

Account of Profits for Breach of Fiduciary Duty

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Abstract

An account of profits operates to strip a fiduciary of unauthorised gains. While the authorities suggest that the duty to account follows almost inexorably from the breach, the precise nature of this obligation reflects the nuances of the particular relationship and the manner in which it was abused. This article explores the varied nature of fiduciary duty and the interplay between causation, remoteness and perceptions of the breach in defining the obligation to account. These elements are contrasted with the award of allowances to the defaulting fiduciary and the anomalous status of such awards in relation to the primary duty of fidelity. Attention is directed to developments in this area and their implications for establishing the amount that is ultimately disgorged as the net gain. It is argued that the process of accounting is dualistic. The first phase is concerned with quantifying gross profits that flow from the breach and the second is directed to the net gain that must be disgorged. The overall objective must be reconciled with the fact that the exercise is driven by different normative considerations.

I Introduction

It is uncontroversial that a defaulting fiduciary may be required to disgorge unauthorised gains by means of an account of profits. However, the nature of the underlying obligation and the scope of the remedial response is less clear. Fiduciary obligations are neither fixed nor immutable — particularly as the fiduciary principle has expanded from the trust paradigm to relationships that are not inherently fiduciary. To understand the role of account of profits in these diverse settings it is necessary to identify the elements of the modern fiduciary principle and the varying duties it engenders.

Attention can then be directed to the function of an account of profits and the manner in which wrongful gains are treated. The authorities suggest that the duty to account for profits follows almost inexorably from the breach. However, it must at least be demonstrated that there is some causal link between the gain and the breach of duty. This will be explored by examining the interplay between causation, remoteness and perceptions of the breach in defining the obligation to account.

It will be argued that the process of accounting is dualistic and that a distinction must be drawn between the exercise of quantifying profits flowing from the breach and the task of determining the amount that should ultimately be disgorged as the net gain. The latter brings into play the award of allowances to defaulting fiduciaries. In assessing such awards it will

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be asked whether recompense for skill and enterprise and exceptionally, apportionment of profits is consistent with the strict expectations of probity that underpin fiduciary duty.

II Scope of the Fiduciary Principle

The fiduciary principle has developed by analogy to rules governing the orthodox trust,¹ and extends to a wide range of relationships of trust and confidence. A duty of loyalty is increasingly regarded as the touchstone of a fiduciary relationship.² It has been observed that this duty

encaptures a situation where one person is in a relationship with another which gives rise to a legitimate expectation, which equity will recognise, that the fiduciary will not utilise his or her position in such a way which is adverse to the interests of the principal.³

Historically, the content of fiduciary obligations has been defined by the classification of the relationship, particularly in respect of relationships that are regarded as inherently fiduciary.⁴ It has also been recognised that fiduciary duties can arise outside these categories, especially where an element of vulnerability and dependence is present. In recent times courts have tended to adopt a holistic approach, focusing on the nature of the obligations engendered by the relationship, transaction, or dealings between the parties.⁵ Thus, the content of the duty is gathered from the circumstances in which a party was acting, not from his or her status or description.⁶ Given the diversity of relationships and dealings that can potentially be characterised as fiduciary, it is unrealistic to regard them as subject to a fixed body of principles or uniform remedies.⁷ While equity imposes strict obligations when fiduciary duties are engaged,⁸ this is qualified to the extent that the scope of the duty is ‘moulded according to the nature of the relationship and the facts of the case’.⁹

¹ This accords with Professor Peter Birks’ view that fiduciary duties were exported from the trust: Peter Birks, ‘The Content of Fiduciary Obligation’ (2000) 34 *Israel Law Review* 3. Cf Joshua Getzler who argues that fiduciary obligations preceded the trust and in fact fostered its creation: ‘Rumford Market and the Genesis of Fiduciary Obligations’ in Andrew Burrows and Alan Rodger (eds), *Mapping the Law: Essays in Memory of Peter Birks* (Oxford University Press, 2006) 577.

² *Bristol and West Building Society v Mothew* [1998] Ch 1, 18 (Millett LJ) (‘*Mothew*’); *Beach Petroleum NL v Kennedy* (1999) 48 NSWLR 1, [196]–[202] (Spigelman CJ, Sheller and Stein JJA) (‘*Beach Petroleum*’); *Strother v 3464920 Canada Inc* [2007] 2 SCR 177, [35], [36] (Binnie, Deschamps, Fish, Charron and Rothstein JJ), [135], [136] (McLachlin CJ, Bastarache, LeBel and Abella JJ) (‘*Strother*’); *Arklow Investments Ltd v MacLean* [2000] 1 WLR 594, 598–600 (Henry J) (‘*Arklow Investments*’) (PC); *Chirnside v Fay* [2007] 1 NZLR 433, [15] (Elias CJ), [78] (Blanchard and Tipping JJ) (‘*Chirnside*’) (Supreme Court).

³ *Arklow Investments* [2000] 1 WLR 594, 598 (Henry J) (Privy Council).

⁴ Relationships in this category include trustee and beneficiary, solicitor and client, director and company, partners, and agent and principal.

⁵ For recent discussion of the fiduciary principle see M Conaglen, ‘The Nature and Function of Fiduciary Loyalty’ (2005) 121 *Law Quarterly Review* 452; R Flannigan, ‘The [Fiduciary] Duty of Fidelity’ (2008) 124 *Law Quarterly Review* 274; R Flannigan, ‘The Strict Character of Fiduciary Liability’ [2006] *New Zealand Law Review* 209.

⁶ *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145, 205 (Lord Browne-Wilkinson), in the context of a fiduciary’s liability for negligence. See also *Mothew* [1998] Ch 1, 16–17 (Millett LJ); *Beach Petroleum* (1999) 48 NSWLR 1, [188] (Spigelman CJ, Sheller and Stein JJA). As PD Finn expressed the proposition: ‘It is not because a person is a “fiduciary” or a “confidant” that a rule applies to him. It is because a particular rule applies to him that he is a fiduciary or confidant for its purposes’: *Fiduciary Obligations* (Law Book Co, 1977) 2 (emphasis in original).

⁷ LS Sealy, ‘Fiduciary Relationships’ [1962] *Cambridge Law Journal* 69, 72–3.

⁸ As classically expressed by Lord Herschell in *Bray v Ford* [1896] AC 44, 51.

⁹ *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, 102 (Mason J) (‘*Hospital Products*’). See also J McGhee (ed), *Snell’s Equity* (Sweet & Maxwell, 31st ed, 2005) 152–3 [7-20].

The flexibility of this approach is conducive to an expansive vision of fiduciary doctrine and facilitates equity's intercession in relationships far removed from the express trust. For example, a commercial joint venture for promoting the respective interests of the parties is not in the normal course fiduciary, but depending upon the form of the undertaking and the obligations assumed, such relationships may attract fiduciary duties.¹⁰ On traditional reasoning it seems incongruous to impose fiduciary obligations in respect of commercial arrangements between equal and independent parties with a view to self-gain. Nevertheless it has been accepted that some aspects of a commercial relationship may legitimately require protection and that a person 'may be in a fiduciary position *quoad* a part of his activities and not *quoad* other parts'.¹¹ In this regard, each may repose an element of trust and confidence in the other on the basis that neither will act in total disregard of their mutual interests and reasonable expectations.¹² The recognition of such relationships as fiduciary, or partly fiduciary, is supported by the analogy between joint ventures and partnerships.

In defining the content of a particular fiduciary relationship it may be necessary to consider the effect of any contractual provisions that purport to define or limit the parties' expectations.¹³ While the content of fiduciary duty can be qualified by contract,¹⁴ it is questionable whether fundamental duties of honesty and good faith can be extinguished.¹⁵ To that extent at least there may be an 'irreducible core of obligations' which cannot be abrogated by contractual terms.¹⁶ Certainly, the pronouncements of the House of Lords in *Hilton v Barker Booth & Eastwood*¹⁷ lend weight to the view that parties in contractual relations will not be readily presumed to have renounced a fiduciary duty of loyalty.¹⁸ At the same time even this basic proposition cannot be expressed in universal terms. The

¹⁰ *United Dominions Corporation Ltd v Brian Proprietary Ltd* (1985) 157 CLR 1, 10–11 (Mason, Brennan and Deane JJ) ('*UDC v Brian*'). This is more the exception than the rule. The outcome may be affected by the categorisation of the undertaking. In *Hospital Products* (1984) 156 CLR 41, the majority of the High Court of Australia considered that no fiduciary relationship arose between parties to an exclusive distribution agreement. In *UDC v Brian* (1985) 157 CLR 1 a joint venture in land development was regarded as a partnership and the relationship was deemed to be fiduciary. In contrast, in *Maruha Corporation v Amaltal Corporation Ltd* [2007] 3 NZLR 192 ('*Amaltal*') the parties relinquished a partnership arrangement in favour of a joint venture company and this was treated as an election to govern their relationship by the rules applicable to a company. Again, a commercial arrangement that was essentially contractual was not regarded as fiduciary in the absence of obligations of trust, loyalty and confidence: *Paper Reclaim Ltd v Aotearoa International Ltd* [2007] 3 NZLR 169 ('*Paper Reclaim*') (Supreme Court).

¹¹ *New Zealand Netherlands Society 'Oranje' Inc v Kuys* [1973] 1 WLR 1126, 1130 (Lord Wilberforce) (Privy Council).

¹² See, eg, *Watson v Dolmark Industries Ltd* [1992] 3 NZLR 311 (Court of Appeal); *Chirnside* [2007] 1 NZLR 433 (Supreme Court).

¹³ *Kelly v Cooper* [1993] AC 205 ('*Kelly*') (Privy Council). See also *Strother* [2007] 2 SCR 177, [34] (Binnie, Deschamps, Fish, Charron and Rothstein JJ), [133] (McLachlin CJ, Bastarache, LeBel and Abella JJ).

¹⁴ A point forcefully drawn by Mason J in *Hospital Products* (1984) 156 CLR 41, 97. See also *Chan v Zacharia* (1984) 154 CLR 178, 196 (Deane J) ('*Chan*'); *Kelly* [1993] AC 205, 215 (Lord Browne-Wilkinson) (PC); *Hilton v Barker Booth & Eastwood* [2005] 1 WLR 567, [30] (Lord Walker) ('*Hilton v Barker*') (House of Lords).

¹⁵ *Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Ltd (No 4)* (2007) 160 FCR 35, [280] (Jacobson J) ('*ASIC v Citigroup*').

¹⁶ *Armitage v Nurse* [1998] Ch 241, 253 (Millett LJ) ('*Armitage*'). *Quaere* whether the irreducible core principle should be treated as a rule of construction, restricting the ambit of a particular provision, or whether it should operate more fundamentally as a principle governing the validity of the disposition. See *Citibank NA v MBIA Assurance SA* [2006] EWHC 3215 (Ch), [48] (Mann J) ('*Citibank*').

¹⁷ [2005] 1 WLR 567. See J Getzler, 'Inconsistent Fiduciary Duties and Implied Consent' (2006) 122 *Law Quarterly Review* 1.

¹⁸ Strictly these were common law proceedings as the plaintiff did not expressly plead breach of fiduciary duty and the action was treated as a claim for breach of contract. The conflict of interest and disloyalty in this case was explanatory of the defendants' failure of duty. As the defendants were a firm of solicitors it was observed that 'the content of [the defendants'] contractual duty ... has roots in the parties' relationship of trust and confidence': *Hilton v Barker* [2005] 1 WLR 567, [30] (Lord Walker).

orientation may well be different in the strictly commercial sphere.¹⁹ Where the trust forms an ancillary aspect of sophisticated dealings between independent commercial parties, the sanctity of even the most hallowed equitable principles may potentially be in jeopardy. Some commentators have ascribed this to the fact that flexibility and the discretionary nature of equitable relief is at odds with the need for certainty in commercial transactions. As Sir Peter Millett, writing extra-curially, elaborates:

Commerce needs the kind of bright line rules which the common law provides and which equity abhors. Resistance to the intrusion of equity into the business world is justified by concern for the certainty and security of commercial transactions.²⁰

To the extent that parties in this environment are free to bargain in their own terms, it can be anticipated that this will have a distorting effect on equitable doctrine.²¹ This is cogently exemplified in *Citibank NA v MBIA Assurance SA*.²²

Citibank concerned an application for directions by Citibank NA ('Citibank') as trustee for the holders of debt notes issued to securitise Eurotunnel debt. The notes had different degrees of subordination and one class had the benefit of a guarantee from MBIA Assurance SA ('MBIA'). A term of the guarantee was that MBIA could issue directions to the trustee in the exercise of most of its powers and discretion. The trust deed provided that instructions by MBIA need not have regard to the interests of the noteholders. The trustee was subject to a mandatory duty to comply with MBIA's instructions. This was coupled with a broad exemption clause absolving the trustee of all liability to the noteholders. In sum, while the financing arrangement in favour of the noteholders was structured as a trust, it was effectively shorn of the core elements of a trust relationship. Nevertheless, the court upheld the scheme, accepting that the trust remained extant even though the trustee was essentially denuded of the fiduciary incidents of its office.²³

Similarly, pre-contract dealings between market equals stand on a different footing from situations where one party owes traditional fiduciary duties. This view was reinforced in *Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Ltd (No 4)*.²⁴ The background in brief was that Toll Holdings Ltd ('Toll'), a transport conglomerate, approached an investment bank, Citigroup Global Markets Australia Pty Ltd ('Citigroup'), for assistance in the planning and execution of a hostile takeover of Patrick Corporation Ltd ('Patrick'). Citigroup was retained to provide a comprehensive range of services including advice, financing and marketing. Citigroup presented a contract that

¹⁹ See *Hospital Products* (1984) 156 CLR 41, 118–19 (Wilson J).

²⁰ PJ Millett, 'Equity's Place in the Law of Commerce' (1998) 114 *Law Quarterly Review* 214.

²¹ On this model, even basic expectations of fidelity are reduced to an exercise in construction.

²² [2006] EWHC 3215 (Ch).

²³ *Ibid.* Mann J accepted that MBIA had been conferred with extensive powers as guarantor, but he considered that the trust regime remained intact. It was observed that the noteholders had consented to this form of arrangement. A strong commercial imperative was evident in this judgment: at [48]. See A Trukhtanov, 'The Irreducible Core of Trust Obligations' (2007) 123 *Law Quarterly Review* 342. The decision was affirmed on appeal. Arden LJ, delivering the leading judgment, held that as a matter of construction the trustee retained certain obligations and discretion. It was therefore unnecessary to directly confront Millett LJ's irreducible core principle. Her Ladyship merely observed that 'it would be a surprising interpretation of the documentation, against which the court should lean, if the powers of the trustee were so reduced that it ceases to be a trustee at all': *Citibank NA v MBIA Assurance SA* [2007] 1 All ER (Comm) 475, [82].

²⁴ (2007) 160 FCR 35. For an analysis of this decision see J Getzler, 'Excluding Fiduciary Duties: The Problem of Investment Banks' (2008) 124 *Law Quarterly Review* 15; J Getzler, '*ASIC v Citigroup*: Bankers' Conflict of Interest and the Contractual Exclusion of Fiduciary Duties' (2007) 2 *Journal of Equity* 62.

purported to exclude any fiduciary duties to Toll.²⁵ There was little, if any, discussion as to the terms of the retainer.

An independent department within Citigroup became involved in trading Patrick's shares. This contributed to an increase in share price, which in turn inflated the amount that Toll was required to bid for Patrick's shares. In proceedings by the Australian Securities and Investments Commission against Citigroup it was argued that Citigroup was in breach of fiduciary duty.²⁶ Given the nature of Citigroup's engagement, it was maintained that Toll could not give valid consent to the contractual exclusion of fiduciary duties without full disclosure by Citigroup as to the nature and extent of the rights that were being renounced.

It was held that the relationship was governed by the contract of retainer, which explicitly and effectively excluded fiduciary duty. For present purposes the status of the parties' pre-contract dealings is noteworthy. Jacobson J distinguished between relationships between sophisticated commercial actors and relationships that are inherently fiduciary.²⁷ In the former, the principal is responsible for protecting its own interests.²⁸ In the latter, the principal is owed a duty of loyalty from the outset and therefore an onus lies on the fiduciary to ensure that the principal is fully apprised of the consequences of entering into an agreement with the fiduciary.

ASIC v Citigroup affirms the view that commercial parties can by agreement abnegate fiduciary obligations that would otherwise arise from their relationship.²⁹ This is not confined to the commercial sphere. As previously noted, fiduciary duties can be fundamentally abridged even in the case of an express trust. Commenting on this state of affairs, the Law Commission for England and Wales accepted that it is settled law³⁰ that trustees can, by appropriate language, gain exemption from all breaches of trust³¹ except fraud and dishonesty.³² While recognising that settlors should be informed of the contents of trustee exemption clauses, the Law Commission rejected statutory controls in favour of self-regulation.³³ The report highlights acceptance — in some quarters at least — that even in the heartland of trusts, the content of fiduciary duty can be profoundly modified.³⁴

Taken together these views suggest that trustee obligations in commercial trusts and express private trusts alike are, in varying degrees, subordinate to contractual terms. This is reinforced by the well-known observation of Mason J in *Hospital Products Ltd v United States Surgical Corporation*³⁵ that contractual and fiduciary relationships may coexist and

²⁵ The contract provided that Citigroup acted solely as an independent contractor and 'not in any other capacity including as a fiduciary'. The agreement also indicated that Citigroup may be providing services to other parties with conflicting interests.

²⁶ Various other claims were advanced for breach of statutory duty under the *Corporations Act 2001* (Cth).

²⁷ *ASIC v Citigroup* (2007) 160 FCR 35, [21]. His Honour termed the latter 'per se' fiduciary relationships.

²⁸ The relationship of Toll and Citigroup clearly fell in this category and no duties therefore arose by Citigroup in the pre-contractual phase of the transaction.

²⁹ See also *Amalal* [2007] 3 NZLR 192, [19]–[20] (Blanchard J).

³⁰ Following the authority of *Armitage* [1998] Ch 241.

³¹ Not every wrong committed by a trustee is necessarily a breach of trust or even a breach of fiduciary duty: see below n 65. The corollary of the Law Commission's reasoning is that liability for lesser forms of duty such as skill and care are even more susceptible to modification or exclusion.

³² The Law Commission for England and Wales, *Trustee Exemption Clauses*, Report No 301 (2006) 20 [2.16].

³³ *Ibid* 84 [7.1]–[7.4]. It was recommended that this should take the form of a rule of practice that any paid trustee who causes a settlor to include in a trust instrument a clause which excludes or limits liability for negligence, should make that party aware of the meaning and effect of the provision.

³⁴ Cf New Zealand Law Commission, *Some Problems in the Law of Trusts*, Report No 79 (2002) 3–8 [5]–[16], which recommends that trustees for reward should be barred from relying on exculpatory clauses.

³⁵ (1984) 156 CLR 41.

‘it is the contractual foundation which is all important because it is the contract that regulates the basic rights and liabilities of the parties’.³⁶

While contract can define the scope of fiduciary duty, Mason J’s pronouncement should not be construed as a charter to undermine the fundamental content of that duty. It is trite that both formal trust relationships and certain non-trust relationships are characterised as fiduciary. The efficacy of exemption and limitation clauses must therefore reflect the nature of the particular relationship,³⁷ and the expectations it engenders, having regard to equity’s diminished policy concerns where relationships are removed from the trust paradigm. However, in all cases, the purported exclusion of core duties of fidelity and honesty must be seen as repugnant to any form of fiduciary undertaking.³⁸ If effect is given to exculpatory terms that go to the fundamentals of a trust or a general fiduciary relationship, then it must be recognised that, irrespective of form, a different legal construct is involved.³⁹

Correspondingly, an account of profits must be understood as being qualified by the specific nature of fiduciary duty in a given case and as a response to the particular events which constitute its breach. In the next section this will be explored from first principles, addressing the role of causation in relation to breach of trust and its function in the hinterland beyond.

III Causation

The conduct of a trustee attracts equity’s most vigorous scrutiny.⁴⁰ The fiduciary’s strict duty to disgorge illicit gains is affirmed by the limited role of causation. This reflects a prophylactic design which is unaffected by concepts that traditionally qualify liability and clearly tilts the scales in favour of the betrayed beneficiary. The prophylactic function advances the policy of equity, even at the expense of a windfall to the wronged party.⁴¹ This is more restrictive than the test for equitable compensation, which holds that a fiduciary is liable if the loss would not have occurred but for the breach.⁴² In the case of an account of profits this inquiry is irrelevant in determining liability to surrender gains.⁴³ This is reinforced by various evidential rules.⁴⁴

³⁶ Ibid 97. In *Kelly* [1993] AC 205, 213–15 Lord Browne-Wilkinson endorsed this approach in defining the nature of an agent’s duty to his or her principal. The board emphasised that agency is a contract, the terms of which define the relevant duties, including fiduciary obligations. See also *Hilton v Barker* [2005] 1 WLR 567, [30] (Lord Walker) pertaining to a solicitor’s duty of loyalty to a client.

³⁷ Even within the express trust there is ambiguity as to the precise (non-core) standards expected of trustees. See, eg, *Bartlett v Barclays Trust Co Ltd (No 1)* [1980] Ch 515, 534 (Brightman J).

³⁸ The demarcation of core and non-core duties is not without controversy but it is generally considered that duties of skill, care and prudence fall outside this category. See, eg, *Mothew* [1998] Ch 1.

³⁹ This is particularly relevant in cases like *Citibank* [2006] EWHC 3215 (Ch), where the scope of the parties’ obligations can legitimately be rationalised in its contractual setting.

⁴⁰ The wider category of a custodial fiduciary is also relevant to this discussion. See CEF Rickett, ‘Equitable Compensation: Towards a Blueprint?’ (2003) 25 *Sydney Law Review* 31, 35–40.

⁴¹ *Strother* [2007] 2 SCR 177, [77] (Binnie, Deschamps, Fish, Charron and Rothstein JJ).

⁴² *Target Holdings Ltd v Redfurns* [1996] AC 421, 434 (Lord Browne-Wilkinson) (‘*Target Holdings*’). See also *Swindle v Harrison* [1997] 4 All ER 705, 717 (Evans LJ).

⁴³ *Bray v Ford* [1896] AC 44, 51–2 (Lord Herschell); *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443, 453 (Roskill J) (‘*IDC v Cooley*’); *Gwembe Valley Development Co Ltd v Koshy (No 3)* [2003] EWCA Civ 1048, [145] (Mummery LJ); *Premium Real Estate Ltd v Stevens* [2009] 2 NZLR 384, [32] (Elias CJ) (‘*Stevens*’).

⁴⁴ In the case of a trustee the duty to account arises immediately upon receipt of trust property and is enforceable regardless of whether there has been any breach of duty. An order for an account of administration is essentially a mechanical exercise founded on the trustee’s obligation to disclose his or her conduct of the

The court will not be drawn into hypothetical inquiries as to what might have happened if the fiduciary had duly performed his or her duty.⁴⁵ There is no room for speculation as to the likely outcome if the fiduciary had made full disclosure to the principal.⁴⁶ Moreover, it is not incumbent on the principal to establish that in the absence of default the fiduciary's gains would have been acquired by the principal.⁴⁷ Such a requirement would be tantamount to casting the burden on the principal to prove loss. These rules reflect the dynamics of the fiduciary's relationship to the principal. The fiduciary has conduct of the principal's interests and usually enjoys a dominant position in terms of knowledge and information.⁴⁸ Suspicion should therefore fall on any self-serving claims by the fiduciary as to what might have occurred in different circumstances.⁴⁹

The reach of accountability is extensive,⁵⁰ but it is not without limit. The authorities suggest that the duty to account for profits follows almost inexorably from the breach.⁵¹ However, even expressed in these terms, it is apparent that liability is not unconditional. By definition, accountability is confined to gains attributable to the breach.⁵² Thus, it must at least be demonstrated that there is *some* causal link between the gain and breach of duty.⁵³ A fiduciary is not accountable for profits irrespective of their source.⁵⁴ Accordingly, an account must be rendered in respect of profits made within the scope of the fiduciary's duty.⁵⁵ This has been variously expressed in terms that focus on the relationship as the source of the gain.⁵⁶

When there is an egregious abuse of office, courts will sometimes take an expansive view of causally-related gains.⁵⁷ *CMS Dolphin Ltd v Simonet*⁵⁸ gives a sense of this

principal's affairs. The process is described by Austin J in *Glazier v Australian Men's Health (No 2)* [2001] NSWSC 6, [36]–[42]. The judgment was reversed on appeal (see *Meehan v Glazier Holdings Pty Ltd* (2002) 54 NSWLR 146) but Austin J's analysis on this point was not challenged.

⁴⁵ *Brickenden v London Loan & Savings Co* [1934] 3 DLR 465 ('*Brickenden*') (Privy Council). See below n 102 and accompanying text.

⁴⁶ *Murad v Al-Saraj* [2005] EWCA Civ 959, [76] (Arden LJ) ('*Murad*').

⁴⁷ *3464920 Canada Inc v Strother* 2005 BCCA 35, [47] (Newbury JA). See also *Strother* [2007] 2 SCR 177; J Edelman, 'Unanticipated Fiduciary Liability' (2008) 124 *Law Quarterly Review* 21.

⁴⁸ As one commentator expresses the point, often the fiduciary is 'information-rich': Vicki Vann, 'Causation and Breach of Fiduciary Duty' [2006] *Singapore Journal of Legal Studies* 86, 98.

⁴⁹ *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134n, 154 (Lord Wright) ('*Regal (Hastings)*').

⁵⁰ See, eg, the expansive language of the Court of Appeal in *Swain v The Law Society* [1982] 1 WLR 17, 29 (Stephenson LJ).

⁵¹ *Keech v Sandford* (1726) Sel Cas T King 61; 25 ER 223; *York Buildings Co v Mackenzie* (1795) 8 Bro PC 42; 3 ER 432; *Ex parte James* (1803) Ves Jun 337; 32 ER 385; *Crawshay v Collins* (1808) 15 Ves Jun 218; 33 ER 736; *Regal (Hastings)* [1967] 2 AC 134n; *Boardman v Phipps* [1967] 2 AC 46 ('*Boardman*'); *IDC v Cooley* [1972] 1 WLR 443.

⁵² *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373, 386, 387 (McTiernan J), 393 (Gibbs J) ('*Consul Development*').

⁵³ *Maguire v Makaronis* (1997) 188 CLR 449, 468 (Brennan CJ, Gaudron, McHugh and Gummow JJ) ('*Maguire*'); *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704, [97] (Lawrence Collins J) ('*CMS Dolphin*'). In the cautionary words of JD Heydon: '[I]t is one thing to strip a fiduciary of profit without much inquiry: it is another to hold him accountable for all loss without enquiry into relative causes': 'Causal Relationships between a Fiduciary's Default and the Principal's Loss' (1994) 110 *Law Quarterly Review* 328, 332.

⁵⁴ *Murad* [2005] EWCA Civ 959, [62] (Arden LJ).

⁵⁵ *Warman International Ltd v Dwyer* (1995) 182 CLR 544, 559 (Mason CJ, Brennan, Deane, Dawson and Gaudron JJ) ('*Warman*'); *Estate Realities Ltd v Wignall* [1992] 2 NZLR 615, 631 (Tipping J) ('*Estate Realities*') (High Court).

⁵⁶ See, eg, *Regal (Hastings)* [1967] 2 AC 134n, 143, 149 (Viscount Sankey), 153 (Lord MacMillan) where directors were liable to account for profits made in the course of executing their office. See also *Maguire* (1997) 188 CLR 449, 468 (Brennan CJ, Gaudron, McHugh and Gummow JJ).

⁵⁷ In a wider sense too, equity's policy dictates can influence the allocation of proprietary and contractual benefits. For example, an agent who has breached fundamental duties of loyalty may be disentitled to any

approach. In this case the defendant was managing director of the plaintiff, CMS Dolphin Ltd ('Dolphin'), an advertising agency. After a year the defendant resigned with immediate effect and started a business in competition with the plaintiff.⁵⁹ Prior to his departure, the defendant encouraged Dolphin's staff, as well as Dolphin's principal clients, to move with him. Dolphin brought proceedings claiming an account of profits and compensation for loss.

Lawrence Collins J held that the defendant was liable for breach of fiduciary duty. The plaintiff was entitled, at its option, to equitable compensation or an account of profits. While acknowledging that there must be some reasonable connection between the breach of duty and the profits for which the fiduciary is accountable, his Lordship was prepared to countenance

profits properly attributable to the breach of fiduciary duty ... together with a sum to take account of other benefits derived from those [Dolphin's] contracts. For example, other contracts might not have been won, or profits made on them, without (for example) the opportunity or cash-flow benefit which flowed from contracts unlawfully obtained.⁶⁰

The defendant was therefore potentially liable not only for diverted business opportunities but also for the benefit of trading with the proceeds of his wrongdoing. In principle, consequential gains could be imputed to the breach.⁶¹

The expansive vision of liability to account expounded in *Dolphin* is controversial and the judgment has also attracted criticism on another ground namely, that the delinquent fiduciary was accountable for profits earned by a third party. The defendant diverted a maturing business opportunity from the plaintiff to a company ('B Ltd') that the defendant had incorporated for this purpose. The defendant had a controlling interest in B Ltd. The question arose whether the defendant was personally accountable for profits made by B Ltd in circumstances in which the latter was insolvent and the defendant had not personally made any profits. Lawrence Collins J held that the defendant and B Ltd were equally liable for jointly participating in a breach of trust.⁶² This reasoning was not followed in *Ultraframe (UK) Ltd v Fielding*.⁶³ Lewison J accepted that there are circumstances in which the court can pierce the corporate veil if the company is a mere cloak or alter ego of the fiduciary, but 'the mere fact that a fiduciary has a substantial interest in a company which knowingly receives trust property does not ... make the *fiduciary* personally accountable for the receipt'.⁶⁴ There is instinctive appeal in a response that resists a form of accountability that

commission for services. This rule is relaxed when the conduct in question is less morally reprehensible as where an agent makes an honest mistake or acts wrongly but in good faith. See *Keppel v Wheeler* [1927] 1 KB 577, 592 (Atkin LJ) (Court of Appeal); *Kelly* [1993] AC 205, 216–17 (Lord Browne-Wilkinson) (Privy Council); *Stevens* [2009] 2 NZLR 384, [89], [90] (Elias CJ). For recent discussion of equity's expectations of an agent see *Imageview Management Ltd v Jack* [2009] 2 All ER 666.

⁵⁸ [2001] 2 BCLC 704 (Chancery Division).

⁵⁹ Initially the defendant entered into a partnership, and subsequently he incorporated a company.

⁶⁰ *CMS Dolphin* [2001] 2 BCLC 704, [97] (Lawrence Collins J). See also *Shepherds Investments Ltd v Walters* [2007] 2 BCLC 202, [133] (Etherton J), where *CMS Dolphin* [2001] 2 BCLC 704 (Chancery Division) was considered in relation to the diversion of a maturing business opportunity.

⁶¹ However the defendant was ultimately found liable on a more restrictive basis. See *CMS Dolphin* [2001] 2 BCLC 704, [140]–[142].

⁶² *Ibid* [103]. His Lordship considered it unnecessary to found liability on an alternative proprietary argument that the maturing business opportunity was the plaintiff's property and therefore B Ltd was accountable as a knowing recipient of trust property.

⁶³ [2005] EWHC 1638.

⁶⁴ *Ibid* [1576] (Lewison J) (emphasis added). See DD Prentice and J Payne, 'Director's Fiduciary Duties' (2006) 122 *Law Quarterly Review* 558. The authors consider that Lewison J's analysis represents the orthodox view.

is more morally driven than principled. At least in cases where the third party's gain is the measure of the plaintiff's loss, relief against the faithless fiduciary would be placed on a sounder footing if the award was instead expressed as damages in that amount.

Clearly, accountability is context-sensitive. Sanctions for breach of trust reflect an element of deterrence with obvious implications for the scope of an account of profits. Outside the orthodox trust, default by a fiduciary attracts censure,⁶⁵ but the extent of the duty to account is influenced by the obligations that have been assumed,⁶⁶ the nature of the relationship,⁶⁷ and the degree to which it has been abused. Where, for example, the wrongdoer is not a custodial fiduciary and the impropriety is not prompted by bad faith, the remedial response may be less stringent. Exceptionally, a fiduciary may retain profits acquired in the course of his or her office. There are several possible explanations. Most obviously, no breach may have been committed, as where the fiduciary was authorised to participate in gains, or where the profits were obtained from an independent source and without any conflict of interest.⁶⁸ Again, the merits of the fiduciary's conduct may fall within the strictly limited class of case where the court is prepared to countenance an apportionment of profits, or allowances which contain a profit element. Such cases are relatively rare. Two judgments commonly cited in this context, *Boardman v Phipps*⁶⁹ and *O'Sullivan v Management Agency & Music Ltd*,⁷⁰ were somewhat extraordinary on their facts and had the redeeming feature that the fiduciary's conduct was clearly beneficial to the principal.

However, this does not explain every situation where the fiduciary obtains relief from the full measure of accountability. Sometimes this is ascribed to the exercise of equitable discretion, or more broadly to the dictates of fairness,⁷¹ or the desire to prevent an 'unconscientious' outcome.⁷² Philosophically, this is consistent with perceptions of equity as an *in personam*, conscience-based jurisdiction. In practical terms it suggests an impressionistic approach to the scope of a remedy. It must be questioned whether the outcome can, or should, rest on such amorphous reasoning or whether it can be placed on a more principled basis. Some gains may simply be regarded as a distant consequence of the wrong and the courts may in effect be applying a test of remoteness.⁷³ This supplies an

⁶⁵ Not every wrong by a trustee or fiduciary is necessarily a breach of fiduciary duty. If the impugned conduct is merely classed as careless or negligent, liability can be governed by relevant common law duties in contract or tort: *Mothew* [1998] Ch 1, 18 (Millett LJ). See also *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 664, 681, 682, 688 (Gault J) (Court of Appeal); *Hilton v Barker* [2005] 1 WLR 567, [29] (Lord Walker). Cf *Youyang Pty Ltd v Minter Ellison Morris Fletcher* (2003) 212 CLR 484, [39] (Gleeson CJ, McHugh, Gummow, Kirby and Hayne JJ). See JD Heydon, 'Are the Duties of Company Directors to Exercise Care and Skill Fiduciary?' in S Degeling and J Edelman (eds), *Equity in Commercial Law* (Lawbook Co, 2005) 185; J Getzler, 'Am I My Beneficiary's Keeper? Fusion and Loss-Based Fiduciary Remedies' in S Degeling and J Edelman (eds), *Equity in Commercial Law* (Lawbook Co, 2005) 239. Getzler argues that a fiduciary's duty of skill and care cannot be divorced from expectations of loyalty. Similarly, Heydon maintains that a director's duty of care is fiduciary in nature. Professor Peter Birks suggests a *via media* between the *Mothew* [1998] Ch 1 line of authority and the view that obligations of skill and care attract higher standards within the context of a fiduciary relationship. Birks claims that the standard is not distinguishable from common law duties but the nature of the fiduciary's office may import the additional expectation that he or she will act disinterestedly: Birks, above n 1).

⁶⁶ *Beach Petroleum* (1999) 48 NSWLR 1, [430], [431] (Spigelman CJ, Sheller and Stein JJA).

⁶⁷ As noted above, the duties associated with the relationship may be qualified by contract.

⁶⁸ By definition there is no obligation to disgorge causally unrelated gains.

⁶⁹ [1967] 2 AC 46.

⁷⁰ [1985] QB 428. For facts see below n 144 and accompanying text.

⁷¹ *Warman* (1995) 182 CLR 544, 567 (Mason CJ, Brennan, Deane, Dawson and Gaudron JJ).

⁷² See, eg, *Chan* (1984) 154 CLR 178, 204–5 (Deane J).

⁷³ See Charles Mitchell, 'Causation, Remoteness, and Fiduciary Gains' (2006) 17 *King's College Law Journal* 325, 327–8.

obvious rationale for the retention of gains by a fiduciary for which he or she is notionally accountable. However, the limitation of this approach is that it substitutes the yardstick of fairness and discretion for a test of almost equivalent uncertainty. In fact the role of remoteness can be formulated with more precision. The court's perception of the gravity of the fiduciary's misconduct in the context of the particular relationship may influence the role of remoteness in defining — and potentially inhibiting — the measure of accountability.⁷⁴ The relationship between the two invites closer analysis.

If remoteness is part of the judicial method in defining causally related gains, it seems that the concept is more obviously relevant in some cases than others. The following hypothetical can be considered. Assume that there are two cases involving breach of fiduciary duty. The first concerns a trustee who acted fraudulently. The second concerns a fiduciary who is not a trustee, who acted honestly but wrongly. The former may be required to account with the objective of ensuring that there are no retained benefits from the wrongdoing.⁷⁵ In contrast, the 'innocent' fiduciary may potentially be allowed to retain causally remote gains.⁷⁶ This cannot be explained solely as an objective factual exercise governed by causation — otherwise the amount disgorged would be the same in both cases. In the case of the 'innocent' fiduciary, remoteness may be invoked to suppress the scope of accountability because the wrongdoer is not a trustee and the breach is not venal. Here the defendant may possibly be absolved from the more distant consequences of the wrong. This approach is also consistent with equity's general policy objectives. Where the deterrent principle is only marginally engaged, the court can be more receptive to the fiduciary's interests.⁷⁷

This is not inconsistent with certain common law approaches for determining whether the defendant's actions were a legally relevant cause of a loss. In contract, for example, inquiry is directed to the scope of the duty that the contract-breaker assumed and the contemplated risks against which there was an obligation to protect the plaintiff. If no duty arose in respect of a particular harm, then the loss is not imputed to the breach.⁷⁸ To that extent the nature of the duty dictates the causal rules.⁷⁹ As noted, this has a counterpart in equity where perceptions of fiduciary duty will influence the extent of the obligation to account. The obvious distinction is that equity's standards are generally more onerous than the common law,⁸⁰ and therefore causation is more tenacious. Naturally, there are variations within the scheme of equitable

⁷⁴ Conversely, of course, these factors may produce a more onerous level of accountability. Where the extent of the relevant gains is in issue the court may be less disposed to resolve uncertainties in favour of parties who have engaged in calculated deception. Similarly, it can be anticipated that more exacting standards will be applied to express trustees. Professor Graham Virgo comments that equity's stringent policy of ensuring that fiduciaries should not profit from their wrongs suggests that a much weaker test of remoteness is adopted to encompass gains made both directly and indirectly from a breach of duty: G Virgo, 'Restitutionary Remedies for Wrongs: Causation and Remoteness' in CEF Rickett (ed), *Justifying Private Law Remedies* (Hart Publishing, 2008) 301, 327.

⁷⁵ *Murad* [2005] EWCA Civ 959, [84] (Arden LJ) is instructive on this point. It was held that because all gains were tainted by breach of fiduciary duty, the entire proceeds should be disgorged.

⁷⁶ J Edelman, *Gain-Based Damages: Contract, Tort, Equity and Intellectual Property* (Hart Publishing, 2002), 108 *et seq.*

⁷⁷ However, as discussed below, it must be questioned whether such matters should more properly be factored into a consideration of allowances.

⁷⁸ See *South Australia Asset Management Corp v York Montague Ltd* [1997] AC 191. See also *Nykredit Mortgage Bank plc v Edward Erdman Group Ltd (No 2)* [1997] 1 WLR 1627; *Platform Home Loans Ltd v Oyston Shipways Ltd* [2000] 2 AC 190; *Aneco Reinsurance Underwriting Ltd (in liq) v Johnson & Higgins Ltd* [2001] 2 All ER (Comm) 929. Cf *Kenny & Good Pty Ltd v MGICA (1992) Ltd* (1999) 199 CLR 413. For a recent review of the English position see *Transfield Shipping Inc v Mercator Shipping Inc* [2009] AC 61.

⁷⁹ See HLA Hart and T Honoré, *Causation in the Law* (Clarendon Press, 2nd ed, 1985).

⁸⁰ In contract, for example, parties are free to bargain in their own terms and particularly in the commercial sphere, risk allocation is more a reflection of market forces than the profile of the parties and any imbalance in their positions.

wrongs. Limiting principles are marginalised in the case of formal trusts and more pronounced in respect of relationships removed from the trust paradigm, which are assessed against diminished policy concerns for protecting the principal.⁸¹

The interplay between causation, remoteness and perceptions of breach can be explored against the facts of *Warman International Ltd v Dwyer*.⁸² In *Warman* the plaintiff was a manufacturer and distributor of slurry pumps. It also had an agency agreement for the distribution of gearboxes manufactured in Italy by Bonfiglioli. Warman International Ltd ('Warman') was based in New South Wales but it had a Queensland branch that was run by its general manager, Dwyer. Dwyer became dissatisfied with his employer's operational decisions, including the reduction of its activities in Queensland. Dwyer incorporated two companies and entered into secret negotiations with Bonfiglioli with a view to a joint venture. He subsequently resigned from Warman and encouraged existing staff to join him in his new business. Around that time Bonfiglioli terminated its agency with Warman and entered into a joint venture agreement with Dwyer's companies.

Warman commenced proceedings against Dwyer and his companies. At first instance it was held that Dwyer was in breach of fiduciary duty and Warman was entitled to equitable damages or alternatively an account of profits for the first four years of the defendant's operations. The Queensland Court of Appeal upheld the finding of liability, but limited the remedy to compensation for losses flowing from the breach. Warman appealed successfully to the High Court of Australia, which reinstated the order for account of profits. This was more advantageous to Warman because the fortunes of its operations in Queensland and Dwyer's new business were driving in opposite economic directions. Warman was winding down, whereas Dwyer had developed a vibrant and expanding business.⁸³ Thus, the measure of Warman's loss was considerably less than Dwyer's gains.

The High Court accepted that Dwyer was in breach of his contractual arrangements with Warman for which compensatory remedies would lie. But in addition he was in a position of trust and the consequences of his actions were therefore more severe.⁸⁴ Liability similarly attached to the two companies formed for the purpose of reaping the benefits of Dwyer's infidelity.⁸⁵ In assessing compensation, the measure of Warman's losses was the detriment sustained by the premature termination of the Bonfiglioli agency. While this was brought about by Dwyer's machinations, the court considered that the association between Warman and Bonfiglioli was destined to end in any event. It was concluded that but for Dwyer's actions the distributorship would have remained on foot for another year. Compensation was therefore assessed on one year's loss of profit.

Dwyer's gains were calculated on a different basis both in temporal and economic terms. The appropriate order was an account of profits for a defined period, having regard to the springboard advantages attributable to the agency business and the services and knowledge of Warman's employees that had been persuaded to defect.⁸⁶ The High Court concluded that the appropriate period for an account of Dwyer's profits was 2 years. Given that Dwyer's business was essentially carved out of Warman's undertaking, Dwyer was

⁸¹ It has been said that where a trustee is under a duty to restore trust assets, causation, foreseeability and remoteness are usually not material: *Re Dawson; Union Fidelity Trustee Co Ltd v Perpetual Trustee Co Ltd* [1966] 2 NSW 211, 214–16 (Street J).

⁸² (1995) 182 CLR 544.

⁸³ In the 4 years preceding trial the defendant's business made net pre-tax profits of \$1.6 million.

⁸⁴ *Warman* (1995) 182 CLR 544, 563 (Mason CJ, Brennan, Deane, Dawson and Gaudron JJ).

⁸⁵ The High Court cited Gibbs J's familiar dictum in *Consul Development* (1975) 132 CLR 373, 397.

⁸⁶ The profits being those of the two companies which Dwyer had incorporated as a vehicle for his activities.

ordered to account for the entirety of the net profits for that period, subject to allowances for his expenses, skill, effort and resources. This meant that the profits in the third and fourth years were exempt from any claim. On what basis were the gains that were accountable distinguished from those that were not?

At one point the court indicated that this was simply a matter of fairness on the particular facts.⁸⁷ Similarly, in the case of a business it was said to be inappropriate and inequitable to compel the errant fiduciary to be accountable for an indefinite period.⁸⁸ However, other passages appear to rationalise the decision in terms that are more consistent with causation. It was noted that the fiduciary should not necessarily be accountable for the whole profit where it is attributable to the skill and resources of the fiduciary. Here the emphasis was on the source of the gain:

[I]t may be said that the relevant proportion of the increased profits is not the product or consequence of the plaintiff's property but the product of the fiduciary's skill, efforts, property and resources.⁸⁹

The case of *Murad v Al-Saraj* ('*Murad*')⁹⁰ reveals some conflicting views on *Warman* and the nature of the duty to account. In *Murad* the majority of the Court of Appeal considered that the award of profits in *Warman* was driven more by a factual determination of causation than an abstract appeal to fairness. Whether the defendants in *Warman* had offended the profit rule or the conflict rule, the High Court's inquiry was directed to the connection between the breach and the subsequent profits from the new business. The defendants' gains would at some stage cease to be attributable to the plaintiff's goodwill and could instead be ascribed to the defendant's own efforts and resources.⁹¹ Similarly, conflict of interest would be dissipated over time:

[A]n order for an account of all the profits of the new business over an indefinite period would in all probability include profits which are not tainted in any way by the position of conflict in which the defendants placed themselves: that is to say profits which ... are not within the scope and ambit of the relevant fiduciary duty and hence not within the scope of the 'no conflict' rule. In *Warman* itself, the court concluded that the appropriate cut off point was the expiry of two years after the commencement of the new business.⁹²

Clarke LJ espoused a more liberal approach to the taking of an account. While accepting that prima facie a fiduciary must account for all unauthorised profits, his Lordship considered that it should be open to him or her to persuade the court that some other solution is just.⁹³ Developing this argument, it was accepted that in determining liability the court should not engage in speculation as to what might have happened if the principal had possessed all the relevant facts. However, such considerations might have a bearing on the

⁸⁷ *Warman* (1995) 182 CLR 544, 567 (Mason CJ, Brennan, Deane, Dawson and Gaudron JJ).

⁸⁸ *Ibid* 561.

⁸⁹ *Ibid*.

⁹⁰ [2005] EWCA Civ 959. This decision raises some vexed issues regarding the strict duty to account for benefits acquired in breach of fiduciary duty, the modern role of the deterrent principle, the relevance of hypothetical consent to wrongdoing and the scope of causation. For a critique see M Conaglen, 'Strict Fiduciary Loyalty and Accounts of Profits' [2006] *Cambridge Law Journal* 278; M McInnes, 'Account of Profits for Breach of Fiduciary Duty' (2006) 122 *Law Quarterly Review* 11.

⁹¹ [2005] EWCA Civ 959, [115] (Jonathan Parker LJ). See also Arden LJ at [79].

⁹² *Ibid*, [116] (Jonathan Parker LJ).

⁹³ *Ibid*, [141], [142] (Clarke LJ).

extent of the duty to account. In this regard, the court may, in the exercise of its equitable discretion, require a fiduciary to only account for a proportion of his or her gains.⁹⁴ *Warman* was cited in support of this reasoning:

In *Warman* itself some account was taken of what would have happened were it not for Dwyer's breach of fiduciary duty. ... The judge had held that the receivership would have continued for about another year. The High Court reduced the profits to be accounted for from a period of four years to a period of two years because the period of four years 'went beyond what is fair and equitable in the circumstances'.⁹⁵

It is submitted that the allocation of profits in *Warman* must be understood in terms of causation, not equitable discretion.⁹⁶ If gains are clearly attributable to a breach of duty, the obligation to account cannot be curtailed by arbitrary appeals to fairness. This would be an unprincipled response to the expectation of probity associated with fiduciary duty. It is not a question of adjusting the parties' rights to achieve an equitable and balanced outcome. At issue is a breach of fiduciary duty. The sanction must be consistent with the principle it protects. Accountability must be exacted, at least to the point that profits in the fiduciary's hands are unquestionably the product of the breach. If there is uncertainty in identifying the extent of causally related gains then further inquiry is needed.⁹⁷ To this end, principles of remoteness can be appropriately invoked. The notion of fairness, at its highest, is a recognition that a duty to account must bear some causal relationship to the wrong. It only informs the court's disposition in that incidental way. The most that can be said is that in some cases it is unfair to make the fiduciary accountable for gains *because* their connection to the wrongdoing is so tenuous.

This approach most aptly fits the facts of *Warman*. The limiting of the defendant's liability to 2 years' profits was not the result of an unqualified judicial instinct for fairness. Rather, the subsequent revenues were not causally connected to the breach. Although issues of fairness were explicitly mentioned in the High Court's judgment, they simply gave momentum to investigating the precise scope of account.

This conclusion can be supported from another perspective. It must be remembered that the defendant in *Warman* engaged in a calculated fraud on his employer. His actions subverted the very interests he was supposed to uphold. This factual scenario was an implausible setting to propound a liberal thesis for profit-sharing based on notions of fairness and good conscience.⁹⁸ At bottom, the High Court's judgment followed traditional lines. There was no division of profits between the parties. The court was mindful that

as a general rule, in conformity with the principle that a fiduciary must not profit from a breach of fiduciary duty, a court will not apportion profits in the absence of an antecedent arrangement for profit-sharing ...⁹⁹

⁹⁴ Ibid [142], [153], [154] (Clarke LJ).

⁹⁵ Ibid [154] (Clarke LJ). The reference to 'receivership' in this passage should be to 'distributorship'.

⁹⁶ See also McInnes, 'Account of Profits for Breach of Fiduciary Duty', above n 90.

⁹⁷ See text, above, where it is suggested that in the case of more morally repugnant breaches of fiduciary duty, equity may be less motivated to embark on an inquiry that could potentially reduce the measure of accountability.

⁹⁸ Conversely, where conduct is not morally culpable, the nature of the transgression and the relevance of deterrence provide a more principled basis for determining causation and remoteness than abstract appeals to fairness.

⁹⁹ *Warman* (1995) 182 CLR 544, 562 (Mason CJ, Brennan, Deane, Dawson and Gaudron JJ).

Revenues from the first 2 years of the defendant's business were causally attributable to the breach of duty to the principal. For that period the defendant was fully accountable. Receipts in subsequent years were unrelated to his misconduct. Causation was spent. This is a more accurate characterisation of the outcome than the assertion that the defendant had a moral claim to participate in gains that were otherwise destined to the plaintiff. In fact the nature of the defendant's wrongdoing in *Warman* would support the opposite conclusion.

Overall it seems that the role of limiting principles in defining the scope of an account of profits has received less analytical attention than the corresponding rules for compensation.¹⁰⁰ The latter is more nuanced in recognising that concepts of fiduciary duty must be responsive to social and economic change and shifts in personal and commercial morality. A reassessment of causation and remoteness is often a stepping stone to relaxing or redefining legal duty for loss.¹⁰¹ This is evident, for example, in regard to the principle in *Brickenden v London Loan & Savings*,¹⁰² which has been modified in recent years to reflect the expansion and diversity of fiduciary relationships¹⁰³ and the different intensities of obligation they engender.¹⁰⁴ Similarly, on the profit side, it has been suggested that 'but for' causation associated with equitable compensation is a legitimate principle in defining the scope of an account of profits.¹⁰⁵

IV Alternative Causal Model

Traditionally, the award of equitable allowances serves to mitigate the harshness of deterrent profit-stripping.¹⁰⁶ As previously noted, the fiduciary's strict duty to disgorge illicit gains is affirmed by the limited role of causation. An alternative thesis is openly to apply limiting principles of foreseeability, remoteness and intervening cause, and to enforce fiduciary standards by means of punitive monetary awards. On this model, where the fiduciary's liability to disgorge is curtailed by principles of causation, the court could, in appropriate cases, impose the additional sanction of damages to condemn and punish the offending conduct. It is not entirely anathema to speak of discretionary damages in this context given that the assessment of allowances and the general application of equitable relief serve to adjust the parties' rights in light of discretionary considerations.

This raises the vexed question whether punitive damages can be awarded for equitable wrongs.¹⁰⁷ The views of the New South Wales Court of Appeal in *Harris v Digital*

¹⁰⁰ *CMS Dolphin* [2001] 2 BCLR 704, [97] (Lawrence Collins J) (Chancery Division). See also *Hospital Products* (1984) 156 CLR 41, 110–14 (Mason J).

¹⁰¹ *Maguire* (1997) 188 CLR 449, 488–92 (Kirby J); *Beach Petroleum* (1999) 48 NSWLR 1, [440]–[446] (Spigelman CJ, Sheller and Stein JJA). See also *Gilbert v Shanahan* [1998] 3 NZLR 528 (Court of Appeal).

¹⁰² [1934] 3 DLR 465, 469 (Lord Thankerton) (Privy Council). Where a fiduciary fails to disclose material facts to a principal who sustains loss as a result, the court will decline to speculate whether the principal would still have adopted the same course and incurred the loss even if all relevant information had been disclosed.

¹⁰³ *Warman* (1995) 182 CLR 544, 559–60 (Mason CJ, Brennan, Deane, Dawson and Gaudron JJ); *Beach Petroleum* (1999) 48 NSWLR 1, [444]–[446] (Spigelman CJ, Sheller and Stein JJA) (Court of Appeal).

¹⁰⁴ It has been said that *Brickenden* [1934] 3 DLR 465 (Privy Council) is now best viewed as a presumption or rule of evidence. See *Maguire* (1997) 188 CLR 449, 490–1 (Kirby J); *Everist v McEvedy* [1996] 3 NZLR 348, 353–4 (Tipping J); *Stevens* [2009] 2 NZLR 384, [85] (Elias CJ). See also *Rigg v Sheridan* [2008] NSWCA 79.

¹⁰⁵ R Cunnington, 'The Assessment of Gain-Based Damages for Breach of Contract' (2008) 71 *Modern Law Review* 559, 583–4. See also Virgo, above n 74, 326–7.

¹⁰⁶ See also discussion under Part V 'Allowances'.

¹⁰⁷ A related consideration is whether punitive damages can be cumulative on an account of profits. On one view, the former is not strictly compensatory and therefore the plaintiff is not put to an election. See *Cook v Evatt (No 2)* [1992] 1 NZLR 676 (High Court).

*Pulse Pty Ltd*¹⁰⁸ are a notable contribution to the debate. The plaintiff company was an information technology business. The defendants, Harris and Eden, were employees engaged in marketing and web design. The defendants incorporated a company to compete with the plaintiff. Using their employment as a springboard, they undertook work for the plaintiff's clients and made secret profits. At first instance Palmer J held that the defendants had breached their contractual and fiduciary duties and misused confidential information.¹⁰⁹ The plaintiff was awarded compensation or an account of profits and elected the latter. In addition, the plaintiff was awarded exemplary damages of \$10 000 against each defendant. The defendants appealed the latter award.

The New South Wales Court of Appeal held, by a majority,¹¹⁰ that there was no power to grant a punitive monetary award for breach of fiduciary duty. While Heydon JA considered that there was no basis in principle or authority for granting punitive damages, Spigelman CJ concurred on the narrower ground that punitive damages are awarded in tort but not in contract. On the facts of the present case there was a closer analogy between breach of fiduciary duty and breach of contract. The analogy argument was debated at length and the Chief Justice left open the possibility that punitive damages could be awarded in equity in cases where the tort analogy was more appropriate.¹¹¹ Professor Burrows presses the point further, arguing that there is sufficient proximity between dishonestly committed torts such as deceit and the kind of equitable wrong evident in *Harris*:

Both concern the dishonestly committed breach of an imposed duty and, as in many typical cases triggering punitive damages, the defendants had cynically committed the breach of fiduciary duty in order to reap a profit.¹¹²

At a more general level, it can be objected that while reasoning by analogy is an accepted methodology in the incremental development of the common law, this focus is unduly restrictive in the present context. In its auxiliary jurisdiction equity provides remedies to shore up deficiencies in the common law and there is force in Mason P's rebuke that if the stripping of profits is an inadequate remedial response, then '[w]hy should equity turn coy in its exclusive jurisdiction?'

The outcome in *Harris* also reflected a perceived distinction between deterrence and punishment. Orthodox reasoning suggests that equity embraces the former and eschews the latter. While equity has historically struck down penalties,¹¹³ the objective of deterrence has long informed equity's remedial regime. Despite the traditional disavowal of penal jurisdiction,¹¹⁴ it may be questioned whether such analysis is more semantic than substantive.¹¹⁵ Although

¹⁰⁸ (2003) 56 NSWLR 298 (*'Harris'*).

¹⁰⁹ *Digital Pulse Pty Ltd v Harris* (2002) 166 FLR 421.

¹¹⁰ Spigelman CJ and Heydon JA (Mason P dissenting).

¹¹¹ *Ibid* [2]. His Honour preferred the term 'punitive monetary award' to 'damages', the latter being a common law concept.

¹¹² A Burrows, 'Remedial Coherence and Punitive Damages' in S Degeling and J Edelman (eds), *Equity in Commercial Law* (Lawbook Co, 2005) 381, 397.

¹¹³ In Somers J's concise utterance: '[E]quity and penalty are strangers' (*Aquaculture Corp v New Zealand Green Mussel Co Ltd* [1990] 3 NZLR 299, 302 (Court of Appeal)). See also Heydon JA in *Harris* (2003) 56 NSWLR 298, [338].

¹¹⁴ *Vyse v Foster* (1872) LR 8 Ch App 309, 333 (James LJ) (*'Vyse'*). See also *Dart Industries Inc v Decor Corporation Pty Ltd* (1993) 179 CLR 101, 111, 114 where Mason CJ, Deane, Dawson and Toohey JJ stated that the purpose of an account of profits is not to punish but to prevent unjust enrichment.

¹¹⁵ *Harris* (2003) 56 NSWLR 298, [160]–[166] (Mason P). Mason P asserted that examples can be discerned of equity exercising a penal jurisdiction, for example, in the granting or withholding of allowances. Cf Heydon JA at [404]–[420].

conceptual distinctions can be drawn between punishment and deterrence, the distinctions are less apparent in their application. At a basic level, sanctions reflecting deterrence will have prejudicial consequences to the wrongdoer. It seems disingenuous to deny that — in practical terms at least — deterrent-inspired remedies have a punitive effect.¹¹⁶

V Allowances

In Part III it was argued that the calculation of profits is essentially an exercise in causation. Where issues of remoteness arise the court may be guided by the nature of the parties' relationship and the context of the wrongdoing. These considerations are particularly relevant to the assessment of allowances where the court fixes the amount that is ultimately to be disgorged as a net gain.

It is here that the philosophical ground shifts. An order to account is restitutionary and the objective of awarding allowances to a party who is in breach of equitable obligations is to maintain an appropriate balance between plaintiff and defendant.¹¹⁷ The defendant fiduciary is not required to account for more than he or she actually received.¹¹⁸ The court will avoid unjust enrichment to the plaintiff and therefore an applicant for relief must not unfairly deny the value provided by the defendant.¹¹⁹ It follows that decisions intended to achieve an equitable adjustment between the parties are properly deferred to the exercise of calculating the net sum that must ultimately be disgorged.¹²⁰ Such considerations have no place in the earlier phase of determining gross profits. The duplication of a moral balancing exercise can distort the ultimate outcome. A possible consequence is that in cases where the fiduciary's conduct is not particularly discreditable and the principal stands to receive a windfall from the proceedings, gains may be reduced in calculating gross profit and further reduced to reflect just allowances.

In the accounting process, a delinquent fiduciary will be reimbursed for expenses incurred in obtaining profits. In addition, in the court's discretion, the fiduciary may be awarded allowances. Expenses are invariably granted because profit in this context denotes the margin of receipts over costs. Technically, the recovery of legitimate expenses is not an allowance. Such sums are deducted from gross receipts to produce the net profit in respect of which allowances are claimed. Allowances properly so-called fall into two basic categories: (i) awards for the fiduciary's industry, enterprise and skill; and (ii) apportionment of profits between fiduciary and principal. The apportionment of profits between defaulting fiduciary and principal is only granted in exceptional cases. The focus of this section is the contentious category of allowances for industry, enterprise and skill.

In the more extreme instances the fiduciary's misconduct may serve to disentitle an allowance for industry, enterprise and skill. In an oft-quoted passage by Lord Denning MR:

¹¹⁶ The terms 'deterrence' and 'punishment' are often used interchangeably. See, eg, *Gray v Motor Accident Commission* (1998) 196 CLR 1, [15] (Gleeson CJ, McHugh, Gummow and Hayne JJ). In *Harris* (2003) 56 NSWLR 298, [162], Mason P regarded the distinction as illusory.

¹¹⁷ In cases where a windfall to one party or the other is unavoidable, the court is likely to favour the party wronged. See *LAC Minerals Ltd v International Corona Resources Ltd* [1989] 2 SCR 574.

¹¹⁸ *Vyse* (1872) LR 8 Ch App 309, 333 (James LJ). This is subject to the court's jurisdiction to award profits on the basis of wilful default, or, if the defendant has not reached the stage of obtaining returns, a sum that represents unrealised profit. See *Chirnside* [2007] 1 NZLR 433 (Supreme Court).

¹¹⁹ In part this is an application of the maxim, 'He who seeks equity must do equity'.

¹²⁰ The duality of this exercise was acknowledged in *Town and Country Property Management Services Pty Ltd v Kaltoum* [2002] NSWSC 166, [84] (Campbell J); *Biscayne Partners Pty Ltd v Valance Corp Pty Ltd* [2003] NSWSC 874, [229], [230] (Einstein J).

If the defendant has done valuable work in making the profit, then the court in its discretion may allow him a recompense. It depends on the circumstances. If the agent has been guilty of any dishonesty or bad faith, or surreptitious dealing, he might not be allowed any remuneration or reward.¹²¹

However, this is expressed in unduly restrictive terms. Most proceedings involve an element of wrongdoing,¹²² and in practice allowances are usually granted when there is some degree of moral culpability.¹²³ There are differing perceptions as to where the line should be drawn. Two broad approaches will be considered.

A *Conservative View*

A common concern is that if a wrongdoer is unduly rewarded for his or her actions, this will undermine the cardinal principle that those in a position of trust must be financially disinterested in the execution of their duties. This perspective was evident in the landmark case of *Boardman v Phipps*.¹²⁴ The facts of *Boardman* were somewhat unique in that there was no element of fraud or concealment and the defendant had acted throughout in good faith. While the defendant was held to account, there was a measure of sympathy for the consequences of a rigorous application of principle in these particular circumstances. The award of remuneration on a liberal scale must be seen in that context. It is questionable whether their Lordships were impliedly espousing a more receptive approach to allowances in general. Certainly any impulse in this direction was stifled by the House of Lords in *Guinness plc v Saunders*.¹²⁵

In *Guinness* a committee of the board of directors agreed to pay the defendant, one of its members, £5.2 million for his services with respect to a takeover bid made by Guinness plc ('Guinness'). It was held that the defendant had breached his fiduciary duty and was not entitled to retain the payment. A claim for allowances was rejected. Lord Templeman emphasised the strict expectation that trustees cannot make a profit from their trust unless expressly authorised (in this case by the articles of association). In this regard his Lordship characterised *Boardman* as an exceptional case in awarding remuneration to a defaulting fiduciary.¹²⁶ Lord Goff of Chieveley was similarly of the view that the profits must be disgorged. However he sought to reconcile *Boardman* with the fundamental principle that a trustee is not entitled to remuneration in the absence of informed consent. His Lordship suggested that *Boardman* can be rationalised as a case where there was no conflict with the policy underlying the conflict rule. That is, an award of allowances would not 'have the effect of encouraging trustees in any way to put themselves in a position where their

¹²¹ *Phipps v Boardman* [1965] Ch 992, 1020–1 (Court of Appeal).

¹²² Every breach of fiduciary duty is an equitable wrong, regardless of whether it was perpetrated innocently or with intent.

¹²³ *O'Sullivan v Management Agency & Music Ltd* [1985] QB 428, 458 (Dunn LJ), 467, 468 (Fox LJ) ('*O'Sullivan*') (Court of Appeal). If this were not so there would be little scope for an allowance. Few cases can be characterised in terms of the 'innocent breach' in *Boardman* [1967] 2 AC 46. Lord Hodson said the defendant had acted in an 'open and honourable manner': at 105. Lord Cohen said the defendant had acted with 'complete honesty throughout': at 104. In *Murad* [2005] EWCA Civ 959, [84], [88] (Arden LJ), [98], [122] (Jonathan Parker LJ), [125], [126] (Clarke LJ) allowances were granted to a fiduciary for his services notwithstanding that his conduct was characterised as fraudulent and involving an acute conflict of interest and bad faith.

¹²⁴ [1967] 2 AC 46.

¹²⁵ [1990] 2 AC 663.

¹²⁶ *Ibid* 694.

interests conflict with their duties as trustees.’¹²⁷ It is submitted that in fact a more fundamental distinction can be drawn between the two cases: in *Boardman* the profit-making was merely incidental to the fiduciary’s obligations, whereas *Guinness* concerned payment in respect of the fiduciary’s primary duties. The latter is strictly governed by the rule that work is done without recompense in the absence of agreement by the beneficiary or the trust deed.¹²⁸

A difficulty with Lord Goff’s reasoning is that outside the narrow confines of ‘innocent breach’ it is difficult to countenance situations where the wrongdoing does not encourage others to place themselves in a position of conflict. Some conflict usually exists in order to attract liability in the first place. On Lord Goff’s approach the availability of allowances must hypothetically lie at the threshold finding of breach, and the claim of a defaulting fiduciary presumably becomes less persuasive where the conduct in question presents a more obvious affront to expectations of fidelity. Most cases fall in the latter category and — notwithstanding the strictures of *Guinness* — it seems that even the more venal breaches of duty do not necessarily preclude the grant of allowances.¹²⁹ This can best be explained by identifying several key permutations and the rationale for the disposition in each case.

B Liberal View

The seemingly disparate views on the court’s response to allowances can be assessed by reference to the nature of the principal’s interest, and the manner in which it is exploited by the defaulting fiduciary.

First, take the case of a trustee who, without authority, appropriates trust property. The act of taking trust property engenders a strict duty to reinstate it, either *in specie* or, if this is impossible, by compensating the trust for its monetary equivalent.¹³⁰ If the trust property also generated profits for the delinquent trustee he or she must likewise surrender such gains. This is not a case where the trustee should be granted an allowance for skill and enterprise in generating the profits.¹³¹ There is a compelling policy reason for this. The fiduciary has gambled with another’s property and in the process violated a fundamental obligation as trustee. Any reward for these actions would provide an incentive for undermining the very basis of trust. The need here for deterrence is paramount. Indeed some jurisdictions reinforce this view by awarding exemplary damages in respect of a flagrant abuse of trust.¹³² In such cases it would be mutually inconsistent to contemplate any form of allowances¹³³ in respect of conduct attracting grave censure.

¹²⁷ Ibid 701.

¹²⁸ See also P Watts, ‘Accounting for Profits — Fiduciaries required to Disgorge in New Zealand’ [1992] *Lloyd’s Maritime and Commercial Law Quarterly* 439.

¹²⁹ See also L Aitken, ‘Reconciling “Irreconcilable Principles” — A Revisionist View of the Defaulting Fiduciary’s “Generous Equitable Allowance”’ (1993–94) 5 *Bond Law Review* 49; J Palmer, ‘The Availability of Allowances in Equity: Rewarding the Bad Guy’ (2004) 21 *New Zealand Universities Law Review* 146.

¹³⁰ *Target Holdings* [1996] AC 421, 434 (Lord Browne-Wilkinson).

¹³¹ The taking of trust property and its exposure to risk at the hands of a miscreant fiduciary must be regarded as a profound breach of trust. A grossly dishonest fiduciary may potentially be deprived of allowances altogether. See *Harris* (2003) 56 NSWLR 298, [164] (Mason P); *US Surgical Corp v Hospital Products International Pty Ltd* [1983] 2 NSWLR 157, 242–3 (Moffitt P, Hope and Samuels JJA) (Court of Appeal).

¹³² *Cook v Evatt [No 2]* [1992] 1 NZLR 676, 691, 705–7 (Fisher J) (High Court). Cf *Paper Reclaim* [2006] 3 NZLR 188, 223 (Chambers J) (Court of Appeal). See also *Aggravated, Exemplary and Restitutionary Damages*, Law Commission Report No 247 (1997) 110 [1.55], which concluded: ‘[D]espite the absence of English authorities for awarding exemplary damages for an equitable wrong, we can ultimately see no reason

A claim for allowances stands on a different footing when the gains are made from the defendant's independent activities, without recourse to trust property. The distinction was clearly acknowledged in *Warman* where a senior employee exploited his position to establish a competing business.¹³⁴ In granting an account of profits in favour of the employer the High Court emphasised that

it may be appropriate to allow the fiduciary a proportion of the profits, depending upon the particular circumstances. That may well be the case when it appears that a significant proportion of an increase in profits has been generated by the skill, efforts, property and resources of the fiduciary, the capital which he has introduced and the risks he has taken, *so long as they are not risks to which the principal's property has been exposed*. Then it may be said that the relevant proportion of the increased profits is *not the product or consequence of the plaintiff's property* but the product of the fiduciary's skill, efforts, property and resources.¹³⁵

There is uncertainty as to which rationale is most appropriate when the defendant misapplies trust property and vastly increases its value. Should this be placed on the same basis as a profit derived from the defendant's independent actions? Or is the claim irretrievably tainted by the fact that trust property was the foundation for the gain? Considering, first, the nature of the wrong, it is trite that there is a strict duty to restore trust property. The trustee therefore compounds the wrongdoing by retaining the asset and treating it as his or her own. If the asset is exposed to risk, the fiduciary has gambled with the principal's property. This should not be understated: a trust asset is as likely to be squandered by a defaulting fiduciary as it is to be a springboard for wealth. On policy grounds the successful exploitation of another's property should not per se engender any right to allowances. The principle is the same regardless of the extent of the gain. And where the trust asset or its exchange product remains identifiable, any claim must be reconciled with the salutary rule that a fiduciary must bear the consequences of mixing personal interests with those of the trust.

Nevertheless, where a significant appreciation in value is attributable to the efforts of the fiduciary the courts may be prepared to consider an apportionment of the benefits. In *Docker v Somes*¹³⁶ Lord Brougham suggested that in some circumstances a trustee who had applied considerable skill and labour to trust property may be awarded a share of the product of his exertions. His Lordship cited the example of use of trust money to purchase a piece of steel or a skein of silk which was worked upon by the trustee to produce goods vastly exceeding the value of the original material.¹³⁷

It is submitted that the extent of the increase in value is an insufficient basis for compromising the strict deterrent-oriented approach to abuse of trust property. If the added value is simply an accretion to the trust asset it seems anomalous to allow the trustee to participate in respect of property to which he or she has no beneficial claim. From a proprietary perspective it is beyond dispute that property that has been unlawfully taken must be returned to the beneficial owner. Profits derived from a misapplied source must be restored

of principle ... for excluding equitable wrongs from any rational statutory expansion of the law of exemplary damages'.

¹³³ With the exception of expenses.

¹³⁴ For more detailed facts of this case, see above n 82 and accompanying text.

¹³⁵ *Warman* (1995) 182 CLR 544, 561 (Mason CJ, Brennan, Deane, Dawson and Gaudron JJ) (emphasis added). See also comments at 560–1.

¹³⁶ (1834) 2 My & K 655; 39 ER 1095.

¹³⁷ *Docker v Somes* (1834) 2 My & K 655, 668; 39 ER 1095, 1099.

in the same manner.¹³⁸ There is no obvious equity to assist the trustee's position. The loss — if it can be so characterised — is the inherent risk of his or her chosen course of conduct.

Second, the taking of accounts is part of the process of rescission. A fiduciary may have acquired property, or made gains, pursuant to an arrangement or bargain that is voidable. It should be noted that a distinction can be drawn between claims for rescission at common law and proceedings in equity to set aside a contract to recover property acquired in breach of a fiduciary relationship. The distinction can be substantive in that common law traditionally requires *restitutio in integrum*, whereas equity takes a more flexible approach and grants relief in circumstances where it is impossible precisely to place the parties in their former position. Accompanying orders can be granted to make such provisions as are practically just between the parties.¹³⁹ For example, in *Estate Realities Ltd v Wignall*¹⁴⁰ the court adopted a remedial approach that paralleled the dynamics of rescission where the subject matter could not be recovered *in specie*.

In *Estate Realities* the defendant stockbrokers purchased shares and options from a client, the plaintiff, without disclosing that they were being acquired by the defendants personally. The shares and options were instrumental in a scheme to obtain a major interest in a company. This required a high degree of skill and risk-taking. Ultimately the defendants sold their interest for a substantial profit. It was held that the defendants were in breach of their fiduciary duty to the plaintiff in failing to disclose their true interest in the transaction and for misrepresenting that they were acting for an independent third party. The plaintiff's contract of sale with the defendants could not be set aside because the shares had passed to a bona fide purchaser. Nevertheless, Tipping J avoided the contract in the sense of impressing the profits in the defendants' hands with a constructive trust in favour of the plaintiff. In effect the plaintiff's rights *in rem* against the shares were converted into an *in personam* claim against the proceeds and reinforced by a proprietary order.¹⁴¹

If the principal elects to rescind the agreement and recover specific property, he or she may also claim any associated profits. Correspondingly, if the agreement was not induced by an egregious abuse of position, the fiduciary may have a compelling claim for allowances for post-contractual activities. Thus, in *Estate Realities*, Tipping J was mindful that '[t]he defendants' conduct is not to be applauded but ... it must be kept in proportion'.¹⁴² The defendants had paid a fair market price for the shares and the advantages they gained were mainly attributable to their subsequent activities. Although the defendants were deserving of censure, his Honour considered that it would be inequitable to deprive them of reasonable recompense for their efforts given that '[t]hey ended up, after nearly two years of effort, skill and risk taking, with a substantial silk purse'.¹⁴³

¹³⁸ The latter is simply an objective recognition of the origin of the gain. If a trustee, without authority, places trust funds in a 'passive' investment, such as a bank deposit account, he or she is accountable for both capital and interest (*Re Tilley's Will Trusts* [1967] Ch 1179, 1193 (Ungoed-Thomas J); *Foskett v McKeown* [2001] 1 AC 102 (House of Lords)). If, instead, the trustee chases his or her arm and applies trust funds in a speculative venture that yields a higher return, there is no additional basis for allowing the trustee to participate in the gains. Moreover, higher profits are often associated with higher risk. This merely compounds the wrongdoing and further affirms the need for a complete disgorgement of the profits.

¹³⁹ *O'Sullivan* [1985] QB 428, 458 (Dunn LJ) (Court of Appeal). See also *Alati v Kruger* (1955) 94 CLR 216, 223 (Dixon CJ, Webb, Kitto and Taylor JJ).

¹⁴⁰ [1992] 2 NZLR 615 (High Court). See Watts, above n 128.

¹⁴¹ *Estate Realities* [1992] 2 NZLR 615, 631–2 (High Court).

¹⁴² *Ibid* 629.

¹⁴³ *Ibid* 630. The defendants' entrepreneurial skill and risk-taking was acknowledged in granting allowances. Tipping J estimated that the premium obtained by the defendants in acquiring control of the target company was 50 cents a share and the defendants were awarded half that sum.

Similar considerations were evident in *O'Sullivan v Management Agency & Music Ltd*. The plaintiff, an unknown composer and performer, entered into comprehensive arrangements with the defendant, a highly regarded and established manager and producer.¹⁴⁴ The arrangements effectively covered most aspects of the plaintiff's professional life. The agreements included recording and publishing contracts, an employment agreement and an assignment of copyright. At that time the plaintiff was young and inexperienced and the agreements were executed without independent advice. The plaintiff subsequently became an international success under the defendant's management. When the plaintiff challenged the agreements, the Court of Appeal held that the parties were in a fiduciary relationship and the agreements should be set aside for presumed undue influence. The contracts in question were voidable, and not void.¹⁴⁵

On facts such as these the case for allowances is compelling. Until the agreements were set aside the defendant was entitled to proceed on the basis that the parties were in a binding contractual relationship. The defendant therefore acted in good faith in providing the contemplated services for the parties' mutual benefit. Moreover, in seeking equitable relief the plaintiff must act consistently with good conscience, reflecting the well-known maxim, 'He who seeks equity must do equity'. Despite the manner in which the relationship was formed, it would have been inequitable to deny the defendant an appropriate allowance for his pivotal role in the plaintiff's success.¹⁴⁶

Third, some forms of breach do not involve the misappropriation or use of trust property. The wrongdoing may not cause any loss to the trust,¹⁴⁷ as where the trustee exploits an opportunity that the trust could not pursue. In such cases the trustee's misconduct is unconnected to the economic interests of the trust. In this setting any gain is functionally attributable to the fiduciary's labours. Here the claim for allowances is persuasive and the court may resist conferring a windfall on the trust when it was not in jeopardy. Indeed this can be extended further. As *Warman* demonstrates, the effect of a breach can be purged over time and a stage will be reached when the rewards from the trustee's actions can no longer be causally imputed to the breach.

VI Conclusion

Fiduciary obligations are imposed in a variety of settings. In the case of express trusts and relationships that are regarded as inherently fiduciary, the determination of liability and its remedial consequences usually follows a predictable course. In the process an account of profits performs the key function of stripping the wrongdoer of unauthorised gains. However, the duty to account is not unconditional. Its precise application will reflect the nuances of the relationship and the manner in which it was abused. This is particularly evident in commercial relationships, where obligations are cast in a context far removed

¹⁴⁴ The actual contracts were between the plaintiff and companies in which the defendant was personally interested.

¹⁴⁵ [1985] QB 428, 449 (Dunn LJ). See also *Erlanger v New Sombrero Phosphate Co* (1878) 3 App Cas 1218, 1277 (Lord Blackburn).

¹⁴⁶ It should also be borne in mind that rescission or an order setting aside a bargain may be refused if, with knowledge of the circumstances, the plaintiff fails to challenge the transaction within a reasonable time. Such inaction is particularly invidious where the plaintiff has nothing to lose and simply allows the other party to exploit the economic opportunity at his or her own risk. *Re Jarvis (decd)* [1958] 2 All ER 336 (Chancery Division) is a signal example.

¹⁴⁷ It has been noted that a fiduciary is accountable regardless of whether the principal has suffered any loss. See also discussion under Part II 'Scope of the Fiduciary Principle'.

from the traditional trust and expectations of loyalty may be qualified by mutual self-interest. Compounding this, fiduciary duties may be profoundly modified by contract. The latter is problematic because there is no obvious reconciliation between equity's discretionary jurisdiction and the need for certainty in commercial transactions. Nevertheless, it must be recognised that the purported exclusion of core duties of fidelity is repugnant to any form of fiduciary undertaking. If effect is given to such provisions then other legal doctrines must fill the void.¹⁴⁸

It has been observed that the court will be particularly mindful of the need for a measured response in imposing sanctions for breach of non-traditional fiduciary relationships. Understandably, some cases present difficulties in determining the stage at which profits are no longer attributable to the breach. In this, and indeed any fiduciary context, accountability is confined to causally related gains. Much will depend on the obligations assumed in the context of the parties' relationship. In this setting the nature of the duty dictates the causal rules and principles of remoteness may be invoked to determine the degree of accountability.¹⁴⁹ Here, competing moral claims and appeals to fairness are irrelevant to the exercise of identifying relevant gains. Such considerations are more properly deferred to the second phase of the accounting exercise.

In this regard it has been suggested that the process of accounting is dualistic. The first phase is concerned with quantifying gross profits that flow from the breach and the second is directed to the net gain that must ultimately be disgorged. The objective of each is distinct. The latter is not tethered to the strict standards by which the substantive duty is judged. The order is restitutionary and not penal. To that extent allowances are intended to achieve an equitable adjustment between the parties. It is here that profits from the misapplication of trust property and cynical abuse of trust can be distinguished from gains arising from less culpable forms of wrongdoing.¹⁵⁰ The dictates of deterrence usually inhibit largesse in favour of an errant fiduciary but the courts are nevertheless attentive to the parties' interests, their conduct and the practical consequences of the breach. There is considerable latitude in the final form of an order but it is fair to say that the authorities have laid a sufficient basis for a principled response.

¹⁴⁸ The most obvious contender being the law of contract.

¹⁴⁹ Where the extent of relevant gains is in issue, the benefit of the doubt is usually conceded less readily for express trustees than those upon whom fiduciary obligations are constructively imposed.

¹⁵⁰ For example, where the fiduciary has only marginally offended the profit or conflict rule and gains are attributable to the fiduciary's independent endeavours.