ‘sufficiently direct causal connection’ between the profits and the underlying wrong.³⁹

(ii) The Transfer Advantage

Proponents of the deterrence rationale also point to a cluster of disgorgement benefits generated by the constructive trust claimant’s power to seek the delivery-up or conveyance of the property subject to the constructive trust. Where the gain or its traceable substitute is non-fungible the transfer of the asset eliminates the risk that the fiduciary will benefit from post-judgment increases in the value of the asset.⁴⁰ It also avoids the risk of inadequate disgorgement resulting from valuation mistakes.⁴¹ Finally, the transfer of the asset to the principal avoids the risk that the fiduciary will retain a consumer surplus because he values the asset more than the market-based measure of a personal disgorgement claim (the problem of ‘subjective valuation’).⁴²

Delivery-up or conveyance of the fiduciary’s gain does not, however, follow automatically from the recognition of a constructive trust but is contingent on the claimant’s election. Whether the claimant elects to have the property transferred will depend on whether its transfer is more advantageous to the claimant than an alternative available remedy, not on whether the property is particularly valuable to the defendant.⁴³ Moreover, from a general deterrence perspective valuation mistakes are a concern only if there is systematic under-valuation of gains. Absent evidence of systematically skewed

³⁵ Virgo (n 34) 321-322. See also James Edelman, *Gain-Based Damages: Contract, Tort, Equity and Intellectual Property* (Hart Publishing 2002) 108-109; William Swadling, ‘Constructive Trusts and Breach of Fiduciary Duty’ (2012) 18 T & T 985, 992; Charles Mitchell, David Hayton & Paul Matthews, *Underhill & Hayton: Law of Trusts and Trustees* (Lexis-Nexis 19th edn, 2016) para 27.32.

³⁶ *Sinclair* (n 6) [90] (Lord Neuberger MR).

³⁷ *Sinclair* (n 6) [53], [90]. Whether the *obiter* survives *FHR* (n 10) may be doubted by some. In *Sinclair* Lord Neuberger MR reasoned that, if he was correct on the issue, ‘it undermines the main policy reason supporting [a] proprietary claim: it does not matter to the defaulting fiduciary if he is stripped of his profits because they are beneficially owned by the beneficiary, or because he has to account for those profits to the beneficiary.’ However, in *FHR* the Supreme Court appeared to accept that deterrence demanded a constructive trust of the fiduciary’s gain: see above n 9 – n 12 and text. In *FHR*, however, the constructive trust was important primarily for reasons of enforcement: see below n 45 – n 46 and text.

³⁸ *United Pan Europe Communications NV v Deutsche Bank AG* [2000] 2 BCLC 461, [47].

³⁹ *Novoship (UK) Ltd v Mikhayluk* [2014] EWCA Civ 908, [2014] QB 499.

⁴⁰ Duggan, ‘Constrictive trusts’ (n 1) 229.

⁴¹ Mistakes may occur because the property is unique and the absence of a suitable comparator makes valuation difficult or because the value of the gain turns on unpredictable future variables, a particular problem with some business opportunities: see *Lac Minerals v International Corona Resources Ltd* (1989) 61 DLR (4th) 14 (Can SC) 48-49 (La Forest J).

⁴² Duggan, ‘Constrictive trusts’ (n 1) 229; Sherwin (n 1) 338.

⁴³ It is true, as the anonymous reviewer of this article noted, that the *availability* of a specific remedy, not its inevitable enforcement, may have deterrent value. Indeed, it may be that cases in which a gain is valued subjectively by the defaulting fiduciary but not claimed *in specie* by the principal will be relatively few. But from an economic perspective so long as a fiduciary can expect to retain a consumer surplus in *some* cases, however few in number, he will discount the expected costs of the remedy accordingly. See further the discussion of the neo-classical economic theory of deterrence below, n 55 – n 56 and text.

valuation we might expect a relatively even distribution of mistakes that are off-setting. It is also worthy of note that the risk a fiduciary may benefit from post-judgment increases in the value of an asset is ameliorated by the claimant's power to elect to postpone the taking of an account of profits until such time as the value of the gain becomes clear.⁴⁴

(iii) Enforcement Advantages

As a consequence of the recourse it provides to third parties, a constructive trust may be particularly effective at cutting off avenues for processing ill-gotten gains. Corrupt fiduciaries in particular might transfer their ill-gotten gains to compliant third parties, leaving themselves with insufficient assets to meet any judgment entered against them. However, assets subject to a constructive trust can be followed into the hands of recipients and recovered, unless the recipient is a *bona fide* purchaser of the legal title without notice. The *FHR* case⁴⁵ illustrates the point. The €10m secret commission was received by Cedar LLC in breach of fiduciary obligation and mixed in its bank accounts with other monies. Transfers equivalent to the value of the commission then were made to Cedar Ltd (a wholly owned subsidiary) and to Mr Mankarious, the moving force behind both companies who used the monies to fund, amongst other things, the purchase of life insurance policies and freehold property. Cedar LLC was left with no assets to satisfy a claim for breach of fiduciary obligation. A proprietary claim allowed the claimants to follow and trace the commission and recover proceeds from Cedar Ltd and Mr Mankarious.⁴⁶

In contrast to proprietary rights, personal rights receive less protection against interference by third parties. A third party who becomes involved in a breach of fiduciary obligation may face accessory liability for inducing, encouraging or assisting in the breach. The accessory will be jointly and severally liable with the fiduciary to compensate the principal for the loss resulting from the breach of fiduciary duty⁴⁷ or, alternatively, liable to account for any profits resulting from the assistance.⁴⁸ However, since higher fault and involvement thresholds are required⁴⁹ a principal without a proprietary claim may be left with no effective redress against a culpable third party.⁵⁰ A significant advantage of the constructive trust is that volunteer recipients of the fiduciary's gain are bound automatically by the trust claim.⁵¹

Corrupt fiduciaries are also likely candidates to abscond. The recognition of a constructive trust has incidental benefits in this regard since more options tend to be available to prevent defendants from dealing in identified assets if the claimant is able to demonstrate a proprietary interest. This was one important reason for the proprietary claim in *Reid*:⁵² recognition of a constructive trust allowed the registration of caveats against the New Zealand properties allegedly purchased with the bribe monies, frustrating Reid's hope that the properties could be 'sold and the proceeds whisked away to some Shangri La which hides bribes and other corrupt moneys in numbered bank accounts'.⁵³ The absence

⁴⁴ *Crown Dilmun v Sutton* [2004] EWHC 52 (Ch), [2004] 1 BCLC 468 [205]-[214] (Peter Smith J) (claimant permitted to postpone the taking of the account until the value of the wrongfully exploited opportunity became clear).

⁴⁵ *FHR* (n 10).

⁴⁶ See *FHR European Ventures LLP v Mankarious* [2016] EWHC 359 (Ch) (Master Clark).

⁴⁷ *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch), [2006] FSR 16, [1600] (Lewison J).

⁴⁸ *Novoship* (n 39).

⁴⁹ Watts, 'Inside Look' (n 1) 530.

⁵⁰ A claim for accessory liability would, however, seem relatively straightforward in cases replicating the *FHR* fact pattern (above n 45 – n 46 and text).

⁵¹ Additionally, a constructive trust of the gain may extend accessory liability to those who assist the fiduciary in dealings with the gain but who did not assist in the wrongdoing that generated the gain: see, for example, the unsuccessful claim in *Fitzalen-Howard v Hibbert* [2009] EWHC 2855 (QB), [2010] PNLR 11.

⁵² *Reid* (n 10). For a more detailed account of the important procedural advantages secured by a proprietary claim in the case, see Richard Nolan, 'The Wages of Sin: Iniquity in Equity Following *A-G for Hong Kong v Reid*' (1994) Comp Law 3, 4-5 but especially footnote 15.

⁵³ *Reid* (n 10) 339.

of a proprietary claim does not, however, necessarily leave a principal without any power to encumber the assets in the hands of a fiduciary.⁵⁴

(b) Neo-Classical Economic Theory of Deterrence

To the extent the constructive trust has superior disgorgement properties relative to an account of profits, neo-classical economic theory provides a short link to the conclusion that a constructive trust of fiduciary gain enhances deterrence.

Neo-classical economic theory views deterrence as nothing more than an application of the general theory of rational choice under uncertainty.⁵⁵ Individuals are assumed to be rational utility maximizers who calculate the probable returns of all available options open to them and pursue the option that gives the greatest return. Thus, rational actors will be deterred from wrongdoing if the expected utility of the commission of a wrong is less than the expected utility of an alternative option. The expected utility of wrongdoing can be reduced by increasing the expected cost of the wrongdoing. The expected cost of wrongdoing is a product of two variables: the objective probability that wrongdoing will be detected and sanctioned (p) multiplied by the sanction (s). It follows that, all other things being equal, the expected cost of wrongdoing can be raised by increasing either p or s , and different combinations of p and s can achieve the same sanction effect: a fall in p can be off-set by a compensating uplift in s and vice-versa.⁵⁶

According to this model, the mere requirement that a wrongdoer give up his gain whenever caught will have little dissuasive effect unless detection and enforcement rates are perfect.⁵⁷ Since they are not, disgorgement *per se* is a poor deterrent because it leaves wrongdoing profitable on average.⁵⁸ However, there likely will be other formal and informal elements of a sanction, in addition to disgorgement, which a rational wrongdoer will factor in to their calculation of the expected cost of wrongdoing. In the fiduciary context, these include: (1) termination or non-renewal of the relationship; (2) firm-level sanctions, such as organisational censure, limited promotion prospects or dismissal;⁵⁹ (3) professional embarrassment, negative peer perception or loss of reputation;⁶⁰ and (4) criminal sanctions.⁶¹

If a constructive trust removes more from a fiduciary than an account of profits its recognition will, in combination with other sanction elements, increase the total value of s and thereby raise the expected cost of disloyalty. By raising the expected cost of disloyalty, fewer opportunities for wrongdoing will yield an expected net benefit in excess of the expected net benefit of legitimate options, resulting in less wrongdoing.

⁵⁴ Freezing orders are available to prevent the disposal of assets with the intention of defeating judgment and, in some jurisdictions, pre-judgment charging orders and caveats against dealings in land are available without a proprietary interest in the relevant land: Watts, 'Constructive Trusts and Insolvency' (n 2) 283.

⁵⁵ Gary Becker, 'Crime and Punishment: An Economic Approach' (1968) 76 J Pol Econ 167.

⁵⁶ Thus, if an expected sanction of £50 is required to deter, and detection and sanctioning of wrongdoing falls from one in two to one in four, the desired level of deterrence can be preserved by increasing the sanction from £100 ($0.5 \times £100 = £50$) to £200 ($0.25 \times £200 = £50$): A Mitchell Polinsky, *An Introduction to Law and Economics* (Little Brown 2nd edn, 1989) 77-78.

⁵⁷ Hence theft cannot be deterred merely by requiring a thief to return stolen property if caught: Cooter & Ulen (n 24) 562.

⁵⁸ Smith (n 3); Lionel Smith, 'Fiduciary Relationships: Ensuring the Loyal Exercise of Judgment on Behalf of Another' (2014) 130 LQR 608, 627.

⁵⁹ As to the powerful influence of such sanctions, see Richard Hollinger & John Clark, 'Formal and Informal Social Controls of Employee Deviance' (1982) 23 Sociological Quarterly 333.

⁶⁰ For professional fiduciaries a reputation for honesty and loyalty may be as important as a brand name is to a manufacturer: Tamar Frankel, 'Fiduciary Law' (1983) 71 Calif L Rev 795, 835-836; Kenneth Davis, 'Judicial Review of Fiduciary Decisionmaking – Some Theoretical Perspectives' (1985) 80 Nw U L Rev 1, 8.

⁶¹ For instance, the receipt of a bribe is punishable by a maximum of ten years imprisonment, an unlimited fine, or both: Bribery Act 2010, s 11(1).

3. THE BEHAVIOURAL CHALLENGE TO RATIONAL CHOICE ECONOMICS

The deterrence thesis follows neo-classical economics in its assumptions about how fiduciaries identify and perceive risk and how they obtain and process information. However, behavioural scientists have shown that in some contexts the traditional economic account of human behaviour not only fails to describe accurately the psychological processes by which humans make decisions, it also lacks predictive power. These insights generally are collected together under the label ‘behavioural economics’.⁶² Behavioural economics attempts ‘to increase the explanatory and predictive power of economic theory by providing it with more psychologically plausible foundations’.⁶³ The field has two distinguishing characteristics. First, it focuses on identifying the systematic and predictable ways in which the behaviour of agents deviates from that predicted by rational choice theory. Secondly, it is empirical in nature in that it looks for evidence about how actors really do behave.

(a) *Systematic and Predictable Deviations From Rationality*

Sometimes, people do not aspire to make optimal decisions because it is not feasible given the constraints under which they operate. Long ago Herbert Simon provided the influential insight that the capacity of humans to make rational decisions is curtailed by limited information, limited time, and limited computational capacity. Simon coined the term ‘bounded rationality’ to capture this insight and offered a model of decision-making in which utility maximisation is replaced with ‘satisficing’, the idea that in many contexts individuals in fact *aim* to make decisions which are approximate and satisfactory rather than optimal.⁶⁴ For instance, when considering how informed individuals are likely to be in a given situation, satisficing provides a more plausible model than the assumption that actors are perfectly informed or will search for an optimal amount of information.⁶⁵

Building on Simon’s insights psychologists Daniel Kahneman and Amos Tversky discovered non-optimal decisions also may be the *unintended* consequence of the operation of heuristics and associated judgment biases.⁶⁶ Heuristics are simplifying shortcuts of intuitive thinking, cognitive ‘rules of thumb’, which reduce the complexity of a task. Heuristics generally are ‘highly economical and usually effective’.⁶⁷ But they also come with characteristic biases which arise in certain, predictable situations. For example, estimates of the probability of an event typically are mediated by an assessment of its ‘availability’ - ‘the ease with which instances or occurrences can be brought to mind’.⁶⁸ Usually, availability is a good indicator of event probability since common events tend to come to mind with greater ease than rare events. However, since factors other than general frequency affect ease of recall – for instance, the vividness of an event – reliance on availability can produce errors.⁶⁹

⁶² For an accessible history, see Richard Thaler, *Misbehaving: The Making of Behavioral Economics* (Allen Lane 2015).

⁶³ Erik Angner & George Loewenstein, ‘Behavioral Economics’ in Uskali Maki (ed), *Handbook of the Philosophy of Science: Philosophy of Economics* (Elsevier 2012) 641, 642.

⁶⁴ Herbert A Simon, ‘A Behavioral Model of Rational Choice’ (1955) 69 Q J Econ 99; Herbert A Simon, ‘Information Processing Models of Cognition’ (1979) 30 Annual Review of Psychology 363. See generally, Peter Earl (ed), *The Legacy of Herbert Simon in Economic Analysis*, vol 1 (Edward Elgar 2001).

⁶⁵ See Section 5, below.

⁶⁶ Daniel Kahneman & Amos Tversky, ‘Prospect Theory: An Analysis of Decisions Under Risk’ (1979) 47 Econometrica 313; Amos Tversky & Daniel Kahneman, ‘Judgment Under Uncertainty: Heuristics and Biases’ in Amos Tversky, Daniel Kahneman & Paul Slovic (eds), *Judgment Under Uncertainty: Heuristics and Biases* (Cambridge University Press 1982) 3; Daniel Kahneman & Amos Tversky, ‘On the Reality of Cognitive Illusions’ (1996) 103 Psychol Rev 582.

⁶⁷ Tversky & Kahneman, ‘Judgment Under Uncertainty’ (n 66) 20. See generally, Gerd Gigerenzer, Peter Todd & ABC Research Group, *Simple Heuristics That Make Us Smart* (OUP 2000).

⁶⁸ Tversky & Kahneman, ‘Judgment Under Uncertainty’ (n 66) 11. See generally, Daniel Kahneman, *Thinking, Fast and Slow* (Penguin Books 2012) 129-145; Scott Plous, *The Psychology of Judgment and Decision Making* (Temple university Press, 1993) 121-130.

⁶⁹ Amos Tversky & Daniel Kahneman, ‘Availability: A Heuristic for Judging Frequency and Probability’ (1973) 5 Cognitive Psychology 207, 209.

A crucial finding of the heuristics and biases research project is that heuristics misfire in predictable ways. In the years following Kahneman & Tversky's pioneering studies, psychologists devised numerous experiments to identify and map the operation of heuristics and their associated biases. This research produced 'a taxonomy of deviations from rationality'⁷⁰ – an outline of the predictable ways in which decision-makers deviate from the rationality assumptions of traditional economics.⁷¹ It provides a 'more subtle, textured understanding of how actors make decisions in various situations' by providing a 'pragmatic collection of situation-specific insights' that can be applied to 'modify the implausible elements of rational choice theory and supplement the inadequate elements in order to create a tool with more predictive power in specific situations'.⁷²

(b) Empirical Foundations of the Behavioural Claims

The claims of behavioural economics are empirical in the sense they are informed by scientific insights about actual human behaviour. Although field studies increasingly are employed to gather data, behavioural economics insights predominantly are derived from laboratory experiments. There are legitimate concerns that insights from laboratory experiments are not capable of easy or reliable generalisation.⁷³ One concern is that experimental settings involve small stakes therefore may lack incentives that cure real-world actors of their biases. However, there is little evidence that increased incentives have the curative effect claimed and some evidence that incentives can in fact exacerbate biases.⁷⁴ A more serious concern is that experimental settings typically do not provide opportunities for individuals to learn to adapt to eliminate biases.⁷⁵ Learning opportunities do not, however, diminish all biases.⁷⁶ Moreover, in some contexts there will be impediments to learning – for instance, because feedback on choices is too infrequent.⁷⁷ Biases affecting the judgment of fiduciaries contemplating disloyal acts, for example, are unlikely to be corrected because feedback is most likely when wrongdoing is detected and this is likely to be infrequently. Finally, there is concern that many of the identified biases pull in opposite directions hence their net effect on behaviour outside of the controlled laboratory environment may be ambiguous.⁷⁸ While this is true, not all real world situations arguably trigger opposing biases. The multiple biases affecting fiduciary perceptions of the risk of detection, for example, are unidirectional, hence cumulative – not conflicting – in effect. Thus, while behavioural economics may be too underdeveloped to be a comprehensive tool of legal analysis, its findings can prove insightful in particular contexts.

⁷⁰ Herbert A Simon, 'The Behavioral and Social Sciences' (1980) 209 *Science* 72, 75.

⁷¹ As to which, see Daniel Kahneman, 'Maps of Bounded Rationality: Psychology for Behavioral Economics' (2003) 93 *Am Econ Rev* 1449; Robyn LeBoeuf & Eldar Shafir, 'Decision Making' in Keith Holyoak & Robert Morrison (eds), *The Oxford Handbook of Thinking and Reasoning* (OUP 2012) 301.

⁷² Russell Korobkin & Tom Ulen, 'Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics' (2000) 88 *Cal L Rev* 1051, 1074-1075. See also Christine Jolls, Cass R Sunstein & Richard Thaler, 'A Behavioral Approach to Law and Economics' (1998) 50 *Stan L Rev* 1471, 1487.

⁷³ Richard A Posner, 'Behavioral Law and Economics: A Critique' (2002) 42 *Economic Education Bulletin* 1, 3; Yulie Foka-Kavalieraki & Aristides Hatzis, 'Rational After All: Toward an Improved Theory of Rationality in Economics' (2011) 12 *Revue de Philosophie Economique* 3, 20-21.

⁷⁴ Eldar Shafir & Robyn LeBoeuf, 'Rationality' (2002) 53 *Annual Review of Psychology* 491, 501-502; Jeffrey Rachlinski, 'The Uncertain Psychological Case for Paternalism' (2002-2003) 97 *Nw U L Rev* 1165, 1167.

⁷⁵ For instance, it appears that the endowment effect, the tendency to place a higher value on something simply because it is owned, is eroded as individuals gain experience of trading in goods: John List, 'Does Market Experience Eliminate Market Anomalies?' (2003) 118 *Q J Econ* 41; John List, 'Neoclassical Theory Versus Prospect Theory: Evidence from the Marketplace' (2004) 72 *Econometrica* 615.

⁷⁶ Shafir & LeBoeuf (n 74) 502

⁷⁷ Rachlinski (n 74) 1220-1224.

⁷⁸ Roger van den Bergh, 'Behavioral Antitrust: Not Ready for the Main Stage' (2013) 9 *J Competition Law & Economics* 203, 211, 214-216; Doron Teichman, 'The Optimism Bias of the Behavioral Analysis of Crime Control' [2011] *U Ill L Rev* 1697.

4. THE FIDUCIARY'S PERCEPTION OF DETECTION RISK

The actual detection and enforcement probability (p) is central to the neo-classical economic theory of deterrence. The value of p will vary, but generally can be expected to be relatively low. Fiduciary law's 'no further inquiry rule' is designed to raise the value of p ,⁷⁹ but enforcement is premised on detection and in many instances, particularly those involving the receipt of bribes and commissions, the actual probability of detection will be small. The issue for conventional economic analysis is whether s is sufficient to compensate for a low p . However, from a behavioural perspective it is not the *actual* but the *perceived* probability of detection and enforcement that is important for deterrence. Perceived probability of detection may diverge significantly from the actual value of p . Moreover, while conventional economic analysis assumes a linear weighting of risk the behavioural evidence suggests otherwise. In particular, it suggests people have difficulties dealing with small risks and may ignore them altogether. This section identifies the causes of low risk perception, examines how these might affect fiduciaries, and considers the implications of low risk perception for deterring disloyalty.

(a) Causes of Low Risk Perception

A fiduciary will not possess actuarial information about detection rates for disloyal acts. An assessment of the risk of detection therefore will be inferential, drawn from past experience and the fiduciary's observations of the risk. This process opens the door for the operation of biases which may lead to the systematic underestimation of p .

(i) Availability Bias

In the absence of statistical information, the subjectively perceived likelihood of an event typically is mediated by its 'availability' – the ease and speed with which the event can be remembered or imagined.⁸⁰ However, factors unrelated to the frequency or probability of an event may influence availability and generate bias. Much of the research on 'availability' emphasises a positive correlation between salience and availability. For instance, witnessing a house fire will have a greater impact on one's perceived risk of house fires than reading about the same fire in a newspaper due to the vividness of physically proximate events which makes them more memorable.⁸¹ Vivid information is more available than 'pallid, abstract or statistical information'.⁸² Equally, recent events usually are more available than earlier ones.⁸³ 'Imaginability' also influences availability.⁸⁴ When scenarios that lead to an event are difficult to imagine, or if no plausible scenario comes to mind, the event tends to be perceived as improbable; if plausible scenarios, or a particularly compelling scenario, can be constructed with ease the event tends to be perceived as probable.⁸⁵

(ii) Optimism Bias

Availability biases often are compounded by the operation of self-serving biases, a loose collection of biases 'driven by a common human tendency to interpret the world to make it square more comfortably with one's own interests and beliefs.'⁸⁶ Thus, individuals tend to ascribe too much weight

⁷⁹ Robert Cooter & Bradley Freedman, 'The Fiduciary Relationship: Its Economic Character and Legal Consequences' (1991) 66 NYUL Rev 1045, 1051-1056.

⁸⁰ See the sources cited in n 68 and n 69.

⁸¹ Tversky & Kahneman, 'Judgment Under Uncertainty' (n 66) 11.

⁸² Plous (n 68) 126.

⁸³ Sunstein & Thaler (n 23) 36.

⁸⁴ Tversky & Kahneman, 'Judgment Under Uncertainty' (n 66) 12.

⁸⁵ See Steven Sherman and others, 'Imagining Can Heighten or Lower the Perceived Likelihood of Contracting a Disease: The Mediating Effect of Ease of Imagery' in Thomas Gilovich, Dale Griffin & Daniel Kahneman (eds), *Heuristics and Biases: The Psychology of intuitive Judgment* (Cambridge University Press 2002) 98.

⁸⁶ Ward Farnsworth, 'The Legal Regulation of Self-Serving Bias' (2003) 37 UC Davis L Rev 567, 570.

to the contributions they make to particular outcomes (ego-centric bias);⁸⁷ have excessive confidence in their own forecasts (over-confidence bias);⁸⁸ and believe their own risk of experiencing a negative outcome is lower than it actually is (optimism bias).⁸⁹ Optimism bias is particularly important given its powerful effects and pervasiveness.⁹⁰ As two leading commentators note, the bias ‘is an indiscriminate and indefatigable cognitive feature’ that causes individuals to ‘underestimate the extent to which a threat applies to them even when they can recognize the severity it poses to others’.⁹¹ From a wrongdoer’s perspective, detection of wrongdoing is a negative event. Evidence suggests over-optimism operates in this domain: people tend to believe their own wrongdoing is less likely to be detected than the wrongdoing of others.⁹² This is particularly likely if a wrongdoer perceives measures to evade detection are within his control. A consistent and robust finding in studies of optimism bias is the existence of a positive correlation between perceptions of control (in the form of steps that can be taken to avoid a negative outcome) and unrealistic optimism about avoiding the outcome.⁹³

(iii) Biased Perceptions of the Level of Wrongdoing

There is plenty of evidence that people assume others engage in unethical and morally undesirable behaviour more often than they do.⁹⁴ A particularly relevant example is bribery. Although actual incidents of bribery may be relatively low,⁹⁵ recent data suggests a majority of people perceive bribery is widespread (64%)⁹⁶ and an accepted part of UK business culture (62%).⁹⁷ One possible explanation for misperceptions about the level of wrongdoing is that they result from the ‘false uniqueness effect’, the tendency of people to under-estimate the extent to which others share their positive attributes.⁹⁸ The implication of this bias is that ‘those who perform a desirable behaviour underestimate the number of others as good as them, whereas those who perform an undesirable behaviour overestimate the number of others as bad as them’.⁹⁹ Misperceptions about others’ conduct also may be generated by the ‘false consensus effect’, the tendency of people to over-estimate the degree to which others

⁸⁷ Michael Ross & Fiore Sicoly, ‘Egocentric Biases in Availability and Attribution’ in Tversky, Kahneman & Slovic (n 66) 179.

⁸⁸ Rachlinski (n 74) 1172.

⁸⁹ Neil Weinstein, ‘Unrealistic Optimism About Future Life Events’ (1980) 39 *J Personality & Social Psychology* 806. For a summary of the vast psychological literature on the bias, see James Sheppherd and others, ‘A Primer on Unrealistic Optimism’ (2015) 24 *Current Directions in Psychological Science* 232.

⁹⁰ See Christine Jolls, ‘On Law Enforcement With Boundedly Rational Actors’ in Francesco Parisi & Vernon Smith (eds), *The Law and Economics of Irrational Behavior* (Stanford University Press 2005) 268, 270, 273 (finding more than 250 studies documenting this ‘highly robust feature of human behaviour’). See also Sheppherd and others (n 89).

⁹¹ Jon Hanson & Douglas Kysar, ‘Taking Behavioralism Seriously: The Problem of Market Manipulation’ (1999) 74 *NYUL Rev* 630, 657-658. See also Tim Smits & Vera Hoorens, ‘How Probable is Probably? It Depends on Whom You’re Talking About’ (2005) 18 *Journal of Behavioral Decision Making* 83 (finding information about the probability of future events is often interpreted in a self-serving way).

⁹² Andrew Guppy, ‘Subjective Probability of Accident and Apprehension in Relation to Self-Other Bias, Age, and Reported Behavior’ (1993) 25 *Accident Analysis & Prevention* 375, 377-380 (most drivers believe they have a better than average chance of avoiding detection for driving while over the prescribed blood alcohol limit). See also Jolls (n 90) 273-274.

⁹³ Peter Harris, ‘Sufficient Grounds for Optimism? The Relationship Between Perceived Controllability and Optimistic Bias’ (1996) 15 *J Social & Clinical Psychology* 9; Cynthia Klein & Marie Helweg-Larsen, ‘Perceived Control and the Optimistic Bias: A Meta-Analytic Review’ (2002) 17 *Psychology & Health* 437.

⁹⁴ For discussion of relevant studies, see Robert Cooter, Michal Feldman & Yuval Feldman, ‘The Misperception of Norms: The Psychology of Bias and the Economics of Equilibrium’ (2008) 4 *Rev L & Econ* 889, 893-895.

⁹⁵ Survey data collected in one notable study suggests actual instances of bribery in the UK are ‘negligible’: Transparency International, *Corruption in the UK: Part One* (2010) 4. A more recent survey found 7% of UK respondents admitted to knowing people who have taken or take bribes: European Commission, *Special Eurobarometer 397: Corruption* (2014) 70. Corruption is more prevalent in some sectors than others – for instance, the construction industry: see Chartered Institute of Building, *Corruption in the UK Construction Industry* (London: 2013) p 15 (35% of respondents in the construction industry had been offered a bribe at least once in their career).

⁹⁶ European Commission, *Eurobarometer* (n 95) 20.

⁹⁷ European Commission, *Eurobarometer* (n 95) 54.

⁹⁸ On the cognitive and motivational causes of this bias, see Cooter, Feldman & Feldman (n 94) 895-898.

⁹⁹ Benoit Monin & Micael Norton, ‘Perceptions of a Fluid Consensus: Uniqueness Bias, False Consensus, False Polarization, and Pluralistic Ignorance in a Water Conservation Crisis’ (2003) 29 *Personality & Social Psychology Bulletin* 559, 560.

share their beliefs, attributes and behaviours.¹⁰⁰ A consequence of this bias is that a person inclined to undesirable behaviour is likely to over-estimate how many others engage in similar behaviour.¹⁰¹

Over-estimation of the frequency with which others violate norms may have important implications for perceptions about the risk of detection for a norm's violation. If violations are perceived as more prevalent than they are, but incidents of detection are not, the risk of getting caught is likely to be underestimated.

(b) The Fiduciary's Perceptions of Detection Risk

Fiduciaries no doubt are likely to be susceptible to such biases when determining the risk that contemplated disloyalty will be detected. Consider first the general characteristics of fiduciary relationships. Most analyses of fiduciary relationships emphasise the asymmetric distribution of information between the parties, the fiduciary's physical or practical control over the enterprise, and the monitoring difficulties faced by the principal.¹⁰² These structural characteristics create numerous opportunities for the fiduciary to render breaches undetectable and no doubt engender feelings of power and control. Given the correlation between perceptions of control and over-optimism, we might expect the very nature of the fiduciary relationship to tend to bias fiduciary perceptions about the prospects of avoiding detection of wrongdoing.

More specifically, consider fiduciary appropriations of opportunities. Some appropriations may be difficult to conceal. Where a fiduciary intercepts a maturing business opportunity, for example, the principal or other monitors may be put on notice by the non-arrival of an expected benefit. Similarly, when a fiduciary engages in competition with his principal the principal may be put on notice by the unexplained erosion of trade or by tip-offs from loyal customers.¹⁰³ However, in other contexts the existence of steps that might be taken to limit the risk of detection may give the fiduciary cause for optimism. The fiduciary might exploit information asymmetries and limited monitoring to prevent an opportunity from ever appearing on the principal's radar. Equally, fiduciaries might (and frequently do) exploit appropriated opportunities through corporate fronts to conceal their ownership.

A fiduciary contemplating the receipt of a bribe or secret commission is particularly likely to underestimate the risk of detection. If, as we might expect,¹⁰⁴ fiduciaries perceive bribe and commission taking as more prevalent than they are, they are likely to under-estimate the detection risk unless incidents of detection similarly are perceived as more numerous than they are. This will be unlikely. Indeed, the opposite may be true since the event of detection is unlikely to be readily available. The fiduciary's control over relevant information and the ease with which illegitimate payments can be concealed is likely to make plausible scenarios of detection difficult to imagine. On the other hand, where the fiduciary previously has engaged in a similar activity (for instance the receipt of a small commission) and, as we might expect, escaped detection, salient instances of detection avoidance are easily called to mind. In such circumstances 'I haven't been caught' easily

¹⁰⁰ Lee Ross, David Greene & Pamela House, 'The "False Consensus Effect": An Egocentric Bias in Social Perception and Attribution Processes' (1977) 13 *J Experimental Social Psychology* 279; Gary Marks & Norman Miller, 'Ten Years of Research on the False Consensus Effect: An Empirical and Theoretical Review' (1987) 102 *Psychological Bulletin* 72.

¹⁰¹ Those exhibiting the bias but who are not inclined to engage in an undesirable behaviour are likely to under-estimate the frequency with which others engage in the behaviour. The situation is more complex for those not inclined to undesirable behaviour who exhibit both false uniqueness and false consensus biases. It may be that the biases are off-setting, giving rise to relatively accurate perceptions: Cooter, Feldman & Feldman (n 94) 892, 905-907. Given we are concerned with fiduciaries contemplating breaching their fiduciary obligation it is not necessary to pursue this issue further.

¹⁰² See Frankel (n 60); Cooter & Freedman (n 79); Larry Ribstein, 'The Structure of the Fiduciary Relationship' (January 4 2003) U Illinois Law & Economics Research Paper No LE03-003 (available at SSRN: <http://ssrn.com/abstract=397641>); Robert Sitkoff, 'The Economic Structure of Fiduciary Law' (2011) 91 *BUL Rev* 1039.

¹⁰³ As in *Normalec Ltd v Britton* [1983] FSR 318 (Ch) 321 (Walton J).

¹⁰⁴ See n 95 – n 97 and text.

translates to ‘I won’t be caught’.¹⁰⁵ Moreover, fiduciaries contemplating bribe and commission taking are probable candidates for optimism bias because they are likely to perceive the risk of detection as highly controllable. It is in the common interest of both the fiduciary and briber (who also faces sanctions if caught) to cover their tracks, and it is largely within the power of both to do so. Payments of bribes and secret commissions are difficult for monitors to detect since harm to the enterprise with which the fiduciary is entrusted usually is ambiguous or invisible.¹⁰⁶ Often, the bare fact of payment is the only indication of wrongdoing and this is the evidence that the wrongdoers control and have the power to conceal.

(c) Implications of Low Risk Perception

It follows we might expect fiduciaries to under-estimate the risk of detection, especially in relation to bribe and commission taking, and to perceive the risk as low. This has three implications for deterring disloyalty.

First, to maintain the desired level of deterrence, it may be necessary to make adjustments to s to compensate for the fiduciary’s under-estimation of p . This suggests that exemplary damages may have a role to play in securing the desired level of deterrence, since they can be adjusted to compensate for low subjective detection and enforcement probabilities.¹⁰⁷ One problem with this strategy, however, is that it assumes the effects of a low p can be off-set by increasing s . In fact, a low p may leave individuals relatively unresponsive to changes in s .¹⁰⁸

Secondly, particular problems arise if the perceived risk of detection falls to zero since at this point sanctions become irrelevant. Such an occurrence may be more common than is appreciated because of the way in which individuals process risk: small risks often are treated as ‘zero risk’ and simply ignored.¹⁰⁹ Thus, it has been observed that individuals may aim to ‘get the gist’ of a risk, hence ‘edit’ small risks to zero.¹¹⁰ Others may use ‘probability thresholds’,¹¹¹ ignoring the consequences of an event if the perceived probability of its occurrence falls below a subjectively determined threshold.¹¹² In one notable experiment over a quarter of subjects were unwilling to pay anything to insure against a 1% risk of loss while over 10% of subjects were unwilling to pay anything to protect against a 10% risk of loss,¹¹³ implying that such subjects ignored the risk of loss entirely. Such findings have clear

¹⁰⁵ Colin Camerer & Howard Kunreuther, ‘Decision Processes for Low Probability Events: Policy Implications’ (1989) 8 J Policy Analysis & Management 565, 569.

¹⁰⁶ Consider, for example, the €10m commission in the *FHR* case (n 10). The principals were content with the €211.5m purchase price they paid for the hotel, presumably because the hotel was difficult to value and the price fell within a broadly acceptable range. This view changed once the commission was discovered, although the extent to which the price was loaded by the commission was unclear. A more modest illustration is *Williams v Barton* [1927] 2 Ch 9 (Ch), where the price paid by the trust for the stockbroker’s service was the usual market rate.

¹⁰⁷ See Anthony Duggan, ‘Exemplary Damages in Equity: A Law and Economics Perspective’ (2006) 26 OJLS 303.

¹⁰⁸ Daniel Nagin & Greg Pogarsky, ‘An Experimental Investigation of Deterrence: Cheating, Self-Serving Bias, and Impulsivity’ (2003) 41 Criminology 167.

¹⁰⁹ Camerer & Kunreuther, (n 105) 570.

¹¹⁰ Eric Stone, Frank Yates & Andrew Parker, ‘Risk Communication: Absolute Versus Relative Expressions of Low-Probability Risks’ (1994) 60 Organizational Behavior & Human Decision Processes 387. Indeed, in some real world decision contexts people often do not seek information about the likelihood of an event, but prefer to base decisions on other factors: Oswald Huber, Roman Wider & Odilo Huber, ‘Active Information Search and Complete Information Presentation in Naturalistic Risky Decision Tasks’ (1997) 95 Acta Psychologica 15.

¹¹¹ Huber, Wider & Huber (n 110) 27 (finding that where a decision maker’s perceived control of variables is such that the probability of a negative event can be brought below a subjective threshold the risk becomes irrelevant); Paul Slovic and others, ‘Preferences for Insurance Against Probable Small Losses: Insurance Implications’ (1977) 44 J Risk & Insurance 237 (probability thresholds explain why individuals frequently fail to purchase insurance to protect against low probability high consequence events).

¹¹² This makes perfect sense: people face many risks in every aspect of their daily lives but can only worry about so many things. Equally, denial of small risks allows people to think about risk in absolute terms, satisfying the psychological desire for certainty: Paul Slovic, Baruch Fischhoff & Sarah Lichtenstein, ‘Rating the Risks’ in Theodore Glickman & Michael Gough (eds), *Readings in Risk* (Johns Hopkins University Press 1990) 61, 66.

¹¹³ Gary McClelland, William Schulze & Don Coursey, ‘Insurance for Low-Probability Hazards: A Bimodal Response to Unlikely Events’ (1993) 7 J Risk & Uncertainty 95, 103 (Figure 2).

implications for the deterrence potential of the remedial regime for fiduciary disloyalty. A fiduciary who is perfectly informed about the remedial consequences of disloyalty will be unresponsive to those consequences if he perceives there is no chance they will have to be faced.¹¹⁴

Finally, even if a low risk is not translated into zero risk, low risk perception is likely to have implications for a fiduciary's incentive to become informed about the sanctions for disloyalty. The lower a fiduciary's perceived risk that wrongdoing will be detected and the principal's rights enforced, the less incentive there is for the fiduciary to expend the effort or to bear the cost of becoming informed about the legal consequences of disloyalty. Consequently, we might expect more costly or difficult-to-process information about the legal consequences of disloyalty to be ignored. This hypothesis and its implications, particularly for the deterrence value of proprietary claims, are explored in the following section.

5. WHAT DO FIDUCIARIES KNOW?

If the superior disgorgement potential of the constructive trust is to influence fiduciary behaviour then fiduciaries must know and understand the implications for them of proprietary disgorgement. The implicit assumption of the deterrence thesis is that the properties of the constructive trust are perceived and clearly understood by fiduciaries. But the foundation of this assumption is not clear. Economic models, which assume fiduciaries either are perfectly informed or gather optimal information given the resources at their disposal, might be applied. However, these models are unrealistic and generate scarcely credible predictions. A more realistic behavioural account of information gathering, on the other hand, suggests fiduciaries are unlikely to know much of the constructive trust or its implications, or will ignore them.

(a) Are Fiduciaries Perfectly or Optimally Informed?

Advocates of the deterrence thesis might assume fiduciaries are perfectly informed. On this view there is no difference between the objective properties of the constructive trust and fiduciaries' perceptions of them. But since perfect knowledge rarely is attainable this assumption is grossly unrealistic.¹¹⁵ Humans are not omniscient; information is costly and time-consuming to obtain, absorb and apply.¹¹⁶ Economic models assuming perfect information thus occupy a 'slum dwelling in the town of economics'.¹¹⁷

Alternatively, advocates of the deterrence thesis might apply economic models of information search which accept that actors operate within constraints (of time, computational ability, money etc) but within those constraints they optimise.¹¹⁸ Accordingly, such constrained optimisers will calculate the costs and benefits of searching for each additional unit of information and stop searching at the point the cost of acquiring an additional unit of information exceeds the benefit.¹¹⁹

¹¹⁴ See n 169 – n 172 and text.

¹¹⁵ Thus, individuals frequently know little of the law. In general, lay people are ignorant of much of the law which is intended to regulate their conduct: see Robert Ellickson, *Order Without Law: How Neighbours Settle Disputes* (1991) 144-145; John Darley, Kevin Carlsmith & Paul Robinson, 'The *Ex Ante* Function of the Criminal Law' (2001) 35 *Law & Soc Rev* 165. Professionals similarly are not immune from ignorance of laws addressed to them. For instance, despite heavy publicity drives in the sector, recent research shows a quarter of those working in the construction industry have no awareness of the Bribery Act 2010. In smaller organisations (employees < 200) 50% have no awareness of the requirements of the legislation: Chartered Institute of Building, (n 95) 17.

¹¹⁶ Gerd Gigerenzer, *Rationality for Mortals: How People Cope with Uncertainty* (OUP 2008) 4; Posner, *Economic Analysis* (n 24) §1.1.

¹¹⁷ George Stigler, 'The Economics of Information' (1961) 69 *J Pol Econ* 213, 213.

¹¹⁸ See, for example, Thomas Sargent, *Bounded Rationality in Microeconomics* (OUP 1993).

¹¹⁹ Stigler (n 117); Sargent (n 118).

It is not, however, clear whether such models would predict a significant correlation between the objective properties of the constructive trust and fiduciaries' perceptions of the remedy. Better information about sanctions allows more accurate calculation of the expected cost of disloyalty. But this is valuable to the fiduciary only to the extent the additional information leads to a different and improved outcome (e.g. the additional information leads to the selection of a 'no-breach' option rather than a 'breach' option because the information allows the fiduciary to calculate that the former option maximises subjective expected utility). The additional benefits flowing from the substantive decision, moreover, must be greater than the costs (including opportunity costs) incurred by the fiduciary allocating time and other resources to information search. Additionally, since the formal legal sanction is but one element of the overall sanction for disloyalty, and since the probability of being sanctioned may be low, the value of information about the legal consequences of disloyalty will be discounted accordingly. This suggests a rational fiduciary is perhaps less likely to seek out information about the remedial implications of disloyalty than proponents of the deterrence thesis assume.

More importantly, optimal search probably is impossible. Optimising criteria, it has been pointed out, create 'an infinite and seemingly intractable regress'.¹²⁰ An individual seeking optimal information for the purpose of making a particular decision requires information about how much information he needs to collect, and if he is to collect optimal information about how much information he needs to collect he requires further information, and so on *ad infinitum*.¹²¹ It follows that optimal search is, arguably, logically impossible: the net value of information gathering is 'unknown and rationally unknowable'.¹²² At any rate, optimal information search is impractical and unrealistic. In most contexts (including the present one) it is not possible for actors to estimate the value of an additional unit of information before it is known.¹²³ Moreover, while optimal search theory assumes individuals are able to recognise the limits of their knowledge, in reality individuals tend to be poor at calibrating their own knowledge and understanding.¹²⁴ To assume optimal search is possible thus invites the omniscient hyper-rational actor of early neo-classical economics to 'sneak in through the back door'.¹²⁵

(b) Realistic Limits to Fiduciary Knowledge

In fact, the behavioural evidence suggests fiduciary knowledge is likely to be curtailed by the operation of biases and the adoption of non-optimising search strategies. Under such conditions, which are explored further below, fiduciaries contemplating disloyalty are much less likely to be cognizant of the properties of the constructive trust than proponents of the deterrence thesis assume.

(a) Biases and Inadvertent Ignorance

Information search may be limited by inadvertent ignorance. Psychological research suggests there is a general tendency for people to assume that things are simpler than they really are. Frequently, they fail to appreciate the existence of relevant information that they do not possess ('unknown unknowns') and they fail to appreciate their own lack of understanding of the information they do possess. For instance, people exhibit a strong tendency to overestimate their understanding of how

¹²⁰ John Conlisk, 'Why Bounded Rationality?' (1996) 34 *J Economic Literature* 669, 687.

¹²¹ See generally Jon Elster, *Sour Grapes: Studies in the Subversion of Rationality* (Cambridge University Press 1983) 17-18; Philippe Mongin & Bernard Walliser, 'Infinite Regressions in the Optimizing Theory of Decision' in Bertrand Munier (ed), *Risk, Decision and Rationality* (Reidel 1987) 435; Conlisk (n 120) 686-688.

¹²² Jon Elster, 'Excessive Ambitions' (2009) 4 *Capitalism & Society*, Article 1 (DOI: 10.2202/1932-0213.1055) 5.

¹²³ Jon Elster, *Nuts and Bolts for the Social Sciences* (Cambridge University Press 1989) 35; Jon Elster, 'The Nature and Scope of Rational Choice Explanations' in Michael Martin & Lee McIntyre (eds), *Readings in the Philosophy of Social Science* (MIT Press 1994) 311, 318.

¹²⁴ See n 126 – 133 and text.

¹²⁵ Gigerenzer, Todd & ABC Research Group, *Simple Heuristics* (n 67) 11.

things work (the ‘illusion of explanatory depth’)¹²⁶ and thereby lack awareness of the complexity of the world around them.¹²⁷ Similarly, people generally are poor at evaluating, and therefore appreciating the limits of, their own knowledge and understanding, believing that comprehension of a given matter has been attained when in fact it has not.¹²⁸ In experiments on text comprehension, for example, subjects asked to read simple expository texts expressed high confidence in their comprehension of the texts, but were unable to identify basic mistakes or contradictions¹²⁹ or to make simple inferences from central propositions contained within the texts.¹³⁰ This ‘illusion of knowing’ may persist even when novel or technical information is encountered,¹³¹ and it is exacerbated by the ease with which large amounts of information can be accessed through modern technology.¹³² The operation of such illusions may be compounded by the tendency of individuals to make overly optimistic assessments of their own abilities, competencies and personal characteristics.¹³³

It follows that in many situations there is a significant gap between what individuals believe they know and what they really do know. This has implications for information gathering: individuals who believe they are better informed than they really are will cease search and deliberation prematurely.

(ii) The ‘Satisficing’ Search Strategy

When we search for information, it is said, ‘we satisfice, we do not maximise’.¹³⁴ That is, we tend to be concerned not with a search for optimal information but with the identification of information that is satisfactory given our needs and circumstances. Thus, decision-makers identify a target or aspiration level of satisfaction and search until they find an alternative that reaches that level.¹³⁵ Aspiration levels are dynamic, not static; they vary with context and may be fine-tuned during search. Thus, in benign environments aspiration levels will rise; in challenging environments they will fall.¹³⁶ Since search is terminated when the individual identifies the first alternative that meets the satisfaction threshold, choice is determined in part by the order in which alternatives are evaluated.¹³⁷

In economics circles satisficing generally is viewed with scepticism, as an elusive ‘moving target’ with too little predictive value because an individual’s satisfaction level is determined subjectively.¹³⁸

¹²⁶ Leonid Rozenblit & Frank Keil, ‘The Misunderstood Limits of Folkscience: An Illusion of Explanatory Depth’ (2002) 26 *Cognitive Science* 521; Frank Keil, ‘Folkscience: Coarse Interpretations of a Complex Reality’ (2003) 7 *Trends in Cognitive Sciences* 368; Frank Keil, ‘Getting to the Truth: Grounding incomplete Knowledge’ (2008) 73 *Brooklyn L Rev* 1035.

¹²⁷ See, for example, Rebecca Lawson, ‘The Science of Cycology: Failure to Understand How Everyday Objects Work’ (2006) 34 *Memory & Cognition* 1667.

¹²⁸ Arthur Glenberg, Alex Wilkinson & William Epstein, ‘The Illusion of Knowing: Failure in the Self-Assessment of Comprehension’ (1982) 10 *Memory & Cognition* 597. For an overview of the experimental literature identifying the illusion, see Arthur Glenberg and others, ‘Enhancing Calibration of Comprehension’ (1987) 116 *J Experimental Psychology: General* 119, 119-121.

¹²⁹ Glenberg, Wilkinson & Epstein, ‘The Illusion of Knowing’ (n 128); William Epstein, Arthur Glenberg & Margaret Bradley, ‘Coactivation and Comprehension: Contribution of Text Variables to Illusion of Knowing’ (1984) 12 *Memory & Cognition* 355.

¹³⁰ Arthur Glenberg & William Epstein, ‘Calibration of Comprehension’ (1985) 11 *J Experimental Psychology: Learning, Memory & Cognition* 702.

¹³¹ Arthur Glenberg & William Epstein, ‘Inexpert Calibration of Comprehension’ (1987) 15 *Memory & Cognition* 84. See also Regina Jucks & Elisabeth Paus, ‘What Makes a Word Difficult? Insights into the Mental Representation of Technical Terms’ (2012) 7 *Metacognition & Learning* 91.

¹³² Matthew Fisher, Mariel Goddu & Frank Keil, ‘Searching for Explanations: How the Internet Inflates Estimates of Internal Knowledge’ (2015) 144 *J Experimental Psychology: General* 674.

¹³³ See Mark Alicke & Olesya Govorun, ‘The Better-Than-Average Effect’ in Mark Alicke, David Dunning & Joachim Kruger (eds), *The Self in Social Judgment* (Taylor & Francis/Psychology Press 2005) 85.

¹³⁴ Russell Harding, *Morality and the Limits of Reason* (1990) 4. See also, James Bowen & Zi-Lei Qiu, ‘Satisficing When Buying Information’ (1992) 51 *Organizational Behavior & Human Decision Processes* 471; Andrew Caplan, Mark Dean & Daniel Martin, ‘Search and Satisficing’ (2011) 101 *Am Econ Rev* 2899.

¹³⁵ Herbert A Simon, ‘Rational Choice and the Structure of the Environment’ (1956) 63 *Psychological Review* 129, 136; Simon, ‘Behavioral Model’ (n 64). See also William Baumol, ‘On Rational Satisficing’ in Mie Augier & James March (eds), *Models of a Man: Essays in Memory of Herbert A Simon* (MIT Press 2004) 57.

¹³⁶ Herbert A Simon, ‘Rational Decision Making in Business Organizations’ (1979) 69 *Am Econ Rev* 493, 503.

¹³⁷ John Payne, James Bettman & Eric Johnson, *The Adaptive Decision Maker* (Cambridge University Press, 1993) 26.

¹³⁸ Foka-Kavaliaraki & Hatzis (n 73) 23.

However, the environmental features of, and psychological processes triggered by, an individual's situation may permit broad predictions about likely satisfaction thresholds and search outcomes. Satisficing may be unable to provide the clear, elegant and precise predictions favoured by economists; but sometimes it is better to be 'messy and vaguely right' than 'elegant and precisely wrong'.¹³⁹

(iii) The Fiduciary's Search

We can now revisit the question 'what is a fiduciary contemplating disloyalty likely to know of the legal implications of his intended disloyal act?' For the reasons offered below, the answer in most cases is likely to be 'very little'.

Initial aspiration levels: A number of factors suggest initial aspiration levels may be modest: (1) fiduciaries have limited time to search; (2) obtaining legal advice about the implications of an intended breach is likely to be financially expensive; (3) if fiduciaries perceive there is little or no risk their contemplated disloyalty will be detected and sanctioned, information about the legal implications of breach will be perceived as being of limited value; (4) the formal legal sanction may not loom as large in the mind of the fiduciary as other elements of the sanction. In particular, the risk of being compelled to give-up future gain is unlikely to be as psychologically proximate as the loss of an existing endowment (for instance, loss of reputation, loss of position by termination of the relationship, or loss of liberty);¹⁴⁰ (5) the fiduciary is likely to (a) appreciate that the law may be complex and that he lacks the requisite skills to access and to understand much legal information; or (b) believe the law is simpler than it is and therefore set out to find a clear but simple answer.

The search environment: The search environment is relatively inhospitable to a fiduciary embarking upon a quest for information about the proprietary implications of a breach of fiduciary obligation. Short of buying tailored legal advice from an expert, which is likely to be relatively expensive, fiduciaries seeking to understand the legal implications of a contemplated breach of duty may adopt a number of strategies. First, they may identify and search a relevant legal source such as a textbook or legal encyclopaedia. This strategy is likely to yield the most accurate and reliable information but such sources are not easily comprehended by non-lawyers.

Secondly, if available, the fiduciary might consult general guidance produced by an information intermediary. Guidance provided by information intermediaries will be more accessible but, for reasons which are explored further below,¹⁴¹ is likely to omit consideration of the proprietary implications of breach of fiduciary obligation.

Thirdly, the fiduciary may undertake a general web search for relevant material. In principle, the world wide web offers quick and low cost access to a vast information repository. However, finding appropriate information may be difficult and time consuming. Search engines are key but typically result in an 'information flood'.¹⁴² It follows that a systematic review of search engine results pages (SERPs) is likely to be prohibitive in terms of time and cognitive effort. Users are more likely to select which links to follow by relying on heuristic processes which focus on a limited range of information. Such processes are quick but can lead to poor evaluation and selection outcomes due to the limited information focus.¹⁴³ For example, users often focus selectively on key words in the

¹³⁹ Richard Thaler, *The Winner's Curse: Paradoxes and Anomalies of Economic Life* (Princeton University Press 1994) 198.

¹⁴⁰ This is the result of the so-called 'endowment effect: people value things that are already part of their endowment more highly than things that they may acquire but which are not yet part of their endowment: see Thaler, 'Misbehaving' (n 62) Ch 2.

¹⁴¹ See n 159 – n 164 and text.

¹⁴² Soo-Young Rieh, Yong-Mi Kim & Karen Markey, 'Amount of Invested Mental Effort (AIME) in Online Searching' (2012) 48 *Information Processing & Management* 1136.

¹⁴³ Miriam Metzger, Andrew Flanagan & Ryan Medders, 'Social and Heuristic Approaches to Credibility Evaluation Online' (2010) 60 *Journal of Communication* 413.

highlighted link for each result or on information which is consistent with expectations.¹⁴⁴ Perhaps most importantly, users also tend to rely heavily on SERP rankings, paying greatest attention to the results at the top of the first SERP and rarely moving to the second SERP or beyond.¹⁴⁵ Since search engines rank pages by reference to the relevance of a page to the search terms and by quality,¹⁴⁶ the highest ranked pages (which are most likely to be selected) will not necessarily be the most accessible.

Much will depend on the adequacy of the search terms employed. Searching a technical field without a technical vocabulary may prove difficult. In the context of corrupt payments, for example, a fiduciary who searches for ‘bribery’, ‘receipt of bribe’, ‘agent receiving bribe’ and ‘corrupt payment’ will be faced with a SERP displaying links relating mostly to the definition of bribery and criminal liability.¹⁴⁷ By contrast, the first SERP for ‘bribes and secret commissions’ contains numerous links to pages discussing the availability of proprietary claims, although the content of the linked pages – predominantly academic articles¹⁴⁸ and update notes written by solicitors – is not particularly accessible to lay readers. Moreover, reference to the implications of proprietary claims (namely, tracing and following) is limited to one or two lines tucked away towards the end of the pages, with little or no explanation of the terminology. Whether such discussion would be noticed by most (non-legally trained) readers,¹⁴⁹ let alone its significance appreciated, is doubtful.¹⁵⁰

Stopping search: Faced with such an environment, fiduciaries in general cannot be expected to cognize the implications of the constructive trust. Recall choice is influenced by the order in which alternatives are evaluated. In addition to possessing some rudimentary understanding of their basic

¹⁴⁴ Metzger, Flanagan & Medders, ‘Social and Heuristic Approaches’ (n 143).

¹⁴⁵ Bing Pan and others, ‘In Google We trust: Users’ Decisions on Rank, Position, and Relevance’ (2007) 12 *Journal of Computer Mediated Communication* 801 (finding rank is a better predictor of link selection than the relevance of the link, with most attention given to the top of the first search page). See also Mark Keane, Maeve O’Brien & Barry Smyth, ‘Are People Biased in Their Use of Search Engines?’ (2008) 51 *Communications of the ACM* 49; Yvonne Kammerer & Peter Gerjets, ‘The Role of Search Result Position and Source Trustworthiness in the Selection of Web Search Results When Using a List or a Grid Interface’ (2014) 30 *International Journal of Human-Computer Interaction* 177 (Study 1); Patricia Wallace, *The Psychology of The Internet* (Cambridge University Press 2nd edn 2016) 7 (noting that the first page of results is ‘about as far as most people ever look’).

¹⁴⁶ Wallace, *Psychology* (n 145) 7-8.

¹⁴⁷ In other contexts, such as the appropriation of a business opportunity, the most obvious search terms (e.g. ‘business opportunity’, ‘taking a business opportunity’, ‘appropriation of business opportunity’ or ‘misappropriation of business opportunity’) return either nothing of legal relevance or pages discussing liability and the corporate opportunities doctrine (searches conducted on Google on 7 March 2018).

¹⁴⁸ E.g. Lord Millett, ‘Bribes and Secret Commissions’ (n 1).

¹⁴⁹ Accessing material via the internet tends to make people more cursory and inattentive readers: see Harald Weinreich and others, ‘Not Quite the Average: An Empirical Study of Web Use’ (2008) 2 *ACM Transactions on the Web*, Article 5, 18-20 (DOI=10.1145/1326566).

¹⁵⁰ The reviewer of this article, for example, suggested searchers may soon find themselves on Wikipedia. The second result for the Wikipedia search ‘bribes and secret commissions’ links to a page on the *FHR* case, which notes that a proprietary claim ‘will allow tracing into the assets of the agent and any relevant third parties in order to claim any fruits of the fraud’: ‘FHR European Ventures v Cedar Capital Partners LLC’ <https://en.wikipedia.org/wiki/FHR_European_Ventures_LLP_v_Cedar_Capital_Partners_LLC> (Accessed 7 March 2018). This, the reviewer suggests, surely is a red flag indicating to the fiduciary that asset shielding through the use of a shell company or other third party will not do. But (1) what is clearly visible to lawyers who know what they are looking for and find what they expect to find is not necessarily visible to those untrained in the art who are unsure of what they are looking for. (2) Different search terms lead to different results; search terms that are most obvious to those with knowledge of the field will not necessarily be employed by those with little or no knowledge of the field. We must be wary of the ‘curse of knowledge’ – the cognitive bias which makes it difficult for us to imagine that others do not share the same knowledge or apply it in the same way as we do: see Colin Camerer, George Loewenstein & Mark Weber, ‘The Curse of Knowledge in Economic Settings: An Experimental Analysis’ (1989) 97 *J Pol Econ* 1232; Richard H Thaler, ‘From Homo Economicus to Homo Sapiens’ (2000) 14 *Journal of Economic Perspectives* 133, 133-134. (3) Recall too that in deciding whether to follow a link users tend to focus on key words in the link (see n 144 and text). A linked case name is perhaps much less likely to be followed than a link containing terms that are more salient to a non-lawyer. (4) A fiduciary who follows the link will need to navigate over 3,000 words of relatively technical text before the pertinent line of text is reached. One suspects most will have given up by this stage or skim over the relevant text given the cursory attention often paid to web pages: see Weinreich and others, ‘Not Quite the Average’ (n 149).

duty not to profit from their position,¹⁵¹ during their search for information fiduciaries likely will view statements to the effect that a fiduciary is liable to ‘account for’, ‘disgorge’ or ‘give-up’ disloyal gain. Such statements often are accompanied by statements of the immateriality of good faith, impossibility arguments and harm to the principal. These statements encapsulate the fundamental principle that fiduciaries must not make unauthorised gain; if they do they must give it up. This notion, moreover, is consistent with the general legal and moral principle, which may have been acquired through social learning, that one ought not to be permitted to profit from one’s own wrongdoing.

It must be questionable whether a fiduciary possessing such information would consider further search beneficial since the legal consequences of breach *appear* to be clearly known (this is especially so where the fiduciary *expects* to find a simple legal answer). In the absence of *actual* knowledge about the peculiar and potentially far-reaching consequences of proprietary claims the *possibility* of such consequences will be difficult to imagine (they are ‘unknown unknowns’).¹⁵² That would involve asking questions such as how one would give up one’s gains and what would be the implications if the initial gain was exchanged, mixed in bank accounts, invested or passed to third parties. Such questions involve additional, more complex, levels of inquiry that evidence and experience tells us people are not very good at making.¹⁵³

Similarly, search may be stopped where a fiduciary perceives his contemplated action will attract criminal sanctions.¹⁵⁴ Here, the deterrence work is likely to be done (if at all) by the criminal law: if, as we might expect, the fiduciary is deflected from the contemplated act by the threat of criminal sanction further search for information on the legal implications of the act is unnecessary. If, on the other hand, the fiduciary is not moved by the threat of criminal sanction, arguably the private law implications of his actions will be of little interest or exert little influence on his behaviour.¹⁵⁵

What of fiduciaries whose searches disclose that disloyal gain is held ‘on constructive trust’? Such terminology is unhelpful to those unskilled in the art so further information is necessary. This may cause fiduciaries to: (1) accept ignorance of the term and satisfice with a basic understanding of disgorgement; (2) attribute meaning to the term, for instance by equating it with the fiduciary’s own subjective notion of disgorgement or otherwise by ‘filling in the gaps’ by reference to existing knowledge;¹⁵⁶ or (3) search for further explanation. The first option will leave the fiduciary with a basic understanding of the disgorgement principle; the second option is unlikely to take things much further. Additional search is likely to be time consuming. Explanations of the concept of a ‘trust’ will generate new terms and concepts such as ‘tracing’ and ‘following’, giving rise to the same three options, and so on until a satisfactory understanding is obtained. In many cases we might expect the time and cognitive costs of such a comprehensive search to be prohibitive given the likely modesty of the initial aspiration levels.

Adjustment of aspirations: A final and related point is that the information environment perhaps is more likely to lead to a downward adjustment of an initially high satisfaction threshold than to an uplift of an initially low satisfaction threshold. As is evident from the above discussion, an individual

¹⁵¹ Most fiduciaries aim to comply with their duties, at least initially, therefore must be cognizant of the basic demands of their office.

¹⁵² See n 126 – n 133 and text.

¹⁵³ Richard Thaler, ‘Homo Economicus’ (n 150), 134-135; Rosenblit & Keil, ‘Misunderstood Limits’ (n 126) 523 (discussing how people conflate higher level general analysis of a system, or functional glosses, with lower level detailed analysis).

¹⁵⁴ See the results of the searches discussed above, n 147 and text.

¹⁵⁵ Craig Rotherham, ‘Deterrence as a Justification for Awarding Accounts of Profits’ (2012) 32 OJLS 537, 550-552.

¹⁵⁶ It is, in fact, more common than we may imagine for people to over-estimate their comprehension of technical and unfamiliar terms: see Jucks & Paus (n 131). It is initially puzzling why a person who encounters a novel term of art would be overly confident about their understanding of the term. One possibility is that meaning is inferred from the context in which the term is used or a familiar meaning is attributed, causing the individual to under-estimate the complexity beneath its lexical surface. This explanation is consistent with theories suggesting feelings of knowledge are elicited by cue familiarity or the ease of access of information prompted by the cue: Asher Koriat & Ravit Levy-Sadot, ‘The Combined Contribution of the Cue-Familiarity and Accessibility Heuristics to Feelings of Knowledge’ (2001) 27 J Experimental Psychology: Learning, Memory & Cognition 34.

seeking a clear understanding of the properties of constructive trust does not face a benign search environment. Information is complex, voluminous and dispersed, there is likely a dearth of accessible accounts provided by information intermediaries, and fiduciaries generally are not skilled in the relevant art, hence will find legal information difficult and time consuming to navigate and to understand. Furthermore, the more effortful it is to process information, the more likely it will be simplified or ignored altogether to avoid ‘cognitive overload’.¹⁵⁷ This process may not be entirely conscious but a part automatic response to negative affect generated by excessive cognitive load.¹⁵⁸ Since negative affect is generated by cognitive load and is unrelated to the significance of the information, there may be downward adjustment of aspiration levels even where information is available and highly relevant.

(c) Information Intermediaries

Frequently, third parties mediate the communication of information to information users, providing information specifically tailored to the users’ needs. We might expect professional bodies, regulators and employers to provide appropriately tailored legal information for fiduciaries by way of guidance notes, handbooks or codes of practice.¹⁵⁹ Targeted information of this kind may limit inadvertent ignorance by making relevant information more visible and increase a satisficer’s satisfaction threshold by creating a more benign information environment. However, information provided by intermediaries necessarily is limited by two factors.

(i) The Accuracy/Accessibility Trade-Off

First, the information must be selected and packaged to meet the needs of the information user. In the present context, the information must be accessible to a predominantly non-legally trained audience at a low enough cost. Reducing complex legal information to concise, relatively simple formulations involves a trade-off between accuracy and accessibility. A complete and accurate account of the implications of a breach of fiduciary obligation necessarily would be detailed and lengthy, hence costly to access and difficult to understand. We therefore might expect intermediaries to provide simplified statements of broad principle that are accessible at lower cost, such as a clear statement of the disgorgement principle indicating fiduciaries will be required to give-up any benefit derived from a breach of fiduciary obligation, but omitting more complicated aspects such as how the gain will be identified/quantified.¹⁶⁰ This would be accessible and convey the basic message that proponents of the deterrence rationale would like to see conveyed: ‘breach and the law removes your gain’.

However, this says nothing about apparently key deterrent aspects of proprietary claims such as the recourse to third parties that the constructive trust provides. Further, the function of an account of profits tends to be described in remarkably similar terms.¹⁶¹ While lawyers make sharp crystalline distinctions between personal and proprietary disgorgement, inevitably the boundaries blur in the process of communication to lay persons. The need to trade accuracy for accessibility, in the end, probably will result in the communication to fiduciaries of a broadly similar ‘end message’ regardless of the availability of proprietary claims.

¹⁵⁷ Melvin Eisenberg, ‘Text Anxiety’ (1986) 59 S Cal L Rev 305.

¹⁵⁸ Ellen Garbarino & Julie Edell, ‘Cognitive Effort, Affect, and Choice’ (1997) 24 J Consumer Research 147.

¹⁵⁹ We might also imagine official, authoritative communications of legal information, such as official pamphlets or accessible, plain language statutory statements. For discussion of these and similar ‘official’ options, see Law Commission, *Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties* (CP 153, 1999) paras 14.8-14.40.

¹⁶⁰ Such an approach was considered the most appropriate by the Company Law Review Steering Group in its consideration of a possible statutory statement of remedies for breach of directors’ duties: Sarah Worthington, ‘Reforming Directors’ Duties’ (2001) 64 MLR 439, 457.

¹⁶¹ *Attorney-General v Guardian Newspapers (No 2)* [1990] 1 AC 109 (HL) 262 (Lord Keith); *United Pan Europe* (n 38) [47] (Morritt LJ) (‘it is not in doubt that the object of the equitable remedies of an account or the imposition of a constructive trust is to ensure that the defaulting fiduciary does not retain the profit’).

(ii) Limited Demand for Remedy Law

The second limitation regarding information provided by intermediaries relates to the low demand for information about remedies. Most fiduciaries aim to comply with their legal duties. Thus, understanding the content of their duties is more important than understanding the legal consequences of failing to comply with them.¹⁶² In other words, for most fiduciaries, ‘duty law’ is highly relevant while ‘remedy law’ is not. This is important since the supply of non-relevant information increases the cost of observing relevant information by increasing total information processing costs.¹⁶³ While the supply of remedy law would reduce the search costs of the small number for whom it is salient (predominantly those contemplating breach), it would increase the cost of access for those seeking duty law. The cost may be minimal if remedy law is dealt with in broad, summary fashion. But we have noted already how this is unlikely to convey to fiduciaries the important properties of the constructive trust. In practice, we find limited supply of remedy law in information products for fiduciaries, still less consideration of the implications of proprietary disgorgement.¹⁶⁴

(d) Big Breaches and Well Informed Fiduciaries

None of this is to suggest that fiduciaries *never* will be well informed of the legal (including proprietary) consequences of disloyalty. Indeed, in some contexts fiduciaries may possess a strong incentive to incur the costs of taking tailored legal advice or engaging in careful and thorough search. For example, fiduciaries who engage in large but infrequent breaches, or who plan ‘one big breach’, can be expected to be more motivated to become informed:¹⁶⁵ the stakes are higher and such fiduciaries may lack the excessive optimism of avoiding detection that small repeat wrongdoers can be expected to exhibit.¹⁶⁶ Nevertheless, fiduciaries who are well informed about the proprietary consequences of acquisitive breaches of fiduciary obligation are likely to be the exception, not the norm. Furthermore, there are good reasons to suspect that even well informed fiduciaries may not be deterred by proprietary disgorgement any more than they would be by disgorgement effected by personal remedy.

First, an accurate understanding of proprietary disgorgement may be a double edged sword: proprietary disgorgement may enhance profit stripping but its limitations can be exploited. For instance, an initial gain can be applied to generate subsequent wealth without leaving a transactional trail or identifiable assets, allowing the sophisticated fiduciary to defeat tracing rules and to avoid accountability for secondary profits.¹⁶⁷ As Dale Oesterle noted long ago, rather than dissuade

¹⁶² The relative importance of substantive duty law over remedy law is broadly recognised: see, for example, Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Completing the Structure* (URN 00/1335, 2000) para 13.9.

¹⁶³ Increasing the volume of information also increases the risk that important information will be simplified, overlooked or ignored to avoid overload: n 157 – n 158 and text.

¹⁶⁴ See, for example, Charity Commission, *Conflicts of interest: A Guide for Charity Trustees* (CC 29, 2014) Part 5 (referring to regulatory, reputational and legal consequences of conflicts but limiting discussion of the latter to rescission of conflicted contracts, liability to compensate for loss, and restitution of money wrongly paid to trustees).

¹⁶⁵ Although such motivation will not immunize the fiduciary from the possible effects of the ‘illusion of knowledge’, which may result in a failure to reach initially high search aspirations: see n 128 – n 133 and text.

¹⁶⁶ See n 105 and text.

¹⁶⁷ Tracing can be defeated by payments through overdrawn accounts; the knowledgeable wrongdoer might apply his gain to reduce or pay off overdrafts, since tracing cannot reach savings made from the reduction or elimination of a liability; and the wrongdoer may use the gain to purchase holidays, food and other consumables, freeing legitimate wealth to purchase profitable investments. Note, however, the increased judicial willingness to infer transactional links to defeat basic laundering attempts: see *Federal Republic of Brazil v Durant International Corporation* [2015] UKPC 35, [2015] 3 WLR 599 [38]-[41] (Toulson JSC); *Relfo Limited (in liquidation) v Varsani* [2014] EWCA Civ 360, [2015] 1 BCLC 14 [56], [62]-[63] (Arden LJ). Defeating tracing, particularly where the amount of money involved is significant, therefore will be difficult.

wrongdoing transactional link tracing is more likely to influence how knowledgeable wrongdoers transact *after* the commission of a wrong.¹⁶⁸

Secondly, and perhaps more importantly, if the constructive trust is to operate as an effective deterrent, it is not only necessary for fiduciaries to perceive its properties but also to view those properties as relevant to a decision whether or not to breach. However, as has been explained already, excessive optimism about the prospects of avoiding detection, or avoiding the effects of particular sanctions, may render those sanctions behaviourally otiose.¹⁶⁹ Since well informed fiduciaries are, by their very nature, more likely to be aware of the steps that can be taken to avoid detection and of the sophisticated laundering techniques that can be employed to obscure the trail of proceeds, they are likely candidates for over-optimism.¹⁷⁰ Optimism about avoiding sanction is also likely to be fostered by highly available instances of the non-detection of wrongdoing – as where a fiduciary previously has engaged in a breach of duty without being caught.¹⁷¹ Instances of an isolated but very large breach of duty are likely to be relatively uncommon. Rather, more serious or significant forms of wrongdoing tend to emerge incrementally. Small transgressions often lead to larger transgressions, but few wrongdoers ever start with the large transgressions.¹⁷² If this dominant account of how wrongdoing develops is correct, we might expect large acquisitive breaches of fiduciary obligation to be preceded, in general, by small breaches, thereby fostering excessive optimism by providing readily available instances of non-detection.

Finally, in the context of corrupt payments, fiduciaries who are well informed of the legal implications of their actions likely will appreciate the possibility of facing criminal sanctions if caught. A fiduciary who is not dissuaded by the possibility of criminal sanctions (including fines, imprisonment and confiscation measures) is unlikely to be influenced by civil law remedies.¹⁷³ In such circumstances the deterrent role of the constructive trust is redundant.

6. CONCLUSION

The deterrence thesis initially appears as compelling as it is simple: a constructive trust can be expected to remove more of the fiduciary's gain than an account of profits therefore fiduciaries will have less incentive to behave disloyally. However, the deterrence thesis rests on unrealistic assumptions about fiduciary behaviour. Applying more nuanced behavioural tools, we find that the influence of proprietary disgorgement on fiduciary behaviour is likely to be negligible. Fiduciaries cannot be influenced by sanctions they do not know, and few fiduciaries will be cognizant of the properties of the constructive trust. Those who are may be relatively unresponsive to such properties because they perceive a low risk of detection. We might wonder whether the prospect of such negligible deterrence gains is sufficient, particularly given the potential impact of constructive trusts on innocent third parties.¹⁷⁴

¹⁶⁸ Dale Oesterle, 'Deficiencies of the Restitutionary Right to Trace Misappropriated Property in Equity and in UCC § 9-306' (1983) 68 Cornell L Rev 172, 203.

¹⁶⁹ See n 93 – n 98 and text.

¹⁷⁰ See n 77 and text.

¹⁷¹ See n 105 and text.

¹⁷² Blake Ashford & Vikas Anand, 'The Normalization of Corruption in Organizations' (2003) Research in Organizational Behavior 1; John Darley, 'The Cognitive and Social Psychology of Contagious Organizational Corruption' (2005) 70 Brooklyn L Rev 1177; Max Bazerman & Francesca Gino, 'When Misconduct Goes Unnoticed: The Acceptability of Gradual Erosion in Others' Unethical Behavior' (2009) 45 J Experimental Social Psychology 708; David Welsh and others, 'Slippery Slope: How Small Ethical Transgressions Pave the Way for Larger Future Transgressions' (2014) 99 J Applied Psychology 114.

¹⁷³ See n 155 and text.

¹⁷⁴ Rotherham, 'Policy and Proprietary Remedies' (n 2) 534. See also Roy Goode, 'Proprietary Restitutionary Claims' in William Cornish and others (eds), *Restitution: Past, Present and Future: Essays in Honour of Gareth Jones* (Hart Publishing 1998) 63, 71-72; Vanessa Finch & Sarah Worthington, 'The *Pari Passu* Principle and Ranking Restitutionary Rights' in Francis Rose (ed), *Restitution and Insolvency* (Mansfield Press 2000) 1, 13-14; Penner (n 32) 1007.

Ironically, the deterrence prospects of the constructive trust are bleakest in cases of bribe and commission taking, the contexts in which calls for the recognition of a constructive trust on deterrence grounds have been at their loudest. Detection rates for bribery and commission taking are particularly likely to be perceived as low, leaving fiduciaries with little incentive to become informed about sanctions and unresponsive to known sanctions.

For the avoidance of doubt, the claim is not that disgorgement does not play an important role in dissuading disloyalty. Most fiduciaries can be expected to be cognizant of the basic idea of disgorgement, although it may have little or no impact on the decisions of those who perceive a very low or zero risk that their disloyalty will be detected. The claim is that employing the constructive trust to effect disgorgement is unlikely to have a material effect on most fiduciary behaviour because fiduciaries cannot generally be expected to understand the legal consequences of disloyalty at the requisite level of detail and complexity. Since the same general disgorgement 'end message' is likely to reach fiduciaries regardless of whether an account of profits or constructive trust is adopted to effect disgorgement the former is preferable given it is less disruptive to third parties.