Singapore Journal of Legal Studies
[2006] 86–107

CAUSATION AND BREACH OF FIDUCIARY DUTY

VICKI VANN*

Two recent English decisions have highlighted the issue of causation in the context of breach of fiduciary duty. In both cases, the defendant implicitly argued that whether the profits or conflicts rule is breached, the causation standard is the same. This article suggests that the causation standards applicable for the profits and conflicts rules are different. When equitable compensation is sought for loss due to breach of the conflicts rule, there must be a causal connection between the conflict and the loss. But there is no special causation standard applicable when an account of profits is sought following a breach of the profits rule. Any unauthorised profit made within the scope of the relationship attracting fiduciary duties must be accounted for. These standards are appropriate in the context of the rules breached, because they best achieve approximation of loyal performance of the duties owed.

I. INTRODUCTION

The natural inclination when there is a loss suffered is to ask what caused the loss. The law of torts considers this question when fixing damages. If the defendant can be said to have caused the plaintiff's loss, damages are assessed to cover that loss. Equity asks the question when awarding equitable compensation in response to breaches of equitable obligations, but not all breaches of equitable obligations result in a loss. This is particularly so in the case of breach of fiduciary duty, where the fiduciary's breach may involve making an unauthorised profit. Equity's traditional response to unauthorised profit is to strip it from the fiduciary, directing it instead to the principal.

Two recent English decisions, *Gwembe Valley Development Company Ltd. v. Koshy*[1] and *Murad v. Al-Saraj*[2] have highlighted arguments about whether the causation question should be asked when the fiduciary has made an unauthorised profit, rather than a loss. What is questioned is whether there must be a causal link between the fiduciary breach and the profit to be stripped from the fiduciary. The kernel of the argument run in both cases was that, as some profit would have been made "but for" the fiduciary's breach of the profits rule, not all of the profit should have been recoverable. In short, the defendants sought to apply the recognised causation test for breach of the conflicts rule to breaches of the profits rule.

* B.A., LL.B. (Hons.) (Qld.) Ph. D. (Monash), Lecturer, Faculty of Law, Monash University. I am grateful for the very helpful comments of my colleague Susan Barkehall Thomas and an anonymous referee. Any errors or omissions remain my own.

[1] [2003] EWCA Civ. 1048 [*Gwembe*].

[2] [2005] EWCA Civ. 959 [*Murad*].

This article will discuss the content and purpose of the two fiduciary obligations, the profits and conflicts rules. It will consider the remedial responses to breaches of those rules, and the causation standards appropriate to such remedies. It is argued that confusion concerning causation is unnecessary. The nature of the particular breach of fiduciary duty must be considered. Breaches of the conflicts rule resulting in loss are remedied by equitable compensation for that loss. There must be a causal link between the breach and the loss. Equity remedies breaches of the profits rule by stripping the profit away from the fiduciary. There is no special "causation" issue relevant to the inquiry as to profits. The two fiduciary obligations call for different causation rules.

Equity's aim when remedying breach is to place the principal in the position that should have existed, had the duty owed been performed properly. When the profits and conflicts rules are breached, equity seeks to remedy the breach by approximating proper performance of the duty. Breach of the profits rule is approximately cured by removing unauthorised profit from the fiduciary. Breach of the conflicts rule is approximately cured by removing the effect of the conflict from the transaction in question. Approximation of each duty calls for different remedial responses, and therefore differing causation standards.

II. The Two Fiduciary Obligations

Fiduciary obligations have been the subject of voluminous writings in the last thirty years.[3] Finn, one of the area's most respected scholars, defines the content of fiduciary obligation succinctly, basing his definition on Deane J.'s formulation in *Chan v. Zacharia*:[4]

> [T]he central idea is service of another's interests. And the consequential obligation a fiduciary finding attracts is itself one designed essentially to procure loyalty in service. It can be cast compendiously in the following terms:
>
> A fiduciary (a) cannot misuse his position, or knowledge or opportunity resulting from it, to his own or to a third party's possible advantage; or (b) cannot, in any matter falling within the scope of his service, have a personal interest or an inconsistent engagement with a third party—unless this is freely and informedly consented to by the beneficiary or is authorized by law.[5]

---

[3] See *e.g.*, R.P. Austin, "Moulding the Content of Fiduciary Duties" in A. J. Oakley ed., *Trends in Contemporary Trust Law* (Oxford: Clarendon Press, 1996); P. Birks, "The Content of Fiduciary Obligation" (2002) 16 Trust L. Int'l. 34 [Birks, "Content of Fiduciary Obligation"]; D. De Mott, "Beyond Metaphor: An Analysis of Fiduciary Obligation" [1988] Duke L.J. 879; D. De Mott, "Fiduciary Obligations Under Intellectual Siege: Contemporary Challenges to the Duty to Be Loyal" (1992) 30 Osgoode Hall L.J. 471 [De Mott, "Fiduciary Obligations"]; P. Finn, "Fiduciary Law and the Modern Commercial World" [Finn, "Fiduciary Law"] in E. McKendrick, ed., *Commercial Aspects of the Trust and Fiduciary Obligations* (Oxford: Clarendon Press, 1992); P. Finn, "The Fiduciary Principle" in T. G. Youdan, ed., *Equity, Fiduciaries and Trusts* (Toronto: Carswell, 1989); P. Finn, "Contract and the Fiduciary Principle" (1989) 12 U.N.S.W.L.J 76; J. Glover, *Commercial Equity: Fiduciary Relationships* (Sydney: Butterworths, 1995); L. Hoyano, "The Flight to the Fiduciary Haven" in P. Birks, ed., *Privacy and Loyalty* (Oxford: Clarendon Press, 1997) [Birks, *Privacy & Loyalty*]; R. Teele, "The Search for a Fiduciary Principle: A Rescue Operation" (1996) 24 Austl. Bus. L. Rev. 110; E.J. Weinrib, "The Fiduciary Obligation" (1975) U.T.L.J.1.

[4] (1984) 154 C.L.R. 179 at 198.

[5] Finn, "Fiduciary Law", *supra* note 3 at 9.

These two obligations are usually referred to as the profits and conflicts rules. Most writers agree the twin fiduciary obligations described above can be described as a duty of loyalty.[6] Loyalty in this context means that, when acting in a fiduciary capacity, the fiduciary is expected to act in the principal's interests to the exclusion of the fiduciary's other interests. The principal therefore does not supervise the fiduciary's performance, which allows opportunities for fiduciary misbehaviour to arise.[7] Remedies for breach of fiduciary duty ensure that the principal's expectation of proper, selfless performance by the fiduciary are met. By applying sanctions when those standards are not met, equity approximates loyal performance by the fiduciary.

Conaglen has recently explained the loyalty involved in fiduciary law as a "subsidiary and prophylactic form of protection for non-fiduciary duties which enhances the chance that those non-fiduciary duties will be properly performed."[8] This is a valuable observation, reminding us that fiduciary obligations do not arise in a vacuum. They are inevitably underpinned by other duties, for example, the duty of care, contractual obligations or directors' duties.[9] Fiduciary duties require that the fiduciary perform those underlying obligations loyally.

In the Anglo-Australian tradition, the identification of obligations indicating loyalty in performance has involved separating out *proscriptive* duties from *prescriptive* duties.[10] It is now generally accepted that only those duties that are proscriptive are truly fiduciary. Fiduciary duties are thus characterised by spelling out what a fiduciary *cannot* do. What the fiduciary cannot do amounts to the two rules[11] mentioned above, the profits and conflicts rules. This view has extensive academic support[12] and has been endorsed by the courts.[13] Any prescriptive duties that bind a fiduciary fall to be enforced by other branches of law, such as contract, trust and tort. Conaglen calls this aspect of fiduciary law "subsidiary", in that fiduciary duties exist to support performance of non-fiduciary duties such as a duty of care.[14]

---

[6] De Mott, "Fiduciary Obligations", *supra* note 3 at 471, 477-479; *Bristol & West Building Society v. Mothew* [1998] Ch. 1 at 18 (Millett L.J.); J.D. McCamus, "Equitable Compensation and Restitutionary Remedies: Recent Developments" in *Law Society of Upper Canada Special Lectures: Law of Remedies*, (Toronto: Carswell, 1995) 295 at 300. M. Conaglen, "The Nature and Function of Fiduciary Loyalty" (2005) 121 Law Q. Rev. 452. Peter Birks disagrees with use of the term "loyalty" to describe fiduciary expectations. He prefers "altruism": Birks, "Content of Fiduciary Obligation", *supra* note 3 at 37. But De Mott proves altruism is not a complete analogy: De Mott, "Fiduciary Obligations", *supra* note 3 at 477-479.

[7] Finn, "Contract and the Fiduciary Principle", *supra* note 3 at 85.

[8] Conaglen, *supra* note 6 at 453.

[9] *Ibid.* at 471.

[10] There are now significant differences between traditional fiduciary jurisprudence, and the fiduciary law applied in North American jurisdictions. This article is limited to traditional concepts of fiduciary law.

[11] Uncertainty has attached to the question whether the conflicts and profits rule are one rule or two. Despite dicta of the highest standing (see *Boardman v. Phipps* [1967] 2 A.C. 46 at 123 (Lord Upjohn)) the better view appears to be that there are two rules having separate operation: *Warman International Ltd v. Dwyer* (1995) 69 A.L.J.R. 362 at 372. See also A. J. McClean, "The Theoretical Basis of the Trustee's Duty of Loyalty" (1968-69) 7 Alta L. Rev.218; J. Glover, *Equity, Restitution and Fraud* (Sydney: LexisNexis Butterworths, 2004) [Glover, *Equity*] at 179. Clearly there is a high degree of overlap in application of both rules.

[12] Birks, *supra* note 3 at 37; D. Hayton, "Fiduciaries in Context: An Overview" in Birks, *Privacy & Loyalty*, *supra* note 3 at 286-292, but see Teele, *supra* note 3 at 112.

[13] *Breen v. Williams* (1996) 186 C.L.R. 71 at 108 (Gaudron and McHugh JJ.); *Pilmer v. Duke Group Ltd. (in liq.)* (2001) 207 C.L.R. 165 at 199 (McHugh, Gummow, Hayne and Callinan JJ.).

[14] Conaglen, *supra* note 6 at 471.

The "subsidiary" nature of fiduciary obligations also explains the concept of "scope" employed in determining the reach of the fiduciary duties owed. Only matters inside the scope of a fiduciary relationship attract fiduciary duties. For example, a trustee owes the beneficiary duties with respect to the trust estate. The trustee also owes the fiduciary obligations contained in the profits and conflicts rules. But the trustee only owes the beneficiary fiduciary obligations in the context of the trust. There is no responsibility not to profit, or not to allow a conflict in matters unrelated to the trust, as for example, in connection with the beneficiary's private life.

The two fiduciary obligations run contrary to the natural human preference for one's own interests.[15] This counter-intuitive dimension of fiduciary obligations explains the severity of equitable remedies. None of the remedies available for breach of fiduciary duty can perform adequately in individual cases as deterrents because all act after the fact. After disloyalty, loyalty can only be approximated by the singular strength of the remedial response to breach of fiduciary duty.

One old case actually claims the fiduciary institution is necessary "for the preservation of mankind."[16] This seems excessive, but more modern commentators have regarded fiduciary obligations as an incident of relatively civilised society.[17] Finn expresses this view more moderately. Fiduciary law, he says:

> [I]s informed in some measure by considerations of public policy aimed at preserving the integrity and utility of these relationships, given the expectation that the community is considered to have of behaviour in them, and given the purpose they serve in society.[18]

However, the two fiduciary obligations respond to two different risks. The profits rule responds to the risk that the fiduciary will give in to greed. This is unacceptable, even though it causes no harm to the principal. The conflicts rule responds to the risk that the fiduciary will prefer interests other than those of the principal, thereby putting the principal's interests in danger. This is unacceptable, even though the fiduciary is not seeking or making a profit from the conflict. Each is unacceptable because it is disloyal.

III. The Profits Rule

A. *Its Rationale*

The profits rule forbids a fiduciary making an unauthorised profit through his or her fiduciary position. Loyalty is demanded, and approximately exacted by stripping the fiduciary of any profits made within the scope of the fiduciary obligation.[19]

---

[15] See also M. McInnes, "Account of Profits for Breach of Fiduciary Duty" [2006] 122 Law Q. Rev. 11 [McInnes, "Account of Profits"].

[16] *Welles v. Middleton* (1784) 1 Cox. 112 at 124-5.

[17] P. Pettit, "The Cunning of Trust" (1995) 24 Philosophy and Public Affairs 202 at 216. See also, P.J. Zak & S. Knack, "Trust and Growth" (2001) 111 The Economic Journal 295, who have shown that economic growth depends upon the level of trust present in a society; T. Frankel, "Fiduciary Law" [1983] 71 Cal. L. Rev. 795 at 802.

[18] Finn, "Fiduciary Law", *supra* note 3 at 10.

[19] This may be subject to allowances made in the fiduciary's favour for skill and effort, etc: *Boardman v. Phipps* [1967] 2 A.C. 46.

The profits rule is based in the social policy of preservation of trusting relationships. That said, the reason for the *severity* of the profits rule is not entirely clear. Some claim it answers "the interests of efficiency."[20] But Bishop and Prentice point out that the profits rule is not necessarily economically efficient; because a complete prohibition is placed on profit-making, the fiduciary has no incentive to seek out profit-making opportunities for the principal.[21] Nevertheless, this arguably inefficient result is accepted because the absolute anti-profit rule has the lowest monitoring cost. The principal need never check to see if the fiduciary is seeking personal opportunities.[22] The utility of the fiduciary relationship and its integrity are guaranteed, even if there is associated inefficiency.

Finn has said that the severity of fiduciary obligations exists primarily to coerce disclosure; "to compel disclosure of certain types of actions so that consent can be given."[23] The fiduciary is given just one escape route. If the fiduciary fails to make disclosure and seek consent, equity assumes the fiduciary *will* give in to greed. Thus, equity is disinterested, at least in theory, as to whether the fiduciary was devious and deliberate in making the gain, or merely inadvertent and perhaps fortunate.[24] If an unauthorised gain is made within the scope of the fiduciary obligation, disloyalty is conclusively presumed. "The remedy is justified simply as the most effective means of supporting the underlying obligation."[25] Clearly there does not have to be any quantifiable loss to the plaintiff before a profit-stripping remedy is ordered, nor is it relevant that the principal could not personally have made the gain. The gain in the hands of the fiduciary points to disloyalty (in the sense that the fiduciary was not acting *only* in the principal's interests) and dictates the remedy. Equity acts as if the fiduciary had loyally made the profit and directs the gain to the principal.

The rule itself is relatively clear, but the devil is in the detail of application. How is the line drawn between unauthorised profit that the fiduciary cannot retain and profit that the fiduciary can legitimately keep? This is the causation question recently considered by the Court of Appeal in *Gwembe* and *Murad*, discussed below.

---

[20] *Murad, supra* note 2 at para. 74, *per* Arden L.J.

[21] W. Bishop & D. D. Prentice, "Some Legal and Economic Aspects of Fiduciary Remuneration" [1982] 46 Mod. L.R. 289 at 295-6; "Some Legal and Economic Aspects of Fiduciary Remuneration: A Postscript" [1986] 49 Mod. L.R. 118. See also P. Pettit, *supra* note 17 at 215, who notes that intrusive levels of regulation can, in fact, be counterproductive; Zak & Knack, *supra* note 17, whose research indicates that levels of trust tend to increase where the trusted party receives recompense; E. Talley, "Taking the "I" out of Team: Intra-Firm Monitoring and the Content of Fiduciary Duties" (1999) J. Contract L. 1001 at 1022. All these may suggest that the profits rule is, in fact, inefficient. But see R. P. Austin, "Fiduciary Accountability for Business Opportunity" in P. D. Finn, ed., *Equity and Commercial Relationships* (Sydney: Law Book Company, 1987) 141 at 163, who suggests that "[t]he law of fiduciary duties as a whole is efficient in economic terms."

[22] Bishop & Prentice, *ibid.* at 296.

[23] Austl., Commonwealth, Senate Standing Committee on Legal and Constitutional Affairs, *Company Directors' Duties* (Official Hansard Report) (Canberra: Australian Government Publishing Service, 1989) at 172 (Prof. Paul Finn) [Finn, *Company Directors' Duties*]. This position is supported by N. P. Beveridge Jr., "The Corporate Director's Fiduciary Duty of Loyalty: Understanding the Self-Interested Director Transaction" (1992) 41 DePaul L. Rev. 655 at 659.

[24] See *Keech v. Sandford* (1726) Sel. Cas. T. King 61, 25 E.R. 223; *Boardman v. Phipps* [1967] 2 A.C. 46. However, it must be noted that a devious fiduciary is less likely to be the recipient of a generous allowance for care and skill.

[25] S. Worthington, "Reconsidering Disgorgement for Wrongs" [1999] 62 Mod. L.R. 218 at 235.

B. *Remedy for Breach of the Profits Rule*

It is clear that disgorgement by way of an account of profits is available for breach of the profits rule. Disgorgement can also be achieved by a remedial constructive trust. But the question arises whether any other kind of remedy is available for such a breach. More particularly, is equitable compensation available for breach of the profits rule? This article suggests that equitable compensation is not an appropriate remedial response to a breach of the profits rule.

A breach of the profits rules is proved by showing that (a) the defendant owes a relevant fiduciary obligation, and (b) the defendant (or a party through them) has made an unauthorised profit. Whether or not the plaintiff has made a loss is irrelevant.[26] The cause of action only requires proof of a gain to the defendant. This suggests that disgorgement is the appropriate remedy[27] and compensation should not be available. On a normative view, the proper remedy for breach of the profits rule must be disgorgement of the profits. As Rickett and Gardner put it:

> [I]t is unclear why compensation is required to relieve a defendant of his or her gain derived from the breach of an equitable duty. One would have thought that calling the defendant to account would provide an adequate *personal* monetary remedy, so that equitable compensation could then properly be reserved for those cases where the plaintiff has actually sustained loss from the relevant breach.[28]

For example, it seems strange to speak of equitable compensation as an available remedy to strip the profit made in *Boardman v. Phipps.*[29] There, the assets of a trust estate included shares in an underperforming company. The trust's agents mounted a takeover of the company, and improved its profitability. This resulted in a personal profit for the agents, but also in a profit for the trust itself, as the value of its shareholding increased. The plaintiff in that case could not possibly have pointed to any loss. There was nothing that required "compensating";[30] quite the opposite.

Support for the view that equitable compensation is not available unless there is a loss can be found in the recent decision, *Gwembe*. A company director did not disclose the extent of his interest in a transaction with the company. He was ordered to account for the profits he made. However, the Court of Appeal held that the trial judge had been entitled to refuse to award equitable compensation, on the basis that no loss was suffered. As the wrongdoing was a breach of the profits rule, it was not appropriate to allow the plaintiff to elect equitable compensation as a remedy.

---

[26] *Keech v. Sandford* (1726) Sel. Cas. T. King 61; 25 E.R. 223; *Attorney-General (Hong Kong) v. Reid* [1994] A.C. 324; *Regal (Hastings) Ltd. v. Gulliver* [1967] 2 A.C. 134; *Boardman v. Phipps* [1967] 2 A.C. 46.

[27] See generally, M. McInnes, "Disgorgement for Wrongs: An Experiment in Alignment" [2000] R.L.R. 516.

[28] C. Rickett & T. Gardner, "Compensating for loss in equity: evolution of a remedy" (1994) V.U.W.L.R. 19 at 30 [emphasis in original].

[29] [1967] 2 A.C. 46.

[30] But see E.J. Weinrib, "Restitutionary Damages as Corrective Justice" [2000] 1 Theoretical Inquiries In Law 1 [Weinrib, "Restitutionary Damages"]. *Contra* J.L. Coleman, "Property, Wrongfulness and the Duty to Compensate" 63 Chicago-Kent L. Rev. 451.

Nevertheless, it sometimes appears that equitable compensation is awarded for breach of the profits rule. Some cases[31] are apparently decided on the basis that the measure of equitable compensation is the amount of profit made by the defendant. Commentators note this phenomenon almost uncritically,[32] but these decisions are misleading at best. If the monetary sum awarded is being calculated by reference to the defendant's gain, it is profit-stripping. If it is calculated by reference to the plaintiff's loss, it is compensation, and in this case, equitable compensation. The two remedies are alternate. It is widely thought that they cannot be had together.[33] They address entirely different questions, and there is no necessary or logical connection between repairing a loss suffered by a principal, and removing a profit made by a fiduciary.

If the quantification of an account of profits and the quantification of equitable compensation are the same in a given case, that is merely fortuitous. It is not because the awards cure the same wrongs. As Berryman says, the information concerning the gain "may be helpful in quantification";[34] but it is "only a justifiable option in the absence of better options."[35] Equitable compensation is not *per se* available for breach of the profits rule. Remedies that achieve disgorgement address breaches of the profits rule.

C. *Causation Standards for Breach of the Profits Rule*

The profits rule is strict. Nevertheless, when disgorgement is considered, are some of the profits made by a fiduciary too distant from the breach of duty to be reached? Clearly, not every profit made by the fiduciary in connection with the transaction

---

[31] *Re Leeds & Hanley Theatres of Varieties Ltd.* [1902] 2 Ch. 809; *Fraser Edmiston Pty. Ltd. v. A.G.T. (Qld) Pty. Ltd.* [1988] 2 Qd. R. 1; *Miles v. Little Caesars Casino Pty. Ltd.* [2001] N.S.WS.C 33; *Disctronics Ltd. v. Edmonds (No 2)* [2002] V.S.C. 534; *Acme Office Services Pty. Ltd. v. Ludstrom* [2002] N.S.W.S.C.R. 277.

[32] R.P. Meagher, J.D. Heydon & M.J Leeming, *Meagher Gummow & Lehane's Equity Doctrines and Remedies*, 4th ed. (Sydney: Butterworths LexisNexis, 2002) at para. 23-020, who appear to accept, if not necessarily support, the situation.

[33] *Tang Man Sit v. Capacious Investments Ltd.* [1996] A.C. 514; *Warman International Ltd. v. Dwyer* (1995) 182 C.L.R. 544, 559; P.M. McDermott, "Election of account of profits" (1996) 70 Austl. L.J. 540; I.E. Davidson, "The Equitable Remedy of Compensation" (1982) 13 Melbourne U.L. Rev. 349 at 354; J. Glover, *Equity, supra* note 11 at 435. But see *Cook v. Evatt (No 2)* [1992] 1 N.Z.L.R. 676; P. Birks, "Inconsistency between Compensation and Restitution" (1996) 112 Law Q. Rev. 375 at 378. Sometimes, the two amounts overlap entirely. In situations where the defendant fiduciary has breached both the profits and the conflicts rule by misappropriating from the principal, there will be a complete confluence in the remedies. See *e.g.*, *Hill v. Rose* [1990] V.R. 129; *Catt v. Marac Australia Ltd.* (1987) 9 N.S.W.L.R. 639.

[34] J. Berryman, "Some observations on the application of equitable compensation in Western Australia: *Dempster v. Mallina Holdings*" [1995] U.W.A. L. Rev. 317 at 322.

[35] A. Phang and P. Lee, "Restitutionary and Exemplary Damages Revisited" (2003) 19 J. Contract L. 1, 10. Some writers see this as "disgorgement damages". J. Edelman, *Gains-Based Damages: Contract, Tort, Equity and Intellectual Property* (Oxford: Hart Publishing, 2002) proves that disgorgement and damages are not necessarily strangers. However, this may be unnecessarily confusing in relation to equitable wrongs. Equity already provides separate methods for disgorgement (account of profits) and compensation (equitable compensation), where common law traditionally only had one label, damages. Equitable compensation is not available for breach of the profits rule, because an account of profits responds adequately to equity's concern by not allowing the fiduciary to retain an illicit profit.

can be attacked by the principal. Solicitors, for example, would find it extremely hard to do business if it were otherwise. There are three methods of explaining this apparent contradiction. First, only those profits made *within the scope* of the fiduciary relationship are subject to the profits rule. As Glover puts it:

> A nexus must exist between profits made by fiduciaries and their fiduciary offices. Profits made "by reason or by use of" fiduciary offices involve the *exploitation* of that office that the rule requires. Merely incidental profits made by fiduciaries, for example, from other employment, writing books or gambling are not proscribed.[36]

Secondly, as Conaglen shows, fiduciary obligations are subsidiary in the sense that they support underlying non-fiduciary obligations.[37] In the case of a solicitor, the fiduciary obligations support the underlying contractual and tortious obligations. The client's contractual obligation to pay the solicitor's fees is not affected by the profits and conflicts rules. Finally, the explanation why some profits cannot be reached is that they are in fact *authorised.* The profits rule only attacks unauthorised profits. Solicitors' fees, for example, are usually authorised by the client at the time of retainer. However, unless the profit is authorised or made outside the scope of the fiduciary office, the fiduciary will be susceptible to an action for account.

It is sometimes suggested that there are other situations in which the fiduciary might not have to account for a profit made. For example, in *Chan v. Zacharia* Deane J. made the following observation:

> [T]he liability to account for a personal benefit or gain obtained or received by use of or by reason of fiduciary position, opportunity or knowledge will not arise in circumstances where it would be unconscientious to assert it or in which, for example, there is no possible conflict between personal interest and fiduciary duty and it is plainly in the interests of the person to whom the fiduciary duty is owed that the fiduciary obtain for himself rights or benefits.[38]

This implies that there are two possible ways in which a fiduciary could obtain a benefit without having to account for it. These are:

1. Where a claim for account would be unconscientious[39] on the part of the principal; or
2. Where there is no possible conflict between interest and duty, and it is in the interests of the principal that the fiduciary be allowed to make a profit.

The first possibility highlights the discretionary nature of all equitable remedies; there is never any guaranteed right to a remedy in equity, where the court may take into account factors that might affect justice, such as the unjust enrichment of the principal. Considerations such as these have led to restricted remedies on occasion,

---

[36] Glover, *Equity*, *supra* note 11 at 202.
[37] Conaglen, *supra* note 6 at 471.
[38] *Ibid.* at 204-5.
[39] It is unclear what Deane J. meant by the use of the word "unconscientious" in this context. Equity denies remedial relief on the basis of "unclean hands", but the use of the term "unconscientious" implies something less than unclean hands.

such as in *Warman International Ltd. v. Dwyer,*[40] where the fiduciary's account of profits was limited to a period of two years. This first possibility cannot be questioned.

The same, however, cannot be said of the second possibility, which, it is argued, is no possibility at all. If the scope of the fiduciary obligation has been determined, then the extent of the possible conflict between interest and duty is known. Any pursuit of personal interest inside that scope attracts potential liability for an account of profits. If there is no possibility of a conflict between interest and duty, then the profit making activity is outside the scope of the fiduciary duty. The fact that it may be in the interests of the principal that the fiduciary be allowed to make a profit is irrelevant.

These points are clearly established by *Boardman v. Phipps*,[41] which although often seen as an extreme case, is undoubtedly good law.[42] In *Boardman v. Phipps* it was clear that the principal (in that case, a trust) itself could not have made the subject profit. As events turned out, it was clearly in the interests of the principal that the fiduciaries be allowed to make a profit for themselves, as they coincidentally made a profit for the principal too. But this was to no avail. The fiduciaries were still ordered to account for the profits made, although a generous allowance was made for skill and effort.

Boardman v. Phipps is also evidence of the strength of the profit-stripping remedy. There can be little doubt that the extra profit coming to the principal was a windfall gain; many would also call it unjust enrichment. But it did perhaps not cross into the "unconscientious" territory Deane J. refers to in *Chan v. Zacharia*.[43] Although not deserved, it was perhaps not *unconscientious* for the principal to claim the profit, given that it was made within the scope of the fiduciary obligation. It is unclear what Deane J. meant by use of the term "unconscientious". In particular, it is unclear whether this concept differs from the equitable requirement of "clean hands". However, *Boardman v. Phipps* would tend to suggest that there is nothing unconscientious in a beneficiary insisting that the agents of a trust disgorge profit made in breach of the profits rule, even if that leads to a windfall gain. The generous allowance made for the defendants' skill care and expertise in *Boardman v. Phipps* no doubt reduced the extent of any enrichment of the principal.[44]

---

[40] *Warman International Ltd. v. Dwyer* (1995) 182 C.L.R. 544 [*Warman*]. This decision is often cited as an example of exercise of remedial discretion, because explicit reference was made (at 561) to a more extreme remedy transforming account "into a vehicle for the unjust enrichment of the plaintiff." The comment was made in the context of making allowances to the fiduciary. However, as McInnes notes, Arden and Jonathan Parker L.JJ. in *Murad* interpreted the case as an example of limitation on recovery because part of the profit claimed was beyond the scope of the fiduciary duty; McInnes, "Account of Profits", *supra* note 15 at 13-14. This may well be the better explanation of *Warman.* Even so, the principle that courts of equity may exercise discretion as to remedy in the interests of justice cannot be doubted: *Giumelli v. Giumelli* (1999) 196 C.L.R. 101.

[41] *Boardman v. Phipps* [1967] 2 A.C. 46.

[42] However, Davies suggests the majority in the House of Lords were incorrect in finding that a fiduciary relationship had been breached: J.D. Davies, "Keeping Fiduciary Liability within Acceptable Limits" [1998] Sing. J.L.S. 1 at 6.

[43] *Supra* note 4 at 204-205.

[44] The difference between *Warman International Ltd. v. Dwyer* (where it was said that remedy was limited to a two year period to avoid unjust enrichment of the principal) and *Boardman v. Phipps* (where it was apparently not unjust to grant a full remedy) may be that the profit claimed in *Warman* went beyond the scope of the fiduciary duty. This is the explanation of *Warman* favoured by Arden and Jonathan Parker LL.J. in *Murad*: see *supra* note 39. If *Warman* is *additionally* an example of a profit claimed by the principal unconscientiously, the decision is then explained on the basis that as the profit was made

The line between the undeserved and unconscientious claim of profit arguably caused concern in the recent decision of *Murad.* Al-Saraj convinced the two Murad sisters to enter a joint venture with him to purchase a hotel. The Murads were to contribute £1 million, and Al-Saraj was to contribute £500,000 towards a purchase price of £4.1million, with the balance raised by loan. All three were to share the profits from running the hotel equally, but when the property was sold, the two Murad sisters were to receive half of the proceeds, with the other half going to Al-Saraj.

In fact, the purchase price listed in the contract was £3.6 million. This figure was achieved when the vendor set off certain sums against the purchase price, which included a secret commission of £369,000 payable to Al-Saraj for introducing the purchasers. The hotel was eventually sold for a profit of £2 million. When the Murad sisters discovered the extent of Al-Saraj's deception concerning the purchase, they sought an account of profits, alleging a breach of fiduciary duty.

The trial judge found as a matter of fact that, had Al-Saraj made disclosure of the true position, the Murad sisters would not have agreed to him receiving half of the profits on sale. However, he held that, although the 50-50 split would not have been acceptable, there would have been *some lesser* amount of profit-sharing to which the sisters would have agreed.[45] Al-Saraj therefore argued on appeal that as the sisters would have agreed to him receiving *some* of the profit, it would be unjust for the *whole* of the profit to be stripped from him.

To be able to consider Al-Saraj's claims, it is necessary to return to first principles. Al-Saraj owed fiduciary duties to his fellow joint-venturers, and was under a responsibility not to make an unauthorised profit. He breached the profits rule. But how much of the profit was referrable to the breach? The Court of Appeal held 2:1 that the whole of the profit made was able to be stripped from him. This may seem harsh, given that the sisters would probably have agreed to Al-Saraj receiving some proportion of the profit. But what *might* have happened was simply not to the point. Even though part of the profit *might* have been authorised upon full disclosure, the profit in fact made was unauthorised. The existence of an unauthorised profit in the context of a fiduciary obligation suggests that the fiduciary has been disloyal. Equity protects *ex poste ante* against that disloyalty. Although the sisters may have done nothing to deserve the extra profit, Al-Saraj was not in a position to claim they were unconscionable towards him, given his disloyalty, and a specific finding of dishonesty.[46] The sisters were, after all, only insisting that the fiduciary act loyally.

The earlier decision, *Gwembe* is to similar effect. A company director failed to disclose full details of his intended profit. Therefore, the whole of the profit made was stripped from him, and he could not "be heard to say, as against the beneficiary company, that he was entitled to retain any of the profits for himself."[47] Further, in *Gwembe* the Court of Appeal made it plain that no other causative argument could be accepted. In particular, it was not incumbent on the principal to prove that, had the director made the necessary disclosure, it would not have entered into the

outside the scope of the fiduciary duty, it would be unconscientious for a principal to make claim to such a profit. This interpretation reduces the impact of the use of the term "unconscientious".

[45] *Supra* note 2 at para. 47.

[46] *Ibid*. at para. 4: The finding made was one of fraudulent misrepresentation.

[47] *Supra* note 1 at para. 137.

transaction.[48] In short, all the company needed to show was an unauthorised profit in the hands of the director.

This suggests that the standard of causation required in relation to an account of profits is virtually non-existent. The principal does not have to satisfy a "but for" test; it is not necessary to show that but for the breach, the fiduciary would not have made the profit.[49] Nor is it relevant that other factors may have contributed to the making of the profit, such as a general increase in the stockmarket. The whole matter can be reduced to a simple equation. Fiduciary obligation plus breach of the profits rule leads inexorably to a profit-stripping remedy. There is no extra dimension of causation required. Authorisation is the only protection available to a fiduciary. In *Murad*, the profit Al-Saraj claimed was not authorised, and unfortunately for him, no other profit was authorised in its place. As McInnes notes, "[a] fiduciary may escape liability by establishing *actual* consent…but it is not enough to show that a principal *would have* assented to a particular scheme if given the opportunity to do so."[50]

However, equity's attitude here ignores the commercial reality that Al-Saraj would not have agreed to become involved in the undertaking for no reward at all. This aspect of the case disturbed the dissentient, Clarke L.J. His Lordship was of opinion that equity should be capable of more flexibility in order to achieve justice. He commented:

> [I]f the matter were free from authority I would hold that a person who makes a profit in the course of a fiduciary relationship must account for the profits he makes, that prima facie he must account for all the profits but that it should be open to him to show that it was always intended that he would make a profit from the transaction and to persuade the court if he can that, …in the circumstances of the particular case, he should not be ordered to account for the whole of the profits.[51]

His Lordship pointed out that this was particularly so where the kind of fiduciary relationship in question was a joint venture.[52] While joint ventures are not partnerships, the analogy is closer to partnership than to the other paradigmatic fiduciary relationship of trustee and beneficiary. It is inconceivable that a partnership arrangement would give one of the partners no reward at all. For Clarke L.J., this meant that the finding that the Murad sisters would have entered into the joint venture, albeit on different profit-sharing terms, had Al-Saraj made full disclosure to them was not irrelevant to the question whether Al-Saraj should have to account for the whole profit.[53]

Both majority judges exhibited some sympathy for the general proposition that equity might one day relax the inflexibility of application of the profits rule.[54]

---

[48] *Ibid.* at para. 144.

[49] *Ibid.*

[50] McInnes, "Account of Profits", *supra* note 15 at 13 [emphasis in original].

[51] S*upra* note 2 at para. 141.

[52] *Ibid.* at para. 153.

[53] Clarke L.J. would have remitted the matter to the trial judge to give Al-Saraj the opportunity to persuade him that it would be inequitable to make him account for the whole of the profits, subject only to an allowance for skill, expertise and expenditure: *ibid.* at para. 162.

[54] *Ibid.* at para. 82, per Arden L.J.; at para. 121, *per* Jonathan Parker L.J.

Jonathan Parker L.J. thought it possible that "commercial conduct which in 1874 was thought to imperil the safety of mankind may not necessarily be regarded nowadays with the same depth of concern."[55] However, neither member of the majority thought *Murad* an appropriate vehicle for any newfound flexibility, focussing on the defendant's fraudulent conduct as a reason for upholding and applying the old rule.[56]

Murad presents as an example of the rule that there is no extra causation "test" that must be met before an account of profits is ordered against a fiduciary making an unauthorised profit within the scope of the fiduciary duty. This was evident in the Court of Appeal's unanimous recognition that authority bound them to an inflexible application of the profits rule, even though particular application might be potentially unpalatable. Evidence of the state of mind of the fiduciary is unnecessary; equity assumes that unauthorised profits are made because the fiduciary has acted in his or her own interests, and therefore, disloyally. No other link is required.

D. *Is the Causation Standard for the Profits Rule Justified?*

The causation standard (or lack thereof) in relation to the profits rule can be criticised as being overly strict. Clarke L.J.'s concern in *Murad* reflected this. His Lordship was most concerned that a strict and inflexible application of the profits rule possibly resulted in the unjust enrichment of the principal.

The traditional manner in which the loyalty required by the profits rule is approximated is to strip the fiduciary of the illicit profit and direct it to the principal, subject to any allowance for skill, care and expertise made at the discretion of the court. The rationale for the rule is said to be prophylaxis, and the deterrence of others. But as is frequently noted, there is not much deterrence in merely stripping illicit profits from a fiduciary. Generally, the fiduciary is no worse off for having been disloyal, and the possibility that the breach will never be detected, allowing the fiduciary to retain the profit, reduces any deterrent effect.

If there is no individual deterrence in application of the rule, but instead general deterrence, it is fair to ask whether strict application of the rule achieves any general deterrence. Is there sufficient information about the rules of equity in the community for any real deterrence to be achieved? This seems doubtful. While solicitors and company directors can be taken to have some knowledge of fiduciary responsibilities, many others in business have little exposure. This is particularly so in cases where fiduciary obligations are found to exist outside the recognised categories, and might perhaps have been the case with the defendant Al-Saraj. If deterrence does not explain the severity of the remedy, another justification is needed.

Any suggested justification must also address the argument that a strict application of the profits rule actually stifles economic development. A fiduciary susceptible to profit-stripping is not given much incentive to make a profit that might also benefit the principal. Presumably, without their fellow joint-venturer, the Murad sisters would never have been in a position to make a profit. Removing all profit from Al-Saraj hardly encourages future entrepreneurial activity. It can be argued that the profits rule instead encourages a fiduciary to sit back and *not* act.

---

[55] *Ibid.* at para. 121.

[56] *Ibid.* at para. 84, *per* Arden L.J.; at para. 122, *per* Jonathan Parker L.J.

Murad is one of those rare cases where the profit-stripping arguably leaves the fiduciary worse off than when he started; it certainly leaves the principals better off than they could have hoped to be. These unusual cases bring to the fore arguments that the profits rule itself may be overly extreme and even unnecessary in the modern world. The Court of Appeal addressed these arguments in *Murad.* For the majority, the arguments were unconvincing. Arden L.J correctly identified that at issue was a potential clash between two policy objectives. The first is the policy that has long underwritten fiduciary law, that is, the enforcement of loyalty where it is rightfully expected. The second is the distaste for unjust enrichment of the principal at the fiduciary's expense because it appears unjust. Her Ladyship commented that, even though it was not required in the present case, because of the defendant's fraud:

> [I]t may be appropriate for a higher court one day to revisit the rule on secret profits and to make it less inflexible in appropriate circumstances, where the unqualified operation of the rule operates particularly harshly and where the result is not compatible with the desire of modern courts to ensure that remedies are proportionate to the justice of the case.[57]

This article suggests that there is no real occasion for redesigning the profits rule. The justification for the severity of the profits rule is not so much prophylaxis or general deterrence, but the best approximation of loyal service. This aim is sufficient justification for the severity of the profits rule. The current system best supports the purpose of fiduciary obligations. As Finn says, that purpose is to coerce disclosure of relevant information to the principal, to give the principal the opportunity to consent.[58] Unauthorised profits in the hands of fiduciaries strongly suggest disloyalty. Almost by definition, a fiduciary is information-rich compared to the information-poor principal. It is too easy for the fiduciary to claim the profit was made inadvertently or unintentionally. If the need arises to prove fiduciary misbehaviour, the principal is in an unenviable position. Therefore, fiduciary principles relieve the principal from the most onerous part of the task, namely, proving the fiduciary's subjective state of mind. Fiduciary rules strongly encourage disclosure, in order to place the fiduciary and principal on an even footing in terms of information. But if disclosure is not made, the current rules presume that unauthorised profit is made disloyally.

This is demonstrated by the exception to the profits rule, the excuse of full disclosure and informed consent. If the fiduciary makes full disclosure and obtains the principal's consent to what would otherwise be a breach, there is no disloyalty. This mechanism protects honest fiduciaries in two ways. First, it may relieve the fiduciary from responsibility to part with the profit. Secondly, if after full disclosure is made, the principal denies consent, the fiduciary has the opportunity to terminate the underlying relationship between the parties, and can avoid investing personal time, care and expertise in an undertaking that will not benefit the fiduciary. A scenario like *Boardman v. Phipps* can be used as an example. Honest fiduciaries failed to make full disclosure, but what would have happened had they made complete disclosure and sought consent? One might question whether a fully informed principal would refuse consent to an action that would benefit both fiduciary and principal. But in

---

[57] *Supra* note 2 at para. 83; Jonathan Parker L.J.'s judgment is to similar effect.

[58] Finn, *Company Directors' Duties*, *supra* note 23.

the event of denial of consent, the fiduciaries would likely reconsider wasting their talents in a way that would benefit only another. They might have directed their time and resources into another scheme, and questioned whether to act for the principal at all in the future. This result would have been counterproductive, in that the trusting relationship might not survive. The exception to the profits rule encourages trusting relationships, and allows for their continuance. The fact that the fiduciary can make full disclosure and obtain consent *after* an unauthorised profit is made indicates the importance society places on enabling maintenance of such relationships.

Let us imagine though, that the fiduciary can *prove* that while acting in the best interests of the principal the fiduciary coincidentally made a personal profit. If the profit made was truly unintentional, the fiduciary can never have expected to make such a profit. The fiduciary will have wasted no time or energy pursuing the gain, and stripping the profit will leave the fiduciary no worse off than he or she ever intended to be. There is nothing "harsh" or "disproportionate" in such an outcome. However, if the fiduciary made the profit intentionally (that is, the fiduciary intended to make a personal profit as well as a profit for the principal), equity is right to be on guard. Conflict may now arise between the two interests. If fiduciaries are permitted to seek a profit for themselves and the principal without reference to the principal, the fiduciary institution is completely undermined, because the incentive to share information with the principal is removed.

The profits rule as currently understood does not address over-enrichment of the principal. Some principals might react in an opportunistic way when they discover the full facts. Arguably, this occurred in *Boardman v. Phipps* and *Murad.* If the principal chooses to act opportunistically and claim an undeserved profit, he or she is merely insisting on loyal performance. The only way an unjust outcome for the fiduciary is avoided under the current law is through exercise of the court's discretion to make proper allowance for the fiduciary's care, skill and expertise. Discretion and uncertainty go hand in hand, and therefore discretion is the bane of fiduciaries. Nevertheless, in a contest between the competing policy objectives of ensuring loyal performance by a fiduciary, and avoiding the undeserved enrichment of the principal, the former should be preferred as a primary position. Numbers alone should point to this conclusion. Cases where a principal may have been undeservedly enriched are few and well-known. Abandoning the current system (profits rule and exception, with discretion to make allowance to the fiduciary) would mean allowing fiduciaries to attempt to prove entitlement to some part of the profit, for whatever reason.[59] Such arguments would no doubt be made in all cases involving fiduciary profit-making, and the forensic benefit given to the otherwise information-poor principal would be undermined.

Nevertheless, even dishonesty should not expose a fiduciary to a punitive profit-stripping exercise. This is why *Murad* may seem harsh. There is a suspicion that the fiduciary may have been left worse off. The only protection available once the action is made out lies in exercise of the court's discretion in awarding a remedy. While considerable flexibility is possible, unless the principles underlying the exercise of the discretion can be described, equity can be criticised as being arbitrary and unjust.

[59] Or, as McInnes puts this, "[a] broad discretion regarding the *scope* of the account of profits inevitably entails a fundamental re-conception of the rules regarding the remedy's *availability*": McInnes, "Account of Profits", *supra* note 15 at 13.

This article suggests that the uncertainties involved in the exercise of discretion are largely overstated; the principles involved are relatively clear.

First, courts aim to place the principal in the position that would have existed had the fiduciary performed loyally. This principle marks out the limit of the court's remedial abilities. In the case of a disgorgement remedy, equity deems done what ought to have been done, and claims the profit for the principal. The fiduciary's failure cannot be rewarding in any way.[60] Second, it should be noted that courts of equity are clearly able to make just allowances; there can be no expectation that a plaintiff will receive all he claims.[61] However, finally, equity does not seek to punish,[62] and even a fraudster who has made a profit for his principal should be recompensed for the time expended in the scheme. Al-Saraj himself was at liberty "to apply to the court for an allowance for his services and disbursements, as indeed he did."[63] Although the grant of an allowance is always discretionary, the fact that the defendants in *Warman* and *Murad* were able to secure allowances strongly indicates that the courts do not visit injustice upon wrongdoers. These uncertainties do not seem so grave, especially when compared to the difficulties a principal would face if it were necessary to prove the matters currently assumed against the fiduciary.

IV. The Conflicts Rule

A. *Its Rationale*

The conflicts rule exists to discourage fiduciaries from behaving in a manner that shifts transactional risk to the principal. This happens in two ways. First, the fiduciary may be in a position where personal interests and the principal's interests overlap. The natural inclination is for the fiduciary to prefer his or her personal interests. Alternatively, the fiduciary can owe conflicting duties to two principals. Then the risk is that one principal will be preferred over the other. If the fiduciary is in a position where personal interest and duty to the principal conflict, or conflicting duties are owed to two principals, equity will step in. Equity will not allow the fiduciary to be led into temptation or placed in an impossible position.

When the fiduciary falls below the expected standards, application of the conflicts rule approximates loyalty in performance. If the fiduciary shifts risk to the principal, and the damage associated with that risk is realised, equity insists that the fiduciary compensate the principal. But equity does not automatically assume that the conflict caused the loss. This must still be proved.[64] This is merely just and equitable. If there was an automatic assumption that conflict caused all loss, the fiduciary would become the principal's insurer. Equity only requires that the fiduciary perform his

---

[60] *Attorney-General (Hong Kong) v. Reid* [1994] 1 A.C. 324.

[61] *Giumelli v. Giumelli* (1999) 196 C.L.R. 101.

[62] Although there is some disagreement on the point, there would appear to be no punitive element to an account of profits. The matter is extensively examined in *Harris v. Digital Pulse Pty. Ltd.* (2003) 56 N.S.W.L.R. 298 at 369-71 *per* Heydon J.A. The discomforting problem that honest and dishonest fiduciaries are treated without distinction could be solved by the adoption of a punitive regime; this would, however, represent a major doctrinal shift in equity.

[63] *Supra* note 2 at para. 88.

[64] *Maguire v. Makaronis* (1997) 188 C.L.R. 449.

or her duties loyally; it does not insist that the fiduciary protect the principal from all loss, no matter how that loss arises.

B. *Remedy for Breach of the Conflicts Rule*

1. *Equitable compensation*

Equity is characterised by the wide range of remedies it grants, including injunction, rescission, equitable compensation and accounts of profits. All of these are available for a breach of fiduciary obligation, however, remedial responses will depend upon the facts of the case before the court, including the nature of the rule breached. It is here that the distinction between the conflicts and the profits rule is brought into stark relief. It is not sufficient to assume that all remedies are available for all breaches of fiduciary obligation.[65] Equitable compensation, for instance, is *only* available for breaches of the conflicts rule.[66] This indicates that the conflicts and profits rules have separate operation.

Breach of the conflicts rule is an essential ingredient in a successful claim for equitable compensation following breach of fiduciary duty. The conflicts rule forbids the fiduciary allowing a conflict of interest and duty, or duty and duty, to exist.[67] Although there is a clear overlap with the profits rule,[68] the conflicts rule has an independent operation.[69] With the conflicts rule, it is irrelevant that the fiduciary has not made, or even sought to make a profit. What is being protected is the beneficiary's right to expect loyalty from the fiduciary. This right can be protected in a number of ways. For example, in the case of a trustee/beneficiary relationship, a court might order replacement of the trustee where the trustee's interests conflict with those of the beneficiaries.[70] A solicitor acting for one client who proposed to act for another in the same matter could be restrained from so doing by injunction.[71] These other remedies also put the plaintiff in the position they ought to occupy.

Suffering of loss differentiates those cases where equitable compensation is available from these others. In cases where a conflict remains unresolved, and the

---

[65] The author does not wish to enter the debate on "discretionary remedialism": see for example, P. Birks, "Three Kinds of Objections to Discretionary Remedialism" [2000] 29 U.W.A. L. Rev. 1; D.M. Jensen, "The Rights and Wrongs of Discretionary Remedialism" [2003] Sing. J.L.S. 178; S. Evans, "Defending Discretionary Remedialism" [2001] 23 Sydney L. Rev. 463. Regardless of the stance one takes on that issue, this article is premised on the belief that there is an unavoidable link between cause of action and *appropriate* remedy. Some remedies are inappropriate to the facts of the matter. As Weinrib comments, "the remedy rectifies the injustice, and thereby reflects its structure and content": Weinrib, "Restitutionary Damages", *supra* note 30 at 4.

[66] This is discussed in at Part III.B, above.

[67] There is no substantive difference between a conflict of interest and duty, and a conflict of duty and duty. Both are manifestations of the overriding duty of undivided loyalty: *Beach Petroleum N.L. v. Kennedy* (1999) 48 N.S.W.L.R. 1 at 47; *Moody v. Cox & Hatt* [1917] 2 Ch. 71 at 81-82, 84-85; *Haywood v. Roadknight* [1927] V.L.R. 512 at 516-7, 521. However, in *Maguire v. Makaronis* (1997) 188 C.L.R. 449 at 474 the majority of the High Court said there was a heightened concern where loss arises from a conflict of duty and interest. See also *White v. Illawarra Mutual Building Society Ltd.* [2002] NSWCA 164.

[68] For there is almost invariably a conflict of interest when the fiduciary breaches the profits rule.

[69] Glover, *Equity*, *supra* note 11 at 179; P. Parkinson, "Fiduciary Obligations" in P. Parkinson, ed., *The Principles of Equity*, 2d. ed, (Sydney: Lawbook Company, 2003) 339 at 358.

[70] *Titterton v. Oates* (1998) 143 F.L.R. 467; *Monty Financial Services Ltd. v. Delmo* [1996] 1 V.R. 65.

[71] *Prince Bolkiah v. KPMG (a firm)* [1999] 2 W.L.R 215.

beneficiary suffers loss as a result, equity will award a personal monetary award, equitable compensation. *Nocton v. Lord Ashburton*[72] perhaps remains the best example of this principle. Breach of the conflicts rule is the only peculiarly fiduciary breach for which equity will award equitable compensation. Equitable compensation is not available for a breach of the profits rule, as has been demonstrated above.

2. *Accounts of profits*

A more difficult question is whether the principal should be entitled to a remedy if it seems the breach of the conflicts rule results in a *gain* to the fiduciary, but no *loss* to the principal. In most cases, such a situation is also covered by the profits rule, and the principal would be clearly entitled to the gain.[73] This is a stringent rule. However, in rare cases like *Re Cape Breton Company*[74] and *Peninsular & Oriental Steam Navigation Co. v. Johnson*,[75] there may be a gain to the fiduciary in circumstances where the profits rule is not breached. *Peninsular* concerned a defendant who was a director of two companies, one a coal mining company, and the other involved in selling mining equipment. The defendant arranged for the equipment company to sell goods at a profit to the mining company. There was a clear conflict of interest. However, the High Court of Australia rejected a claim for an account of profits.[76]

The facts disclosed that the fiduciary had made a profit (in that the goods were sold for more than their purchase costs) but did not show that the principal had suffered a loss; there was no evidence the mining company had paid more than market value for the goods. From a modern perspective, the decision in *Peninsular* appears incorrect, because it seems that the fiduciary was allowed to retain the profit made in circumstances of breach of duty. Nevertheless, on its findings, the case was correctly decided. Importantly, it was held that the circumstances did not involve a breach of the profits rule.[77] The breach of the conflicts rule allowed the principal to obtain the remedy of rescission of the transaction, had it so wished. If loss could be

---

[72] [1914] A.C. 932.

[73] *Keech v. Sandford* (1726) Sel. Cas. T. King 61; 25 E.R. 223.

[74] *In Re Cape Breton Company* (1885) 29 Ch. D. 795. In this case, a new company was formed to purchase certain land. A director of the company had an interest in the land, which he did not disclose. The new company went into liquidation in 1875. A meeting of contributories in 1878, with full knowledge of the director's conflict of interest, affirmed the purchase. Later, recovery of losses against the director was sought. Cotton L.J. in the Court of Appeal held that the director had not breached the profits rule, as he had acquired his property well before his fiduciary duty arose. The director's clear breach of the conflicts rule entitled the company to rescind the contract. On appeal to the House of Lords, it was held that there was no right to compensation as no pecuniary loss had been proved: *Cavendish Bentinck v. Fenn* [1887] 12 H.L. 652 at 662 *per* Lord Herschell, at 666 *per* Lord Watson, at 667 per Lord Fitzgerald, at 669 *per* Lord Macnaghten).

[75] (1938) 60 C.L.R. 189 [*Peninsular*].

[76] *Ibid.* at 249. This was on the basis that no trust property was involved. The High Court appeared to accept that the director had been able to purchase the equipment on behalf of the equipment company without offering the equipment to the coal mining company. It is unlikely such a finding would be made today. See W.S. Martin, "Principles of Equitable Compensation" in R. Carroll, ed., *Civil Remedies: Issues and Developments* (Sydney: The Federation Press, 1996) 114 at 126.

[77] *Supra* note 75.

proved, equitable compensation should have been available.[78] There was, however, no evidence of any loss, because the company had only paid market value for the goods. It had not paid an inflated price. Therefore, equity had no outstanding remedial interest. The principal was already in the position it would have occupied but for the breach. The fiduciary's conflict has not affected the principal's position in relation to the transaction.

Therefore, it would appear that remedy and factual situation are closely allied. If the facts disclose a breach of the profits rule, the fiduciary is liable to have any unauthorised profit stripped from him. The fiduciary is not, however, liable to pay equitable compensation to the principal, because the principal does not need "compensating". Most breaches of the conflicts rule that result in a profit to the fiduciary will *also* be breaches of the profits rule, and therefore an account of those profits is an available remedy. However, in those rare cases where the fiduciary's profit is *not* made in breach of the profits rule, the profit cannot be stripped from him. The fiduciary will, nevertheless, be required to compensate the principal for any loss suffered.

C. *Causation Standards for Breach of the Conflicts Rule*

Equitable compensation is only available for breaches of fiduciary duty that cause loss to the principal. Equity's remedial interest is to restore the principal to the position that should have existed, had the duty been performed properly and without conflict. This is achieved by making good whatever losses the principal suffers due to the fiduciary's conflicted position.

However, the issue of loss is not open-ended. It is limited to the loss that is caused by a breach of the conflicts rule. The plaintiff is restored only to the extent the fiduciary's conflict has impacted upon the transaction in question. There is a necessary causal link between the fiduciary's conflict and the damage suffered. Other losses are not referrable to breach of fiduciary duty. The fiduciary's conflict is cured when the effect of the conflict is removed from the transaction. The principal is approximately placed in position as if the duty has been properly performed.

One older decision, *Brickenden v. London Loan & Savings Co.*[79] is often cited as authority for the proposition that a fiduciary bears absolute responsibility for losses incurred following a failure to make full disclosure to the principal, without the need to show causation.[80] *Brickenden* has been applied by various courts,[81] but

---

[78] If rescission is unavailable because *restitutio in integrum* is not possible, it is clearly unjust to deny the principal some remedy. The principal should be able to recover pecuniary rescission. This is arguably one of the explanations of *McKenzie v. McDonald* [1927] V.L.R. 134.

[79] [1934] D.L.R 465 [*Brickenden*].

[80] *Brickenden* concerned a solicitor who engineered a loan for a borrower from his client, a loan company. The borrower already owed the solicitor money, and the amount borrowed from the loan company was to be used in part by the borrower to repay the solicitor. The solicitor did not disclose his interest in the matter, (and in fact, actively induced the client's entry into the transaction). The solicitor was held liable to compensate the loan company for the full amount it advanced to the borrower.

[81] For *e.g.*, *Commonwealth Bank of Australia v. Smith* (1990) 102 A.L.R 453; *Hill v. Rose* [1990] V.R. 129.

distinguished by others,[82] and has been the subject of academic criticism.[83] It is now common to interpret *Brickenden* in a manner that limits its extreme application.[84] Despite the refusal of the Australian High Court to overrule *Brickenden* in the 1997 decision *Maguire v. Makaronis*,[85] subsequent Australian courts have been reluctant to apply its extreme view of causation.[86] *Brickenden's* position in England is also uncertain. Never technically binding,[87] it has not been explicitly denied, but is perhaps under even greater threat than in Australia. It is extremely hard to align with the important House of Lords decision, *Target Holdings Ltd. v. Redferns,*[88] with which it is arguably inconsistent.[89] In *Swindle v. Harrison*[90] all three members of the Court of Appeal preferred *Target's* general "but for" causation test to the supposed width of *Brickenden*. The 1934 *Brickenden* decision may be reaching the end of its useful life.[91]

More recent cases show that there is a discernable causation standard applied for breaches of the conflicts rule:

> A primary inquiry to be made by each court of equity faced with a fraud is not, How much will roughly compensate the plaintiff for the harm he has suffered? It is, what exactly would have happened between the parties had the defendant not been fraudulent? When the answer is settled, the consequences of that are made to follow anyway. Equitable frauds which come to light are never consummated with success.[92]

Equity intervenes in cases of breach of the conflicts rule, not to strip the defendant of any gain, but to remove the effect of the defendant's conflict. When the effect of the conflict is removed, it is as if the defendant's fiduciary duty has been performed properly. Loyal performance is thus approximated. Equitable compensation for breach of the conflicts rule is therefore necessarily limited to an amount required to remove the effect of the defendant's conflict. This determines causation. Only the loss caused by the fiduciary's conflict is recoverable.[93] Causation is frequently said

---

[82] For *e.g.*, *White v. Illawarra Mutual Building Society* [2002] N.SW.C.A. 164.

[83] J.D. Heydon, "Causal Relationships Between a Fiduciary's Default and the Principal's Loss" (1994) 110 Law Q. Rev. 328.

[84] See *e.g. Whitten-Hannah v. Davis* [1995] 2 N.Z.L.R. 141; *Everist v. McEvedy* [1996] 3 N.Z.L.R. 348; *Swindle v. Harrison* [1997] 4 All E.R. 705 at 717 *per* Evans J; *Beach Petroleum N.L. v. Kennedy* (1999) 48 N.S.W.L.R. 1.

[85] (1997) 188 C.L.R. 449.

[86] See *Aequitas Ltd. v. AEFC Leasing Pty. Ltd.* (2001) 19 A.C.L.C. 1006; *Re HIH Insurance Ltd. (in prov liq)*; *Australian Securities and Investments Commission v. Adler* (2001) 41 A.C.S.R. 72 at 235-236; *White v. Illawarra Mutual Building Society* [2002] N.S.W.C.A 164.

[87] It was a decision of the Privy Council, on appeal from Canada.

[88] [1996] 1 A.C. 421.

[89] *Contra* J. Getzler, "Inconsistent Fiduciary Duties and Implied Consent", (2006) 122 Law Q. Rev. 1 at 5.

[90] [1997] 4 All E.R. 705.

[91] The difficulties with and limitations of the *Brickenden* decision are discussed in the author's doctoral thesis, "Equitable Compensation in Australia: Principles and Problems", submitted to the Faculty of Law, Monash University, 15 December 2004, at 178-193.

[92] L.A. Sheridan, *Fraud in Equity,* (London: Sir Isaac Pitman & Sons, 1957) at 186-187.

[93] This can be explained by reference to an example. In *Stewart v. Layton* (1992) 111 A.L.R. 687, a solicitor acted for both a vendor and purchaser in a conveyance. When a conflict arose, he had to refer the vendor to another solicitor. However, before a new solicitor could take over the file, the first solicitor came into relevant information, which he failed to disclose to the vendor. Lack of the relevant information resulted in the vendor providing the purchaser with finance; the solicitor was held liable for losses resulting from

to be determined according to the "but for" standard: the question is whether the loss would have occurred but for the defendant's breach. However, the term "but for" is misleading, unless coupled with words indicating the nature of the duty breached. "But for the fiduciary's breach" is better expressed as "but for the fiduciary's unresolved conflict of interest". Once this is cured, the situation obtained is "as if" the duty not to suffer a conflict to continue has been performed.

> The rubric "breach of fiduciary duty" has come to encompass so many different types of liability that it is not now possible to determine the appropriate remedy by defining the wrong simply as a "breach of fiduciary duty". It is necessary, instead, to look through the categorisation of the wrong as a "breach of fiduciary duty" to the true nature of the wrong, and to move from there to determination of the remedy.[94]

Therefore, focus must be on the breach of the conflicts rule. Seen in this light, causation causes fewer difficulties. Only the effect of the conflict should attract equitable remedies. If there are any further losses outstanding, they must be remedied via other arms of the law, if at all. The loss that is referable to the effect of the conflict is remedied strictly; the fiduciary can be said to be liable upon a "but for" basis.

D. *Is the Causation Standard for Breach of the Conflicts Rule Justified?*

The purpose of the conflicts rule is to guard against fiduciaries placing the principal's interests at risk through a preference for other interests. If the fiduciary discloses the conflict prior to damage arising, the principal may either choose to accept the conflict and the associated risk by giving consent, or terminate the relationship. If a principal is prepared to continue in a relationship with knowledge of the conflict, he or she has no grounds for complaint.

The situation is different if the principal does not discover the conflict until after the relevant damage has occurred. Once the very thing guarded against has happened, the causation test currently used is the only appropriate test for selection. It is the only causation standard that can approximate loyal performance. The principal must be put in the position he or she would have occupied had the fiduciary acted without conflict. This is not so much a matter of prophylaxis, or the deterrence of others. It is the restoration of the principal to the position he or she would have been in, had the fiduciary been loyal.

This is the appropriate causation standard for breaches of the conflicts rule, because it is the only standard that can achieve an approximately loyal outcome after loss has been incurred. Had the fiduciary performed loyally, the principal's interests would not have been placed at risk, and loss would not have followed. The "but for" standard is the only causation standard that can restore the principal to the position that would have existed had the fiduciary acted loyally. There is no case for the "no causation" test of the profits rule. A "no causation" test would make the

---

that aspect of the matter. However, he was not held liable for the losses that flowed from the purchaser's inability to settle in the first place. Those losses would have occurred regardless of the solicitor's position of conflict.

[94] *Canson Enterprises Ltd. v. Boughton & Co.* 61 D.L.R. (4th) 732 at 737.

fiduciary the principal's insurer against all loss.[95] This is both potentially unjust, and counterproductive. Few would willingly take on responsibilities that might be regarded as fiduciary obligations under such a system.

V. Different Causation Standards

The causation standard when compensation is sought after breach of the conflicts rule is therefore different to the causation standard applicable to breaches of the profits rule. This is graphically illustrated by the *Gwembe* case. The Court of Appeal was in no doubt that there was no extra element of causation to be established between a fiduciary breach and the stripping of profit.[96] On the other hand, the Court was not prepared to apply the same standard to the question of compensation for loss. In such a case:

> [T]he court is not precluded by authority or principle from considering what would have happened if the material facts had been disclosed. If the commission of the wrong has not caused loss to the company, why should the company be entitled to recover compensation, as distinct from rescinding the transaction and stripping the director of the unauthorised profits made by him? …In our judgment, a director is not legally liable for loss, which the company would probably have suffered, even if the director had complied with the fiduciary-dealing rules on disclosure of interests.[97]

It is suggested that the two causation standards are not usefully conflated. Likening them to each other leads to the kind of arguments presented by the defendants in *Gwembe* and *Murad*. In those cases the gist of the argument was that, as some profit would have been made "but for" the fiduciary's breach of the profits rule, the causation test applied to breaches of the conflicts rule should have been applied; this would suggest that not all of the profit should have been recoverable. This is confused thought. It does not give due deference to the duality of fiduciary obligations, and fails to appreciate the different causation standards applicable. The decision in *Gwembe* clearly demonstrates the failings of such an argument, and in neither *Gwembe* nor *Murad* did the Court of Appeal endorse such an approach. In both cases, all of the profit was liable to confiscation.

It is not uncommon for this sort of confusion to arise in the field of fiduciary law. Arden L.J.'s judgment in *Murad* provides an obvious example. Her Ladyship chose to "highlight two well-established points about the reach of the equitable remedies."[98] She continued by stating the following propositions:

> (1) the liability of a fiduciary to account does not depend on whether the person to whom the fiduciary duty was owed could himself have made the profit.
> (2) when awarding equitable compensation, the court does not apply the common law principles of causation.[99]

---

[95] Recovery of all transactional losses should only be available if the fiduciary's conflict caused the principal's *entry* into the transaction, if "but for" the fiduciary's conflict, the principal would have attracted none of the risk. *Hodgkinson v. Simms* [1994] 3 S.C.R. 377 can be explained on this basis.

[96] *Supra* note 1 at paras. 144-145.

[97] *Ibid.* at para. 147.

[98] *Supra* note 2 at para. 59.

[99] *Ibid.*

This coupling was criticised by Clarke L.J. His Lordship did "not think that the correct approach to the taking of account is to be determined by reference to the principles relevant to the test of causation in respect of equitable compensation for loss."[100] Therefore, his Lordship thought that the second proposition mentioned above was not relevant to the question of whether the fiduciary could argue that he should not be compelled to disgorge the whole profit.[101] In this, his Lordship was correct. It is no doubt preferable to keep the two fiduciary rules, and their respective causation standards, separate. Including discussion of causation when accounts of profits are sought is largely misleading.

VI. Conclusion

These recent cases indicate that causation in respect of breach of a fiduciary obligation should not cause confusion. The court must first consider the relationship between the parties. Invariably, the fiduciary will owe the principal non-fiduciary duties, which do not affect and are not affected by the fiduciary duties owed. The scope of the non-fiduciary relationship between the parties allows the court to determine the scope of the fiduciary duties, that is, the factual matrix to which the profits and conflicts rules can apply. Within that scope, the fiduciary must not make an unauthorised profit, and must not allow a conflict to continue. The rule against unauthorised profits is strict; only those profits that are authorised are immune from confiscation. There is no *extra* requirement of a causal link between the fiduciary duty and the profit.

Where the conflicts rule has been breached, different considerations apply. There is no automatic assumption that conflict is causative of loss. When a loss arises in the context of a conflict, causation is shown according to the "but for" standard. The principal must be placed in the position he or she would have occupied had the duty been performed without conflict. The question is: "but for the breach of the conflicts rule, what position would the principal have occupied?"

These causation standards naturally reflect the different rules they address. With breaches of the profits rule, the question is not whether the breach of the profits rule caused the making of the profit. Instead it is limited to asking whether the profit made in the context of a fiduciary relationship was authorised or not. If a loss is made in the context of a fiduciary conflict, causation addresses how much of the loss is referable to the fiduciary's conflict. If the loss would not have been made "but for" the disloyal performance, then equitable compensation is available.

This article suggests that the causation standards applied are appropriate. They each reflect equity's attempt to approximate loyal performance of the duties that the fiduciary owes. For breaches of the conflicts rule, this means compensation for losses causally linked to the fiduciary's conflict. For breaches of the profits rule, this automatically means recovery of all of the profit, subject to allowances for skill, care and expertise made at the court's discretion. They are the only appropriate standards for each breach, because they provide the best method for approximating loyal performance of the particular duty owed after a breach has occurred.

---

[100] *Ibid.* at para. 137.
[101] *Ibid.*