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FIDUCIARY DUTIES AND PROPRIETARY REMEDIES: ADDRESSING THE FAILURE OF EQUITABLE FORMULAE

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ABSTRACT. *This article proposes a new framework for determining the availability of proprietary remedies for breach of the fiduciary duty of loyalty. It examines the alternative and conflicting arguments put forward in the leading cases, and suggests that they fail to justify their conclusions, either under- or over-estimating the incidence of proprietary relief for fiduciary disloyalty. These shortcomings appear to be the result of inappropriate reliance on familiar equitable formulae, in particular the routine equitable duty to account, the seemingly inescapable maxim that "equity treats as done that which ought to be done", and the potent rules of tracing.*

KEYWORDS: *Fiduciaries; conflict of duty and interest; bribes; proprietary remedies.*

I. RIGHTS AND REMEDIES

The law on fiduciaries is in something of a mess. This is now most obvious with proprietary remedies for disgorgement of fiduciary gains,[1] although problems also exist elsewhere.[2] Since so much private and commercial activity is now managed by fiduciaries, it is imperative that we have robust rules which indicate precisely what the fiduciary role requires and what consequences will follow from any shortfalls.

This article seeks to provide a simple path through the terrain. It revisits the fundamental doctrines associated with fiduciaries and with proprietary remedies, and advances a systematic structure for the analysis of proprietary and personal remedies for the disgorgement

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[1] See especially *Sinclair Investments (UK) Ltd. v Versailles Trade Finance Ltd (in admin rec)* [2011] EWCA Civ 347 (CA) ("*Sinclair*"); and *FHR European Ventures LLP v Mankarious* [2013] EWCA Civ 17 (CA) ("*Mankarious*"). Also see *A.G. for Hong Kong v Reid* [1994] 1 A.C. 324 (PC) ("*Reid*") and *Lister & Co. v Stubbs* (1890) L.R. 45 Ch. D. 1 (CA) ("*Lister*"). Also see Lord Millett, "Bribes and Secret Commissions Again" [2012] C.L.J. 583.

[2] The scope of the fiduciary's role and of tracing into secondary profits are also discussed here. The range of individuals subjected to fiduciary obligations is not considered.

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of fiduciary gains. In so doing, it highlights a number of dangerous pitfalls arising out of the lax use of some of our most common equitable formulae. In particular, it identifies how the equitable duty to account, the maxim that "equity treats as done that which ought to be done", and the use of tracing to access investment gains have each, in different ways, contributed to the troubles which now beset this area.

We need rules which enable us to provide clear answers to simple questions. At the most basic level, if the director of a haulage company buys an adjacent high-rise development site on his own account, we need to know what difference it makes to the question of breach, and to the remedies for breach, that the sale was publicly advertised or offered privately to the company, or that the director used only his own resources or alternatively made use of the company's assets in the development endeavour, or that the company was looking to expand its premises, or even that it simply made business sense to acquire such a well-located site. At the moment the answers are far from clear.

The model proposed here emerges out of the foundational rules on fiduciary loyalty. On careful analysis, these rules suggest that there are only three doctrinally distinguishable categories of disloyal gain which a fiduciary might be required to disgorge:

(1) gains derived from any use of the principal's property;
(2) gains derived from opportunities which are within the scope of the fiduciary's field of endeavour on the principal's behalf;
(3) gains derived from opportunities which arise solely because of the fiduciary's role.

These three categories require further elaboration so that their content is clear, but the facts of any case can then be easily and predictably classified. These categories provide a simple analytical hierarchy. If a gain falls within categories (1) or (2), then the resulting disgorgement remedy is proprietary. If the gain is outside those categories, but within category (3), then the disgorgement remedy is personal. If the gain is outside all three categories, then the fiduciary has not behaved disloyally and the gain need not be disgorged at all.

The assertion that remedies are proprietary in categories (1) and (2) requires careful argument. The conclusion cannot be built on the fiduciary's mandatory obligation to disgorge nor on property analogies in describing the gains, despite earlier efforts in that direction. What is needed once again is a detailed consideration of the role and function of the rules on fiduciary loyalty. These fiduciary rules are proscriptive not prescriptive: they insist that the fiduciary *must not* make disloyal gains; they do not prescribe what the fiduciary *must* do. This matters where remedies are concerned, and indeed it is here that lax use of equitable formulae has been especially problematic. In particular, we

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might consciously notice that proprietary remedies are generated by operation of law only when it can be said not only that the defendant must *not* have the property, but also that the claimant *must* have it. This is a far tougher test, but one that is implicitly adhered to in all cases of constructive trust outside the context of fiduciary gains. Consistency demands its application here too. It follows that the proscriptive fiduciary disgorgement rules cannot of themselves provide the necessary underpinning for proprietary remedies. But there is a twist. Given the purpose and function of the fiduciary relationship, choices *actually* made by the fiduciary have consequences. Then the principal can sometimes make out the additional requirement for a proprietary claim. As it turns out, that is possible with category (1) and (2) gains, but not with category (3) gains.

In short, this article has two objectives: one specific, which attempts to articulate a workable approach to proprietary remedies for a fiduciary's breach of the duty of loyalty, an approach which is inherently applicable to all proprietary remedies; and one wide-ranging, which questions the modern and often inappropriately mechanical use of some of our more familiar equitable formulae.

In delivering these ends, the first section sets out the status quo. The second revisits favoured explanations of fiduciary loyalty. The goal is to extract a more compelling classification of the paradigm fact patterns of fiduciary breach which will deliver either proprietary or personal remedies. The next section looks at particularly contentious equitable formulae, and proposes a more thoughtful and careful use of their powerful mechanisms. The final section summarises the revised rules which might, if adopted, deliver predictable and defensible answers to the perennial question of when the remedy for fiduciary disloyalty is proprietary.

II. The Current State of Play

For almost two decades, the remedies for fiduciary disloyalty seemed well-settled although perhaps not well-liked.[3] But the English Court of Appeal in *Sinclair v Versailles*[4] (the facts are footnoted) upset

[3] See *Mankarious* [2013] EWCA Civ 17 at [79] (Etherton C.) affirming the widely held view that *Reid* [1994] 1 A.C. 324 would be followed notwithstanding its merely persuasive authority. On the critics and supporters, see *Sinclair* [2011] EWCA Civ 347 at [81]–[82] (Lord Neuberger); *Mankarious* [2013] EWCA Civ 17 at [15] (Lewison L.J.); *Sinclair Investments (UK) Ltd. v Versailles Trade Finance Ltd. (in administrative receivership)* [2010] EWHC 1614 (Ch) at [50]–[52] (Lewison J.); Millett [2012] C.L.J. 583.

[4] *Sinclair* [2011] EWCA Civ 347. In summary, the principals' money (held by the fiduciary on trust) was used by the fiduciary in an unauthorised and elaborate Ponzi scheme. The money was not exchanged, but was used to give the impression of substantial trading activity in various companies in which the fiduciary had an interest. As a consequence, the share price in those companies escalated, and the fiduciary was able to sell shares for a price in excess of £28 million when their real value was probably nil. It was conceded by both sides that this profit, and its

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complacencies by delivering a carefully considered judgment which reverted to earlier orthodoxies, insisting that its stance was not only required by precedent, but was amply justified on the grounds of both principle and policy.[5]

Predictably, the decision reignited old debates surrounding the protections accorded to parties who leave their affairs in the hands of fiduciaries.[6] All agree that the fiduciary cannot keep the disloyal profits; they must be paid over to the principal.[7] The fiduciary must "account in equity". The Privy Council in *A.G. for Hong Kong v Reid*[8] had suggested that it then followed, from the very nature of things, that such a remedy would be proprietary if the gain was identifiable, since "equity treats as done that which ought to be done".[9] This had been the dominant view for decades, both in England and in many commonwealth jurisdictions. It was a view which had explicitly rejected an earlier Court of Appeal decision in *Lister & Co. v Stubbs*[10] which held that proprietary remedies would lead to such unacceptable consequences for third parties that they could not possibly represent the law. In short, at least in relation to bribes, *Reid* took one firm view of what ought to be done, and *Lister* another; commentators were divided.[11]

traceable proceeds including the sale proceeds from a house purchased with the funds, represented an unauthorised fiduciary gain for which the fiduciary was accountable to the principals. The principals claimed the remedy was proprietary. The Court of Appeal held it was not. This was fatal to the principals' claim, since the funds/traceable proceeds had been paid over to banks, including banks with the security of a floating charge. Had the principals' claim been proprietary, the principals would only have been successful against the banks if the banks were not bona fide purchasers without notice. Although the fiduciary's profits were not by way of bribe, the case was argued on the basis that if current law was to the effect that a bribe was held on constructive trust, then this gain too would inevitably be held on constructive trust. Equally, it seems to have been conceded that if a bribe would not be held by fiduciary on constructive trust, then nor would these gains. As a consequence, the argument focused entirely on whether *Reid* [1994] 1 A.C. 324 or *Lister* (1890) L.R. 45 Ch. D. 1 provided the right legal analysis of the problem.

5 *Sinclair* [2011] EWCA Civ 347, especially [76]–[84].

6 See note 24 below for the detail, but in favour of *Sinclair*: R. Goode (2011) 127 L.Q.R. 493; G. Virgo [2011] C.L.J. 502; W. Swadling, (2012) 18 *Trusts and Trustees* 985; J.E. Penner (2012) 18 *Trusts and Trustees* 1000. Against: D. Hayton (2011) 127 L.Q.R. 487; P. Millett [2012] C.L.J. 583; L. Smith [2013] C.L.J. 260; *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6 (FCAust Fed Ct).

7 The fiduciary's bona fides are irrelevant; so too is the fact that a principal may receive a completely unexpected windfall: *Boardman v Phipps* [1967] 2 A.C. 46 (H.L.) ("*Boardman*") is usually cited by way of illustration.

8 *Reid* [1994] 1 A.C. 324. A public prosecutor in Hong Kong took bribes to "lose" files, thus subverting prosecutions. The bribes were used to buy houses in New Zealand, held in the names of the fiduciary's wife and solicitor. The Privy Council held that the fiduciary (or his wife or solicitor) held the bribes or their proceeds on constructive trust for the Crown.

9 *Reid* [1994] 1 A.C. 324, 331. If it makes a difference, Lord Millett has added a further gloss to this, suggesting that the conclusion can be justified on the basis that the breach was not the fiduciary's receipt of the bribe, but the failure to hand it over: "Restitution and Constructive Trusts" (1998) 114 L.Q.R. 399, 407. Also see "Proprietary Restitution" in S. Degeling and J. Edelman (eds.), *Equity in Commercial Law* (Sydney 2005), 309ff at 324.

10 *Lister* (1890) L.R. 45 Ch. D. 1. In *Lister & Co. v Stubbs*, an agent took bribes from the vendor in return for contracts with his principal. The Court of Appeal held that the agent was personally liable to the principal for the value of the bribe only, and neither the bribe nor its successful investment proceeds were held on constructive trust for the principal.

11 See above, especially notes 3 and 6.

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The debate needed firm resolution, and in *Sinclair v Versailles*,[12] the Court of Appeal refused to follow *Reid*, affirmed *Lister v Stubbs*, and limited the circumstances in which a constructive trust could be imposed over fiduciary gains to cases where the gain was derived either from the disloyal fiduciary's use of the principal's assets (category 1) or from opportunities or rights which were "beneficially"[13] or "properly [those] of"[14] the principal (category 2). The property analogies are plain.[15] By contrast, *Reid* had focused on obligation, and insisted the remedy was proprietary, and inevitably so, by virtue of the mandatory disgorgement obligation owed by the fiduciary.[16] Dramatically different outcomes followed: in relation to bribes, *Sinclair* and *Lister* insisted the remedy was personal; *Reid* insisted it was proprietary.

The difference matters because all sides are agreed that *if* the principal's remedy is proprietary then it carries with it a number of significant advantages. Most obviously, it gives the principal insolvency protection as against the fiduciary's creditors.[17] It also entitles the principal to trace into any identifiable exchange products and to assert a proprietary interest in those too.[18] And, finally, it entitles the principal to follow the bribe or its traceable proceeds into the hands of any third party recipients who are not bona fide purchasers for value without notice of the principal's interest, and to assert the principal's proprietary interest as against those third parties.[19] All this significantly privileges the principal, and all these benefits are contingent on the initial claim to the disloyal profits being proprietary.[20]

The clash between *Sinclair* and *Reid* has been further fuelled by the latest Court of Appeal decision on this issue. In *FHR European Ventures LLP v Mankarious*,[21] the Court purported to follow *Sinclair*, as it must, but concluded, on facts which appear materially indistinguishable from *Lister*, that the remedy was proprietary, and deservedly so as a matter of both precedent and policy. Given this

[12] *Sinclair* [2011] EWCA Civ 347, affirming Lewison J., [2010] EWHC 1614 (Ch).
[13] *Sinclair* [2011] EWCA Civ 347 at [88], [89].
[14] *Sinclair* [2011] EWCA Civ 347 at [88].
[15] They are analogies by way of language only: Lord Neuberger never once suggested that an opportunity *is* property.
[16] *Reid* [1994] 1 A.C. 324, 331.
[17] Being both its unsecured creditors *and* those holding charges (whether taken before or after receipt of the bribe). Chargees are caught since, if the disgorgement remedy is proprietary, and applying the analysis in *A.G. for Hong Kong v Reid*, the bribe would be held by the fiduciary on constructive trust for the principal from the instant it is received by the disloyal fiduciary. In those circumstances, an earlier charge on the fiduciary's assets would have nothing to bite on, and a subsequent charge would of course lose out under the normal rules of priority.
[18] Being profits generated by successful investment of the bribe: see the investments in land in both *Reid* [1994] 1 A.C. 324 at note 8 above; and *Sinclair* [2011] EWCA Civ 347 at note 4 above.
[19] See *Reid* [1994] 1 A.C. 324 at note 8 above, and the claims against the fiduciary's wife and solicitor.
[20] It is a separate question whether, if the claim to the bribe is personal only, there might nevertheless be a further personal claim to secondary profits: *Sinclair* [2011] EWCA Civ 347 at [90]–[91] suggests yes; *Lister* (1890) L.R. 45 Ch. D. 1 suggests no, both by way of dicta only. Also see below.
[21] *Mankarious* [2013] EWCA Civ 17.

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stand-off, proponents of one camp need to do a lot more work to persuade proponents of the other. The issue is thus ripe for Supreme Court analysis.[22]

The right answer cannot be gleaned simply by recourse to precedent[23] or to the eminence of academic support:[24] both sides are impressively well-matched. Both sides can also call into play compelling (and often common) policy concerns in advancing their conflicting causes.[25] Nor can the right answer be gleaned from international practice. Much might be made of the fact that the Court of Appeal appears to have set its face against the rest of the common law world,[26] but here appearances belie the facts. These comparator countries typically regard the constructive trust as "remedial",[27] and just when proprietary consequences really matter those courts may well decide that a proprietary remedy should be denied.[28] On insolvency, but also more

[22] *Mankarious* [2013] EWCA Civ 17 at [116] (Etherton C.).

[23] *Sinclair* [2011] EWCA Civ 347, details the authorities favouring *Lister*; Millett [2012] C.L.J. 583 details those favouring *Reid*, including international authorities. Also see notes 3 and 6 above and 24 below, and the references cited there.

[24] For example, in favour of *Reid*, see: P. Millett, "Bribes and Secret Commissions" [1993] R.L.R. 7 (relied upon by the Privy Council in *Reid* itself), and subsequently, e.g. in Sir Peter Millett, "Remedies: The Error in *Lister v Stubbs*" in P. Birks (ed.), *The Frontiers of Liability: Vol I* (Oxford 1994), pp. 51ff at p. 56 and "Proprietary Restitution" in S. Degeling and J. Edelman (eds.), *Equity in Commercial Law* (Sydney 2005), ch. 12 at pp. 312–319; D. Hayton, "Proprietary liability for secret profits" [2011] 127 L.Q.R. 487; and the majority of text books, although a good number rather briefly, and on the basis that *Reid* likely represented the current state of the law: as cited in *Sinclair* [2011] EWCA Civ 347 at [82], see e.g. *Goff & Jones, The Law of Restitution* (7th ed, 2007), para. 33–025, *Underhill & Hayton, Law of Trusts and Trustees* (18th ed, 2010), paras. 27.29–27.30, *Lewin on Trusts*, (18th ed, 2008), p. 589; and *Snell's Equity*, (32nd ed, 2010), paras. 7–041-7–042; but in contrast also see *Bowstead & Reynolds on Agency*, (19th ed, 2010), paras. 6–040-6–043.

And in favour of *Lister v Stubbs*: P. Birks, *An Introduction to the Law of Restitution*, revd ed. (Oxford 1989), at pp. 386–389; R.M. Goode, "Proprietary liability for secret profits – a reply" [2011] 127 L.Q.R. 493, and earlier in "Ownership and Obligation in Commercial Transactions " (1987) 103 L.Q.R. 433; "Proprietary Restitutionary Claims "in W. Cornish et al (eds.), *Restitution: Past, Present and Future* (Oxford 1998), ch. 5; "Property and Unjust Enrichment" in A. Burrows (ed.), *Essays on the Law of Restitution* (Oxford 1991), 215; "The Recovery of a Director's Improper Gains: Proprietary Remedies for the Infringement of Non-Proprietary Rights" in E. McKendrick (ed.), *Commercial Aspects of Trusts and Fiduciary Obligations* (Oxford 1992), 137. In addition, see: G. Virgo, *The Principles of the Law of Restitution* (2nd ed, Oxford 2006), 519–524; A. Burrows, *The Law of Restitution* (2nd ed, Oxford 2002), 500, and also at (2001) 117 L.Q.R. 412, 427; and A. Tettenborn, *The Law of Restitution in England and Ireland*, 3rd ed. (London 2001), 231–233; P. Watts, "Bribes and Constructive Trusts " (1994) 110 L.Q.R. 178; D. Crilley, "A Case of Proprietary Overkill " [1994] R.L.R. 57; G. McCormack, "The Remedial Constructive Trust and Commercial Transactions " (1996) 17 *Co. Lawyer* 3.

Also see A.D. Hicks, "The Remedial Principle of *Keech v Sandford* Reconsidered" [2010] C.L.J. 287; S. Gardner, "Two Maxims of Equity" [1995] C.L.J. 60, and the references cited in note 6 above.

[25] See especially the policy arguments relating to insolvency concerns in *Lister*, *Reid* and *Sinclair*, all at note 1 above.

[26] See the details in Millett [2012] C.L.J. 583. Also see especially *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6 (FCAust Fed Ct), handed down after *Sinclair*, and with the judgment given by Finn J, the author of *Fiduciary Obligations* (Sydney 1977).

[27] *Mankarious* [2013] EWCA Civ 17 at [13] (Lewison L.J), and [76] (Etherton C.). For the possibility of this in the future in English law, see *Westdeutsche Landesbank Girozentrale v Islington L.B.C.* [1996] A.C. 669 (H.L.) ("*Westdeutsche*"), 716 (Lord Browne-Wilkinson).

[28] See *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6 (Full Ct Aust Fed Ct), at [583] (Finn J): "…to accept that money bribes can be captured by a constructive trust does not mean that they necessarily will be in all circumstances. As is well accepted, a constructive trust ought not

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generally, this discretionary approach to proprietary entitlements has little to recommend it. In short, these international comparisons make it plain that what is really in issue is not the outcome in these cases, but the rationale for delivering it.

If this potted history tells is anything, it is that we have not yet articulated a truly compelling legal rule. Some commentators doubt we ever will, especially after all this time and rather unrelenting debate.[29] Rather going against that counsel of despair, and as indicated in the introduction, I suggest there *is* a different route through the proprietary remedy minefield. It is one that gives proprietary remedies a greater role than *Sinclair* admits, although not the universal role *Reid* envisages.

III. The Paradigm Fact Patterns in Fiduciary Disloyalty: Asking the Right Questions

In defining the proprietary incidents of a fiduciary's liability to disgorge the profits of disloyal conduct, there is an obvious need to categorise the factual situations to which solutions are needed. The simplest possible approach would be to have one category only, and see disgorgements of fiduciary gains as either *always* proprietary (as in *Reid*[30]) or *always* personal.[31] Such simplicity has its own inherent attractions, but if the ongoing debate in this area tells us anything, it is that this will not do. As the previous section indicates, no jurisdiction has found it attractive and uncontroversial to adopt either extreme. Moreover, the doctrinal shortcomings inherent in either of these simple options emerge clearly from the analysis proposed below.

Equally, two categories will not do. It is evident from *Sinclair v Versailles*, and indeed from all the cases before and since, that there is no accepted opposition between cases where the fiduciary uses the principal's property (universally conceded to deliver proprietary consequences[32]) and all other instances of fiduciary disloyalty, with proprietary remedies for the former but not the latter. There is some

to be imposed if there are other orders capable of doing full justice … Such could be the case, for example, where a bribed fiduciary, having profitably invested the bribe, is then bankrupted and, apart from the investment, is hopelessly insolvent. In such a case a lien on that property may well be sufficient to achieve "practical justice" in the circumstances. This said, a constructive trust is likely to be awarded as of course where the bribe still exists in its original, or in a traceable, form, and no third party issue arises." Also see [582].

[29] Put rather pithily, it has been suggested that in these unenviable circumstances it might at least "be useful to have a judgment in English law which is right because it is final [as] there is precious little prospect of agreement on a judgment that is final because it is right.": R. Nolan, "Bribes: a reprise" (2011) 127 L.Q.R. 19, 23.

[30] *Reid* [1994] 1 A.C. 324, 331.

[31] See, e.g., Swadling, note 6 above, decrying an immediate trust.

[32] Except perhaps Swadling, note 6 above.

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intermediate category, not clearly defined, where the fiduciary's principal is also entitled to privileged proprietary protection.

As noted earlier, Lord Neuberger in *Sinclair v Versailles* defined it thus: proprietary remedies are available where the gain is derived *either* from the disloyal fiduciary's use of the principal's assets (category 1) *or* from opportunities or rights which were "beneficially"[33] or "properly [those] of"[34] the principal (category 2); otherwise the remedies are merely personal (category 3). This classification uses the language of property to define the intermediate or second category, and that implicitly justifies the further consequence that disgorgement in this category is proprietary.[35] But this classification system faces two problems. First, opportunities are not property,[36] so we need to find some alternative and independent justification for the proprietary consequences which attach to this category. And, secondly, the boundary between this second category and the third non-proprietary category is most unclear.[37] This will not do. Without clear boundaries, the classification system loses its practical value as a tool for distinguishing one class of cases from another. There are far too many fiduciary cases where it is this very question which is in issue.

Perhaps surprisingly, the classification difficulties on this scheme are apparent even in relation to bribes and secret commissions, long considered the simplest of cases to classify. In *Sinclair* itself, the *Lister* and *Reid* bribe cases were regarded as clearly in category 3. By contrast, in *Mankarious*, using the same set of categories, the secret commission was equally clearly regarded as falling within category 2.

These problems are inordinately greater in the fiduciary "opportunity" cases. The analysis in *Sinclair* makes it plain that category 2 is small, but which small class of opportunities falls into category 2 and which into category 3? The dividing line is too ill-defined even to be sure how the paradigm cases of *Keech v Sandford*,[38] *Cook v Deeks*,[39] *Boardman v Phipps*[40] and *Regal (Hastings) Ltd. v Gulliver*[41] should

[33] *Sinclair* [2011] EWCA Civ 347 at [88], [89].

[34] *Sinclair* [2011] EWCA Civ 347 at [88].

[35] Although without ever asserting that an opportunity *is* property: Lord Neuberger would not make that mistake.

[36] See especially *Mankarious* [2013] EWCA Civ 17 at [57] (Lewison L.J.) and [84] (Etherton C.) and the references cited there. Also see R.P. Austin, "Fiduciary Accountability for Business Opportunities" in P.D. Finn (ed.), *Equity and Commercial Relationships* (Sydney 1987), ch. 6.

[37] *Mankarious* [2013] EWCA Civ 17 at [83]–[84] (Etherton C.).

[38] (1726) Sel. Cas. Ch. 61, expressly regarded in *Sinclair* as category (1), with a proprietary remedy, since the opportunity to renew a lease could be regarded as a "perpetual estate" belonging to the principal: *Sinclair* [2011] EWCA Civ 347 at [58].

[39] [1916] 1 A.C. 554 (P.C.), not mentioned in the judgment in *Sinclair*, but regarded by most as warranting a proprietary remedy, so therefore perhaps category (2).

[40] [1967] 2 A.C. 46 (H.L.), not classified in *Sinclair*, but the context suggests a personal remedy would be favoured by Lord Neuberger ([70]), so category (3). The remedy awarded in this case was in fact proprietary: see Millett [2012] C.L.J. 583 and *Mankarious* [2013] EWCA Civ 17 at [96].

[41] [1967] 2 A.C. 134 (H.L.) ("*Regal Hastings*"), not classified in *Sinclair*, but the context suggests a personal remedy would have been favoured by Lord Neuberger ([69]), so category (3). And indeed

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be classified. The difficulty is not that a given set of facts is amenable to classification under more than one head. That is readily resolved: the principal can simply pursue the most advantageous remedy. The problem is rather that it is impossible to say whether a given set of facts is or is not amenable to classification within the category *at all*.

Other commentators have sought to address this difficulty by tweaking this intermediate second category, and including in it only those opportunities which the principal *would* have obtained were they not intercepted by the fiduciary (termed deemed agency gains, and thus, it would seem, capturing *Cook v Deeks*,[42] but perhaps not the other paradigm cases mentioned above, and certainly holding *Lister* and *Reid* to be instances where the remedy should be personal),[43] or alternatively including in the category all those opportunities which the principal *could* have obtained were they not intercepted by the fiduciary (thus, it would seem, perhaps rather oddly excluding *Keech v Sandford*[44] – given the lessor's refusal to renew for the beneficiary – but perhaps capturing the gains in the other three paradigm cases, although that is not certain).[45] The problem with these refinements is not simply that they introduce further distinctions which are no more certain in their application to different sets of facts, but also that they leave too much control over the outcome in the hands of the defaulting fiduciary. This is precisely the problem which fiduciary rules and their remedies are designed to forestall. Disgorgement of gains is required whether or not the fiduciary acts in good faith, or honestly, and whether or not the principal could have or would have taken advantage of the opportunity in question. It would be odd, and most unsatisfactory, if the distinction between personal and proprietary disgorgement were then to turn on these quite elusive factual matters. Better that the distinction rest on other more durable and general features of the particular fiduciary role, and in particular the specific undertakings inherent in it. This is what is proposed below, with the consequence that a then redefined category (2) is dramatically larger than that proposed either in *Sinclair* or by the other commentators noted here.

a personal remedy was awarded in that case, although without argument, and indeed necessarily so since the disloyal benefit was cash (from the sale of the shares to the new owners), so there were probably no readily traceable proceeds over which to assert a constructive trust, and the trouble that might involve was in any event unnecessary since the directors in question were not insolvent.

[42] [1916] 1 A.C. 554 (P.C.).

[43] R. Goode, "Property and Unjust Enrichment" in A. Burrows (ed.), *Essays on the Law of Restitution* (Oxford 1991), ch. 9 at p. 230; and "Proprietary Restitutionary Claims", in W.R. Cornish et al. (eds.), *Restitution: Past, Present and Future* (Oxford 1998), 63. For other writings by Goode, see note 24 above. It might well be the case that Lord Neuberger's category 2 is merely a differently worded assertion of the same test as advocated by Professor Goode. Both clearly advocate a very small category 2.

[44] (1726) Sel. Cas. Ch. 61.

[45] S. Scott, "Corporate Opportunity Doctrine and Impossibility Arguments" (2003) 66 M.L.R. 852.

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In addition, Lord Neuberger leaves hanging the issue of what is to happen with secondary profits (typically profits generated from the successful investment of the initial disloyal fiduciary gains[46]). These too must be dealt with in a principled fashion. In *Reid*, their capture by proprietary means followed as a matter of course since the principal had a proprietary claim to the initial pre-investment fiduciary gain. In *Lister*, the diametrically opposite solution was deemed apt: a personal claim to the initial fiduciary gain did not generate a claim of any sort to its secondary or traceable investment profits. In *Sinclair*, the court proposed a third way. It agreed (obiter) that the fiduciary must be stripped of all the profits of the breach, but was uncertain as to how this imperative might lead to the automatic capture of secondary profits when the starting point was only a personal claim.[47] This issue must be dealt with properly. It does not require a fourth category, but it does require careful thought about the rules on fiduciary loyalty, and then a proper and limited use of the equitable tracing rules.

But return to the main problem. To work well, any classification system must not only provide more certain answers to the practical problem of classification of factual scenarios; it must also facilitate simple theoretical justifications for proprietary consequences in some categories but not in others. The scheme proposed here meets those twin needs. It also has the added advantage of clarifying the persistent problem of the disjunction between the two recognised limbs of the rules on fiduciary loyalty, the "no conflict" and "no profit" rules, a disjunction which is itself apt to confuse.

These twin fiduciary rules are described in innumerable cases and commentary. For now it is sufficient to take one much-cited illustration, from *Chan v. Zacharia*,[48] where Deane J. notes that the fundamental rule that obliges fiduciaries to account for disloyal gains has two separate themes,[49] commonly labelled the "no conflict rule" and the "no profit rule":

> The first is that which appropriates for the benefit of the person to whom the fiduciary duty is owed any benefit or gain obtained or

[46] E.g. the land in both *Reid* and *Sinclair*.

[47] *Sinclair* [2011] EWCA Civ 347 at [90]–[91].

[48] (1984) 154 CLR 178, 198, cited with approval in *Don King Productions Inc. v. Warren* [2000] Ch. 291 (CA) at [40], and in *Ultraframe (UK) Ltd. v Fielding* [2005] EWHC 1638 (Ch) ("*Ultraframe*") at [1305] (Lewison J.).

[49] Noting too, further in the same paragraph, that "Notwithstanding authoritative statements to the effect that the "use of fiduciary position" doctrine is but an illustration or part of a wider "conflict of interest and duty" doctrine (see e.g., *Phipps v. Boardman* [1967] 2 A.C. 46, 123; *N.Z. Netherlands Society "Oranjei" Inc. v Kuys* [1973] 1 W.L.R. 1126, 1129), the two themes, while overlapping, are distinct. Neither theme fully comprehends the other and a formulation of the principle by reference to one only of them will be incomplete." That is the approach adopted here, and implicitly adopted in a good number of English cases: see, e.g., *Don King Productions Inc. v. Warren* [2000] Ch. 291 (C.A.) at [40]; *Ultraframe*, ibid., at [1306] (Lewison J.); *In Plus Group Ltd. v. Pyke* [2002] 2 BCLC 201, 220.

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> received by the fiduciary in circumstances where there existed a conflict of personal interest and fiduciary duty or a significant possibility of such conflict: the objective is to preclude the fiduciary from being swayed by considerations of personal interest. The second is that which requires the fiduciary to account for any benefit or gain obtained or received by reason of or by use of his fiduciary position or of opportunity or knowledge resulting from it: the objective is to preclude the fiduciary from actually misusing his position for his personal advantage.

Although nothing turned on the particular language used here, nor was likely intended by it, it is notable that gains from the "no conflict rule" would be "appropriate[d] for the benefit of the person to whom the fiduciary duty is owed", whereas gains from the "no profit rule" would be subject "to account". The language is proprietary in the first instance, but personal in the second. This is the same divide identified by Newey J. in *Cadogan Petroleum plc v Tolley*,[50] where, re-wording and amalgamating the categories identified in *Sinclair*, he noted that:[51]

> As I see it, it is also apparent from *Sinclair* that a distinction is to be drawn between (a) the exploitation by a fiduciary of property or opportunities subject to fiduciary obligations and (b) other exploitation by a fiduciary of his position.

As it turns out, this distinction between "no conflicts" and "no profits" (or – more informatively – between "conflicts of duty and interest" and "misuse of position") does indeed appear to mark the long elusive crucial divide between proprietary and non-proprietary disgorgement. It is also a distinction which can be confidently applied to different factual contexts.

With these two categories as the new markers, the three categories proposed here are as follows, elaborating slightly on the outline in the introduction:

(1) gains derived from any use of the principal's property;
(2) gains derived from opportunities which are within the scope of the fiduciary's field of endeavour on the principal's behalf (i.e. gains involving "conflicts of duty and interest", judged with very careful regard to issues of scope for reasons explained below); and
(3) gains derived from opportunities which arise solely because of the fiduciary's role (i.e. gains typically described as arising from "misuse of position", but with that term defined precisely, as described below).

[50] *Cadogan Petroleum plc v Tolley* [2011] EWHC 2286 (Ch).
[51] Ibid., at [23].

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More needs to be said about each of these categories. In particular, something more needs to be said about what counts as "property" and "use of property" in category (1), and what counts as a "conflict of duty and interest" to bring a case within category (2). Both of these issues have created problems in modern fiduciary law.

The important question for now, however, is why this division should carry the day where others have failed to persuade. The answer, unsurprisingly, takes us back to first principles in analysing fiduciary loyalty.

Fiduciaries are required to act in the best interests of their principals. Within the scope of their appointment, they must exercise their manifold discretions in their principals' interests, and not in their own. Sometimes endpoints are defined (e.g. defined investments must be pursued), but more typically the outcomes are left to the fiduciary's discretion. Legal regulation of the fiduciary's conduct cannot then follow the contractual model. It must instead pay regard not to outcomes, but to the manner in which discretions are exercised:[52] carefully, in good faith, for proper purposes, taking into account relevant considerations, and loyally. This last constraint – the requirement to act loyally – is the concern of fiduciary law. It requires the fiduciary to act selflessly, to exercise self-denial;[53] it proscribes rather than prescribes, and in doing so it denies to the fiduciary any benefits that might be obtained disloyally, and in particular it requires disgorgement of gains which involve conflicts of duty and interest or misuse of position. Equity's approach to these categories has been described as punitive, in the sense that it matters not that the fiduciary acted honestly, or in good faith, nor that the principal could not have derived the benefit itself, or was not harmed and may indeed have benefited. All such gains, derived from any self-serving use of the principal's property, any conflicts, or any misuse of position (which indeed turns out to mean any *use* of position) must be disgorged. The normative justifications for this general obligation to disgorge disloyal gains are not in dispute: given a fiduciary's power and discretion, even in conducting the simplest of tasks, loyalty can only be promoted by such deterrence. Any disloyal gains must be disgorged because the fiduciary *must not* have them, even though there is often no particular further and additional reason why the principal *must* have them. These gains are therefore often described as windfalls to the principal.

But these fierce proscriptive fiduciary rules are not ends in themselves. They are designed to serve the primary goal of fiduciary loyalty. That requires the fiduciary to act in the best interests of the principal in

[52] See S. Worthington, *Equity*, 2nd edn. (Oxford 2006), 131–140.
[53] S. Worthington, "Fiduciaries: When is Self-Denial Obligatory?" [1999] C.L.J. 500.

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dealing with the principal's property or in pursuing investment opportunities within the defined scope of the fiduciary's appointment. This has consequences. Although the fiduciary cannot generally be sued for failure to achieve a defined endpoint, that is not the end of the matter. If the fiduciary selects a particular use of the principal's property, or selects an investment opportunity which is in the line of business which it is his obligation to pursue on behalf of the principal, and purports to select it for himself, that stands as proof positive that of all the range of possible choices the fiduciary might have made in the principal's interest either with the principal's property or within the defined line of business, this was regarded as most advantageous – indeed, so advantageous that the principal secretly elected to take the benefit personally. In those circumstances, the fiduciary himself has defined the most desirable endpoint out of the range of infinite choices otherwise available, and in those circumstances the principal can insist that *this* is the precise endpoint which the fiduciary *ought* to have achieved for the principal, and if it has in fact been achieved by the fiduciary, then the fiduciary holds that benefit for the principal.[54] The general discretionary obligation to act in the best interests of the principal has been given a defined endpoint by the fiduciary's own discretionary choice, and that is a choice which the courts will specifically enforce in favour of the principal on the principal's request.[55] The principal can *adopt* the fiduciary's choice. The remedy is proprietary. This proprietary conclusion requires further justification, but that can wait until later, when we turn to considering the proper remit of our various equitable formulae, and in particular the formula that "equity treats as done that which ought to be done". That formula does not convert every equitable obligation into property, but it serves that purpose in this particular context.

By contrast, this same analysis cannot apply to gains which are derived exclusively from misuse of position.[56] To support that assertion, something more needs to be said about misuse of position. The expression has no settled meaning in fiduciary disgorgement cases,[57] nor in related statutes[58] or commentary, but must be given one here.

[54] As Newey J. put it (see above, text at note 50), these two categories concern "property or opportunities subject to fiduciary obligations'".

[55] Of course, the principal is not compelled to pursue this claim; no legal remedies are obligatory.

[56] More specifically, at least in those category (3) cases which are not, alternatively, amenable to classification as category (1) or (2) cases.

[57] For example, sometimes the "misuse of position"/"no profit" rule is regarded as part of the "conflict of duty and interest"/"no conflict" rule: *Bray v Ford* [1896] A.C. 44, 51–2; *Boardman v Phipps* [1967] 2 A.C. 46, 123. But other cases have regarded the two rules as distinct, although overlapping, so that a breach of the former cannot always be readily analysed as a breach of the latter: see, e.g., *Regal Hastings* [1967] 2 A.C. 134.

[58] E.g., in the Companies Act 2006, the "conflicts" section, s. 175, combines aspects of categories (1), (2) and (3), and allocates to a separate section, s. 176, the specific duty not to accept benefits from third parties. There was, nevertheless, no indication that the Act intended to eliminate certain

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The expression is sometimes used to describe *any* gain made by a fiduciary without the consent of the principal: true, all disloyalty could be described rather loosely as a misuse of position, but here we need to use the term far more precisely. Even in cases which explicitly address the divide between categories (2) and (3) (the "no conflicts" and "misuse of position" cases) the distinctions are hazy.[59] The most familiar description of "misuse of position" is that given by Lord Russell in *Regal Hastings*,[60] where, abridging his words, category (3) gains would be defined as those made exclusively "by reason of and in the course of" executing the position occupied by the fiduciary. But the precise remit of those words has never been properly teased out. Until now it has not been necessary to distinguish this category of disloyal gain from the categories involving use of opportunities or property. Indeed, on the facts of *Regal Hastings* itself, the gain made by the directors was both a misuse of position[61] and a clear conflict of duty and interest: the directors took precisely the opportunity they had been contemplating for the company. That being the case, they could not conceivably argue that the opportunity fell outside the scope of their fiduciary endeavour. It is irrelevant that they could make the further argument that it was not practically possible to take that investment opportunity for the company.

Lord Russell's words nonetheless capture the spirit of category (3), and with a little more elaboration they will suffice to define a category of gain which is distinct from categories (1) or (2), but is a gain which must be disgorged by the disloyal fiduciary. The precise ambit of this category emerges most clearly by illustration.

The words "by reason of and in the course of" (to abbreviate Lord Russell's test) are often assumed to indicate a "but for" test. They have that tenor: "but for" the fiduciary's role, the gain could not have been made. But that test will not do; it is far too wide. A short pause for thought makes that clear. Fiduciaries are often presented with opportunities which meet this test: "but for" the role, the fiduciary would not be rich enough, or skilled enough, or qualified enough, or knowledgeable enough to take up the opportunity. Examples abound of fiduciaries finding out about opportunities at business cocktail

features of the common law rules on breach (although it amended the rules on their ratification). In short, the Act simply categorises the fiduciary duties differently, perhaps on the basis that certain distinctions are irrelevant in the assertion of breach, and relevant only in the characterisation of remedies, a matter which is left to the common law rules (s. 178).

59 This is not the place to elaborate on the various difficulties, but the problems are laid bare in the many cases referred to by Lewison J. in *Ultraframe* [2005] EWHC 1638 at [1305]ff and again by Lewison J. in *Sinclair* [2010] EWHC 1614 (Ch) at [31]ff, with cases discussed under the "no profit" heading which might equally well be classified as conflicts of duty and interest.

60 See the well-known words of Lord Russell in *Regal (Hastings) Ltd. v Gulliver* [1967] 2 A.C. 134, 147: "[these shares] were acquired by reason and only by reason of the fact that [the defendants were directors] and in the course of their execution of that office."

61 Ibid.

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parties, or using their enhanced knowledge and skills to write books[62] or make lucrative investments.[63] Of course, if these private gains fall into categories (1) or (2), then disgorgement is required, and proprietary disgorgement at that. But otherwise the mere fact of the "but for" test being met is not enough.

Take a concrete example. Suppose an auction house invites all the FTSE 100 directors to an exclusive art sale. These directors have the opportunity to invest only because they are FTSE 100 directors. Of course, if they use corporate assets to buy art, or if their company is in the business of acquiring art, then the director's acquisition on his own account will have to be disgorged under categories (1) or (2). But, absent those facts, the director's acquisition on his own account will not fall within category (3); it will not constitute a disloyal gain from "misuse of position". To fall within that category, the invitation would need to be to the directors to attend the auction *on their company's account* to purchase for their company.[64] It is only then that the director's personal gain is disloyal, acquired "by reason of *and in the course of*" executing the fiduciary role; the additional words are not mere surplusage. It is only then, in those limited circumstances, that there are any normative reasons for requiring the fiduciary to disgorge the gain as being one obtained disloyally.

Similarly, returning to the illustration of the haulage company used in the introduction, it is easy to see when the director's acquisition of the adjacent development might constitute a category (1) or (2) disloyal gain. But, absent those concerns, the acquisition at a public sale would not fall within category (3). It would not matter that the director's knowledge and experience made him better equipped to assess the commercial potential. By contrast, though, if the site were offered directly to the company for private sale – typically an offer received by the potentially disloyal director – and the director took the investment on his own account, then the director's acquisition would constitute a category (3) gain, and would do so even though the acquisition was quite outside the scope of the corporate endeavour and involved no use of the company's property.

Category (3) is thus tightly circumscribed. It captures gains derived from opportunities which arise solely because of the fiduciary's role, being opportunities presented to the fiduciary *as fiduciary*. Only then is the shorthand apt that the fiduciary made the gain "by reason of *and* in the course of" executing the fiduciary role.[65] It is then immaterial that

[62] *Aas v Benham* [1891] 2 Ch. 244 (CA), 256 (Lindley L.J.).

[63] *Boardman v Phipps* [1967] 2 A.C. 46, 130, for the example given by Lord Upjohn in his dissenting opinion of the purchase of Whiteacre by the trustee of Blackacre.

[64] Se the argument in *Aas v Benham* [1891] 2 Ch. 244.

[65] What should be noticed here is that, with fiduciaries, this misuse of position rule is tough, in the way that fiduciary rules typically are, in that within the restricted context just described the rule

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the gain involved no use of the principal's property and was not within the scope of the fiduciary's endeavour.

A little reflection reveals that cases which fall only into category (3) are exceptionally rare. Most fiduciary disloyalty falls into categories (1) or (2). But *A.G. for Hong Kong v Reid* is just such a category (3) case. The Hong Kong prosecutor did not use the Crown's property; he did not take an opportunity which was within the scope of his fiduciary endeavour; what he did was accept bribes which were offered to him only *as fiduciary*, "by reason of and in the course of" his fiduciary role.

More is said about all these category (3) cases in the final section, but for now their remit is sufficiently well described to allow for some preliminary comments on the nature of their remedy. The contrasting illustrations of the FTSE 100 directors and of *Reid* illustrate the operation of this category whether the fiduciary has broad or narrow discretions. The fiduciary's disloyalty is in taking a personal benefit from exercise of the fiduciary role, even though it is one that involves no use of the principal's property nor pursuit of an opportunity within the scope of the role. It follows that in these category (3) cases, although it is clear that the disloyal fiduciary *must not* have the disloyal gain – and must disgorge it – it cannot be said that the principal *must* have it, as by contrast it could in category (1) and (2) cases. In category (3), the principal cannot assert that the fiduciary has done on his own account what his discretion requires him to do for the benefit of the principal, either in managing the principal's property or in pursuing opportunities within the scope of the fiduciary's endeavour; he cannot therefore adopt his fiduciary's exercise of discretion. The remedy is thus personal only. This non-proprietary conclusion requires further justification of course, but that will emerge later from the discussion of our various equitable formulae.

For now, in concluding this section, two points are important. First, on this analysis there are three simple categories of fiduciary gain, each sufficiently clearly defined to ensure that any given set of facts can be confidently assigned to the appropriate category. Taken together, these three categories identify the full spectrum of conduct constituting disloyalty in carrying out the fiduciary role. All these disloyal gains must be disgorged. Secondly, the conclusion that disgorgement remedies are proprietary in two of these categories but not in the third is justified by a robust analysis of the fiduciary rules which these remedies exist

requires disgorgement of profits made by *use* of position, even though a non-fiduciary would be liable only for *misuse* of position, being e.g. unauthorised use of confidential information, or breach of contract. Reflecting some discomfort generally with the extent of disgorgement remedies, see *Muraj v Al Saraj* [2005] EWCA Civ 959 at [82] (Arden L.J.) and [121] (Jonathan Parker L.J.), on the merits of relaxing the extent of disgorgement due under the no conflicts rule.

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to support, not simply by reliance on the mechanical application of various equitable formulae. It is to such problematic mechanical applications that we now turn.

IV. Failing Equitable Formulae

Various familiar equitable formulae are routinely called into play to serve one side or the other in debates on proprietary disgorgement. In truth, these formulae rarely deliver the firepower claimed for them. This is true of the fiduciary's "duty to account", of the maxim that "equity treats as done that which ought to be done", and of the equitable tracing rules in delivering up secondary profits. Each might therefore be termed "failing equitable formulae", although their failings arise only by virtue of common misuse. Each serves a perfectly proper and necessary function if used carefully. Each is considered below.

A. The fiduciary must "account in equity"

In bribe cases, the defaulting fiduciary's[66] obligation to "account in equity" is taken by some to indicate that the disgorgement obligation is personal only (*Lister v Stubbs, Sinclair v Versailles*)[67] and by others to indicate that it is inherently proprietary (*Reid*). In truth, the expression tells us nothing about the nature of the remedial obligation.[68] It simply makes the far more limited point that the fiduciary is required to provide the principal with an account of the conduct of his role.[69] If done properly, this will help identify shortcomings and potential legal remedies. But the duty to account does not indicate the nature of any remedies (in particular whether they are for disgorgement or for compensation,[70] or are personal or proprietary) and nor does it deliver those remedies.

More dangerously, the language of account masks some important practical issues. It is typically said that the fiduciary will be treated as having acted properly (notwithstanding the reality), and the accounts will be falsified or surcharged so as to record that presumed proper activity. This is the "good man" theory, with its proprietary

[66] And indeed it is a moot point whether the language applies only to trustees or more widely to fiduciaries in general. It is commonly said that fiduciaries (using the expression generally) are obliged to "account in equity", but assertions that the principal can "falsify" or "surcharge" the accounts is typically confined to express trustees.

[67] Also see Swadling, note 6 above.

[68] It might be said that Lord Millett has unintentionally contributed to this confusion by making such a point of the fiduciary's duty to account: see P. Millett, "Equity's place in the law of commerce" (1998) 114 L.Q.R. 214.

[69] L. Smith, "Fusion and Tradition" in S. Degeling and J. Edelman (eds.), *Equity in Commercial Law* (Sydney 2005), at p. 34.

[70] Regardless of whether the loss is caused by the fiduciary acting without power, or by the fiduciary exercising legitimate powers negligently.

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consequences, so favoured in *Reid*.[71] For example, if the fiduciary puts his hand in the till, takes £1000, and spends it on a skiing trip, the principal can "falsify" the accounts, disallowing the disbursement, and insisting that the accounts still show that £1000 is there in the principal's fund.[72] Alternatively, faced with a negligent fiduciary, the principal could "surcharge" the accounts to show what should have been there if the fiduciary had behaved with due diligence. This suggests that the written record of the fiduciary's management of the principal's property will then show that all is fine. But the records do not match reality until the fiduciary actually corrects the errors (or the remedy, being proprietary, achieves that end by operation of law). And if the fiduciary is insolvent, the principal cannot simply insist that the insolvency distributions reflect the corrected paperwork. Even if the fiduciary has £1,000 in his personal reserves, insisting the accounts are put in order will not of itself replace the £1000 that should have been in the principal's fund.

This is all rather negative. Surely the obligation "to account in equity" has some more useful purpose? It does, but its principal practical advantage seems to be universally ignored. One of the oddities of trusts is that when the principal sues the fiduciary for breach, the remedy which is awarded is not necessarily one which ought to be paid directly to the litigating principal; typically the remedy should go to augment the funds held for the principal, and should be held or distributed according to the terms of the original engagement. The accounts serve to record the division between the fiduciary's personal patrimony and the principal's patrimony. They will – when the remedy is satisfied – once again match reality, and without any transfer of assets to the principal.

Of course – and this is the important point of debate in these bribe cases – if the principal's remedy *is* proprietary, then, in equity, the disputed assets *are* already held by the fiduciary on trust for the principal, and are held in that way even before the accounts are falsified, so in that rare case the principal *will* have insolvency protection, because the transfer to the "principal's patrimony" has occurred by operation of law, in advance of either the allegations or the paperwork to falsify the accounts.

The short point, however, is that it is not possible to transit from "accounting in equity" to *any* practical conclusion without pause for thought. And in particular, the mechanism of "account" cannot simply be asserted so as to convert a claim against the fiduciary into a proprietary claim, and nothing of that nature is achieved simply by

[71] See Lord Millett's writings generally as cited in note 24 above.
[72] P. Millett, in Degeling et al, note 24 above, at p. 310.

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"adjusting" the accounts between the fiduciary and principal. The proprietary nature of the remedial claim must itself be proven; it does not arise *because* the fiduciary must "account in equity".

B. *"Equity treats as done that which ought to be done"*

The maxim that "Equity treats as done that which ought to be done" was used to explain the proprietary remedy in *Reid*. The expression does hold a kernel of truth,[73] but its critics are right that it begs the very question in issue,[74] or at least it does if not underpinned by some prior analysis of the context. All turns on the perception of what "ought to be done", and, as *Lister*, *Reid* and *Sinclair* indicate, the answer is controversial.

It will not do simply to dismiss this formula. It underpins the analysis pursued, explicitly or implicitly, in all the familiar non-fiduciary contexts where the court finds that defendants hold assets on constructive trust for claimants. This is true whether the constructive trust arises in response to specifically enforceable contracts of sale, or failed gifts found to be effective in equity, or claims based on proprietary estoppel.[75] In all these categories, the courts find – for one reason or another – that there is an identifiable asset which the defendant can no longer retain as his personal property, and which must be transferred to the claimant: "treating as done that which ought to be done", the asset is considered as transferred in equity from the time the relevant circumstances arise, with the result that the defendant no longer holds the asset beneficially for himself, but holds it on constructive trust for the claimant.

Natural justice does not demand that our legal system be so protective. When one person is under a personal obligation to transfer an asset to another, it is a matter of choice for the legal system whether that obligation merits proprietary protection.[76] Some jurisdictions provide no such protection. By contrast, although all the detail cannot be explored here,[77] it is clear that the English jurisdiction has chosen to provide proprietary protection to obligations to transfer where the asset is special (e.g. land),[78] or where the

[73] S. Worthington, *Proprietary Interests in Commercial Transactions* (Oxford 1996), ch. 8, especially pp. 192–4; M. Bridge, L. Gullifer, G. McMeel and S. Worthington, *The Law of Personal Property* (London 2013), ch. 15 generally.

[74] *Sinclair* [2011] EWCA Civ 347; and the pro-*Sinclair* references cited at note 24 above.

[75] See M. Bridge, L. Gullifer, G. McMeel and S. Worthington, *The Law of Personal Property* (London 2013), ch. 15, for all the detail, also covered in all standard Equity textbooks.

[76] Lord Millett has acknowledged that "[t]he rule is not a rule of natural law. It is not universal. We do not have to have such a rule. We choose to have it. Most civilian systems do not.": see "Proprietary Restitution", note 24 above, at p. 314.

[77] See Worthington, *Equity*, note 52 above, pp.134–140.

[78] And then regardless of the nature of the relationship between transferor and transferee.

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relationship between transferor and transferee is special (e.g. fiduciary/principal).[79]

This is familiar territory, but it is easy to see how the formulation just advanced can lead to an assertion that a fiduciary who is subject to a personal obligation to disgorge disloyal gains to his principal should, by that very fact, hold those gains on constructive trust for the principal. This is the argument in *Reid*. It is not answered by saying the outcome is unfair. Our law respects property rights, both on insolvency and as against third parties. *If* the principal has a property right, then certain consequences follow, and they are very likely to seem unfair in some circumstances to some parties. That is not peculiar to proprietary interests in fiduciary contexts.

But *does* the principal have a property right in these circumstances? This requires careful examination of the issues if we are not to fall into the trap of relying on equitable formulae in inappropriate contexts. First, it might be noticed that the obligation to disgorge disloyal gains is quite different from the positive or prescriptive obligations which typically generate constructive trusts. In these latter cases the purpose of the obligation is to deliver a particular asset to the claimant, and, where a constructive trust is recognised, that is simply shorthand for the assertion that equity recognises that the claimant *must* have the asset in question, and can insist on having it not only as against the defendant but also as against any stranger to that relationship. This is what it means to have a proprietary interest in an asset. By contrast, in the fiduciary disgorgement cases the same assertion cannot be made. The purpose of the disgorgement obligation is not to transfer to the principal an asset to which he is entitled; it is, instead, to remove from the fiduciary an asset to which he is *not* entitled. Put another way, although we can say here that the fiduciary *must not* have the asset, we cannot say, as we could above, that the principal *must* have the asset. Although the defaulting fiduciary is under an obligation to transfer the disloyal gain, there is no particular reason to give the principal special advance proprietary protection to secure his interest in the gain. There is, in short, no reason as there was in earlier cases to treat the principal as already owning the asset in equity. This is not "what ought to be done"; this is not the function of the disgorgement obligation. If the principal wishes to make a successful claim to a proprietary interest in the disloyal gains, the principal must assert some different claim, a claim that explains why the principal, and no-one else, *must* have the asset in issue, not simply why the fiduciary *must not* have it.

As noted earlier, it is just this alternative claim which the principal *can* advance where the fiduciary has used the principal's property for

[79] And then regardless of the nature of the asset which is the subject matter of the obligation.

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personal advantage, or has selected for his own advantage an investment opportunity which is in the line of business which it is his obligation to pursue on behalf of the principal. In these circumstances the principal need not rely simply on the proscriptive aspects of the rules on fiduciary loyalty, but can instead turn to their positive underpinnings. Those positive underpinnings oblige the fiduciary to act in the best interests of the principal in dealing with the principal's property or in pursuing investment opportunities within the defined scope of the fiduciary's appointment. Within this realm of fiduciary activity, the principal can *adopt* the fiduciary's choices, and insist that their benefits are delivered to the principal and not held by the fiduciary. This positive duty will be specifically enforced in equity, not because the subject matter of the obligation is special, but because the relationship between the parties is special,[80] and the fiduciary's discretion is to be used selflessly to deliver the best possible advantages from use of the principal's property or pursuit of investment opportunities within the scope of the fiduciary's defined endeavour. As explained earlier, the same cannot be said of the disgorgement gains generates exclusively by misuse of position (category (3)), but it can be said of the disgorgement gains generated in categories (1) and (2).

These three categories of fiduciary gain are considered in more detail below. For now, the point to note is that the maxim "equity treats as done that which ought to be done" must be applied carefully. It does not justify constructive trusts when all that can be said is that the fiduciary *must not* have the asset, and that what ought to be done is simply to remove disloyal gains from a defaulting fiduciary. This is all that the proscriptive duties of loyalty demand. On the other hand, the maxim can be used where the principal *must* have the asset in question. This positive assertion can only be made when, given the scope of the fiduciary's endeavour, the principal is entitled to *adopt* the fiduciary's own selected choices in managing the fiduciary's property or pursuing investment gains within the scope of the fiduciary endeavour, and can insist that those choices are held *for* the advantage of the principal, not simply *not for* the advantage of the fiduciary.

C. Tracing and secondary profits

Finally, we can say something about secondary profits. A disloyal fiduciary must disgorge the gains so derived. But if these disloyal gains are then used to generate further profits, must they too be disgorged? The issue was material in *Lister*, *Reid* and *Sinclair*. Two strong lines of argument emerge from the cases. Each merits pause for thought.

[80] See note 77 above and associated text.

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First, if the principal has a proprietary interest in the initial fiduciary gain, then, according to *Foskett v McKeown*,[81] the principal will invariably have a proprietary interest in any traceable proceeds; according to the House of Lords, that follows automatically as a matter of English property law. The earlier case of *Reid*[82] relied on just such proprietary tracing assumptions to enable the capture from third party volunteers of the real estate investment gains which Lord Templeman thought the defaulting fiduciary needed to give up.

By contrast, if the principal has no proprietary interest in the initial fiduciary gain, there are equally strong suggestions that the principal can then have no claim at all to their traceable proceeds: see *Reid*, *Lister*, and *Westdeutsche*.[83] As against this, however, *Sinclair*[84] suggests, by way of dicta, that even in these circumstances the prophylactic rationale of fiduciary law makes it imperative that the defaulting fiduciary be stripped of *all* gains acquired by virtue of the breach, notwithstanding earlier cases militating against this conclusion.[85] That logic is surely compelling.

But what these assertions risk confusing is the proper remit of tracing and of the prophylactic rationale. They are directed at different ends. Tracing is another of our equitable formulae that can so easily trip us up. The technique of tracing is used to identify what has happened to the principal's property, and then – if an appropriate claim can be advanced – the principal may be able to assert a proprietary interest in identifiable traceable proceeds. Where the original asset being traced is held by a fiduciary for the benefit of his principal, the principal is invariably entitled to adopt successful investments and insist that the fiduciary holds those too for the principal. This is justified because it is precisely what the fiduciary role demands: the fiduciary must selflessly use the principal's property solely for the benefit of the principal. If the fiduciary purports to use it for his own benefit, the principal can insist that the investment is held for him. As argued elsewhere,[86] this explanation of the consequences of tracing in a fiduciary context seems preferable to the assertion that the outcome follows as a matter of English property law. Where the defendant is a fiduciary, the difference is one of analysis, not outcome; but, as emerges in the paragraphs below, the difference matters when the defendant is not a fiduciary.

[81] [2001] 1 A.C. 102 (H.L.).
[82] See notes 1 and 3 above.
[83] See notes 1 and 27 above.
[84] [2011] EWCA Civ 347.
[85] Ibid., at [90]–[91].
[86] See S. Worthington, "Justifying Claims to Secondary Profits" in E. Schrage (ed.), *Unjust Enrichment and the Law of Contract* (The Hague, 2001), 452ff; and *Equity* (2nd ed., 2006), p. 106.

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This analysis has important consequences in the context of fiduciary disgorgement. Any disloyal gains falling into categories (1) or (2) are held by the fiduciary on constructive trust for the principal: those gains belong to the principal in equity. It follows that *their* traceable investment proceeds can also be adopted by the principal, and they too will belong in equity to the principal as further category (1) gains. The only necessary link between the initial disloyal fiduciary gain and the investment proceeds claimed at the end of the tracing trail is the requirement for tracing, or the provable substitution of one asset for another down the investment chain. It is irrelevant that the disloyal fiduciary was acting honestly and in good faith, or that he could have used his own funds to make the lucrative investment. No matter how fortuitous the windfall for the principal, the very fact of traceable investment proceeds is enough to give the principal a proprietary claim.

By contrast, the prophylactic goal is directed at stripping the fiduciary of any profits he would not hold *but for* his disloyalty. This does not depend on tracing at all. It depends upon proof of causal links. To take a simple illustration, suppose the fiduciary's disloyal gain is £100,000, and it is exclusively a category (3) gain to which the principal therefore has only a personal claim. If the fiduciary uses £10 from this fund to buy a winning lottery ticket, it will count for nothing that the lottery millions are the traceable proceeds of the disloyal gain, since the principal has no proprietary interest in the original disloyal gain.[87] The goal of prophylaxis demands that the lottery millions be disgorged only if they could not have been generated but for the fiduciary's disloyalty. Given that the winning investment cost £10, the "but for" test is unlikely to be met, and so the principal will be unable to insist on disgorgement. In short, there is no necessary link between *traceable* assets and assets which meet the "*but for*" test required for prophylaxis.

It might then be thought that a fiduciary such as the prosecutor in *Reid* can, with impunity, use his category (3) gains to generate secondary profits which will not be recoverable. But that would be incorrect. It is unlikely that Reid could have purchased his real estate investments "but for" his use of the bribes he had taken. These too are category (3) gains. Their remedy is personal, not proprietary, since the gain is not derived from use of the principal's property nor from pursuit of conflicting opportunities. The motivation for disgorgement is to strip the fiduciary; it is not to transfer to the principal an asset to which the principal is entitled ahead of anyone else.[88]

[87] By contrast, if the principal has a constructive trust over the original £100,000, then she can trace her £10 into the lottery millions.

[88] And if the concern is then to strip the third party volunteers with interests in these investments (e.g., in *Reid*, Reid's wife and solicitor) it might be hoped that there is scope within the dishonest assistance claim to strip them too, via a personal claim.

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Finally, and for the sake of completeness, recall that one of the advantages of a proprietary claim is that the principal can assert the claim against any third parties who are not bona fide purchasers for value without notice of the principal's claim. It follows that if the disloyal fiduciary transfers a category (1) or (2) gain[89] to an innocent donee, the principal can recover her property if she can follow the original asset into the donee's hands. This outcome rests on the priority of competing property interests. But if the donee uses this initial receipt to generate further profitable traceable proceeds, can the principal claim those too? The issue was not material in *Foskett*, but that case suggests a positive answer on the basis that, as a matter of English property law, the principal is entitled to all the traceable proceeds derived from her property. As noted earlier, that is doubted.[90] If the donee owes the principal no fiduciary obligations in relation to the asset, then the principal's claim against the donee is surely restricted to return of the original receipt, or if it is no longer in the donee's hands, then to its value protected by a lien against the traceable investment proceeds.[91] This scenario, too, illustrates the potential difficulties with overly mechanical use of the tracing rules.

V. Using the Proposed Classification Scheme

Now we are at the stage where it is possible to make some final remarks about categories (1)–(3). A number of important points emerge.

A. Category (1) – gains from use of the principal's property

The first point to note is that category (1) includes *all* gains derived from use of the principal's property, regardless of whether those gains are within or outside the scope of the fiduciary endeavour. A fiduciary who takes the principal's funds and invests them illegitimately in railways rather than legitimately in canals, or bets them on the horses rather than dutifully buying shares, will nonetheless hold those investment gains on constructive trust for the principal. The question of scope is irrelevant. The reason is simple. The fiduciary is required to use the principal's property only in the best interests of the principal. The terms of the fiduciary engagement will usually specify the scope or range of appropriate investments. If the fiduciary invests outside that range, the principal can of course insist on compensation for the resulting loss,[92] but can, alternatively, simply adopt the unauthorised

[89] Or its identifiable secondary profit to which the principal has a proprietary claim.
[90] See "Justifying Claims to Secondary Profits", note 86 above, and as conceded in relation to these good faith volunteers by Lord Millett in "Proprietary Restitution", note 24 above, at pp. 314–316.
[91] See "Justifying Claims to Secondary Profits", ibid.
[92] *Target Holdings Ltd. v Redferns* [1996] A.C. 421 (H.L.).

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investment and demand that the fiduciary hold it for the principal.[93] This was discussed earlier. In short, to claim the benefit of a constructive trust over category (1) gains, all the principal needs to do is identify the gain and prove that it was derived from the principal's property.

Secondly, category (1) clearly embraces gains the fiduciary makes from trading with the principal's property on his own account. But it also includes gains made from *using* the principal's property. It is irrelevant that the principal's assets remain intact in the fiduciary's hands, and the principal seems to have lost nothing. Fiduciary disgorgement is not concerned with the principal's loss, but with the fiduciary's disloyal gain. Suppose the fiduciary generates a personal gain by using the principal's vehicle as a taxi, or by selling licences to access the principal's intellectual property. It is uncontroversial that the fiduciary will then be required to disgorge the proceeds of such use, and will hold those proceeds, if they can be identified,[94] on constructive trust for the principal.[95] To repeat, it is immaterial that the principal's original assets remain intact in the fiduciary's hands. But, if this is true, then this same analysis ought surely to apply to the facts of *Sinclair v Versailles*.[96] There the disloyal fiduciary did not exchange the principal's investment funds for substitute assets; instead, he circulated those funds around his own companies, creating the appearance of hectic trading, and thereby fraudulently inflated the market value of his own companies, which gain he then realised by selling his shares at their grossly inflated price. It is hard to describe this gain in any way other than a gain derived from the "use" of the principal's assets. It ought to follow, therefore, that the fiduciary's profits are held on constructive trust for the principal. This argument was not before the court, since both sides conceded the applicability of the bribe analogy, and argument therefore centred on which of the competing analyses in *Lister* and *Reid* was preferable. In retrospect, perhaps that approach left much to be desired.

B. Category (2) – gains from opportunities within the scope of the fiduciary's endeavour (i.e. involving a conflict of duty and interest)

The third important point concerns category (2). By contrast with category (1), in category (2) the issue of scope is all important.

[93] See *Tang Man Sit v Capacious Investments Ltd.* [1996] A.C. 415 (P.C.): the principal can elect between compensation and disgorgement provided there is no double recovery.

[94] Take the haulage company illustration used in the introductory section: if the fiduciary used the company's vehicles to undertake parts of the development, there would be no traceable gain, so no possibility of a proprietary remedy; but the fiduciary would nevertheless have profited from the vehicles' free provision in generating his development gain, and he would therefore be liable to disgorge a part of that gain representing his disloyal secret profit.

[95] *Tang Man Sit v Capacious Investments Ltd.* [1996] A.C. 415 (P.C.) illustrates just such "use" gains, as distinct from "exchange gains".

[96] [2011] EWCA Civ 347 and note 4 above.

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Category (2) catches *only* those gains which are within the scope of the fiduciary's endeavour. This is because, as discussed earlier, it is only then that the principal is entitled to say that if the fiduciary acquired the opportunity, then it ought to have been acquired for the principal, being an opportunity which, on the fiduciary's own choice of options, was selected as being the most advantageous within the defined line of business or scope of the fiduciary's endeavour. In all three disgorgement categories it is irrelevant that the fiduciary acted in good faith, or that the principal was not harmed; and in category (2) it matters not that the principal could not or would not have taken up the opportunity if offered. That decision is one for the principal alone, and cannot be anticipated by the fiduciary.

For example, in *Keech v Sandford*,[97] it was within the remit of the fiduciary role for the fiduciary to acquire a renewal of the lease for the benefit of the infant beneficiary, and if the fiduciary managed to do that, and found it to be so advantageous that he was motivated to take the benefit for himself, then the renewal is a category (2) gain which must be held on constructive trust for the beneficiary.[98] It is irrelevant that the lessor had declined to renew in favour of the infant beneficiary; if the fiduciary wanted to take the benefit personally, then the beneficiary must first consent.[99]

Similarly, *Boardman* and *Regal* are also in this category.[100] It is no answer that the opportunity could not, or would not, in fact have been obtained by the principal, either for legal or for practical reasons. If that was indeed the truth of the matter, then the fiduciary should have no difficulty persuading the principal to consent to the fiduciary's personal acquisition of the benefit. Absent that consent, the fiduciary's duty is to pursue to the best of his endeavours his own selection of the best opportunities that will benefit the principal in the defined line of business. In both these cases, the opportunity taken personally by the fiduciary fell within that class. The principal therefore had a proprietary claim. Of course, if the fiduciary is solvent, it can be a

[97] (1726) Sel. Cas. Ch. 61.

[98] Some commentators class this as a "no profit" or misuse of position case, but the approach offered here seems preferable.

[99] (1726) Sel Cas 61,62: "the trustee is the only person of all mankind who might not have the lease."

[100] Lord Upjohn in *Boardman v Phipps*, note 40 above, at p. 124, classified *Regal Hastings* as a clear case of conflict of duty and interest for reasons which seem impeccable. The majority of the House in *Boardman* probably decided the case as a misuse of property, unacceptably classing information as property. For reasons indicated earlier, this case should equally clearly be classed as a conflicts case: the trust owned shares in the target company; it could not be argued, therefore, that it was outside the scope of the fiduciary's endeavour to consider whether that holding should be increased or decreased. And it is immaterial to the scope issue that the principal would not or could not take up the opportunity in issue, a matter which seemed to preoccupy the House unduly. On the other hand, their sympathy for the defendants seems well-founded, given the rather technical nature of the fiduciaries' failures to get proper consent.

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matter of practical indifference to the principal whether the recoveries are rendered by way of recognition of a personal or proprietary claim.

Finally, and undoubtedly more controversially, *Lister v Stubbs*[101] is also in this category (the facts were noted earlier). This is not because the opportunity to take the bribe was one that ought to have been taken for the principal, or any other such similar formulation which has so dogged *Reid*. It is because the essence of the fiduciary endeavour was one that required the fiduciary to negotiate the purchase of dye-stuffs at the best possible price for the principal. The fiduciary's receipt of a bribe from the seller is proof positive that the seller was willing to receive less for the sale than the price charged to the principal. The fiduciary has therefore taken for his own account an opportunity which it was his duty to pursue for his principal. The analysis adopted in *FHR v Mankarious*[102] to reach the same conclusion is compelling. Most bribe cases in commercial contexts follow this model. They should all be classed as category (2) cases. As noted earlier, the non-commercial case of *Reid* is the exception; there the bribe did not involve a conflict of duty and interest, only a misuse of position.

So the question of scope is vital. It delineates the crucial boundary of category (2) cases. This means that any uncertainty in defining the scope of the fiduciary's endeavour is problematic. The issue has generated a line of cases focused on determining whether an opportunity is a "corporate opportunity" (i.e. an opportunity which, given the specific ambit of the director's fiduciary duty, might legitimately be pursued for the benefit of the company),[103] or, similarly, a "partnership opportunity".[104] There is good reason to suppose that modern courts are drawing this line in the wrong place,[105] and that deeper thought about the precise import of the general rule against conflicts of duty and interest would see wider adoption of the approach taken in the partnership case of *Aas v Benham*.[106] It must surely be true that even fiduciaries have a private sphere of operation,[107] despite some assertions to

[101] (1890) L.R. 45 Ch. D. 1 and note 10 above.
[102] [2013] EWCA Civ 17.
[103] Earlier cases on the equitable rule vary in their approach, some taking a narrow view of which opportunities are caught (*Balston Ltd. v Headline Filters Ltd.* [1990] FSR 385, 412; *Industrial Development Consultants Ltd. v Cooley* [1972] 1 W.L.R. 443), and some a wider view (*Bhullar v Bhullarb* [2003] EWCA Civ 424; *Allied Business and Financial Consultants Ltd. v Shanahan* (also known as *O'Donnell v Shanahan*) [2009] EWCA Civ 751).
[104] *Aas v Benham* [1891] 2 Ch. 244.
[105] See the discussion in L. Sealy and S. Worthington, *Sealy & Worthington's Cases and Materials in Company Law*, 10th edn (Oxford 2013), 372ff. The explanation is perhaps simple: the courts' focus has been on establishing the *existence* of a fiduciary breach, rather than identifying its precise genesis. And the remedial consequences of one categorisation over another have not often been in issue, since the litigation has generally been between principal and solvent fiduciary.
[106] [1891] 2 Ch. 244 (C.A.).
[107] See Lindley L.J. in *Aas v Benham*, [1891] 2 Ch. 244, 256, giving the example of a partner using his increased scientific knowledge, gleaned from working with the partnership, to publish a book on the subject, being a book which did not in any way compete with the partnership business: this profit would not be recoverable by the other partners.

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the contrary,[108] and that not every successful profit-making endeavour can be captured by the principal.[109]

For example, most modern companies have unrestricted objects. This cannot mean that directors have a duty to present to the company for its approval every personal investment they propose to make, or otherwise run the risk that the company will be able to claim the gain as a disloyal profit made in breach of the conflict rule on the basis that *every* opportunity is a potential corporate opportunity. Yet, taken at face value, that is just the proposition advanced in *Bhullar v Bhullar*,[110] where the court held that the director had one capacity only, and that was as a fiduciary. In that case, the directors had purchased on their own account a block of land adjacent to one already owned by the company. The court held that this had been acquired in breach of their fiduciary obligations, and was therefore held on constructive trust for the company. Since the company was in the business of buying property for investment, that conclusion might not seem unreasonable. On those bald facts, the acquisition was certainly one within the scope of the fiduciary endeavour and thus a category (2) gain. This would be true whether or not the company had the funds to make the investment, or would, if given the choice, have decided to do so. All those matters are for the principal to determine, not for the fiduciary to presume. But in this particular case the company was a family-owned company, and on the breakdown of the family relationship the other side of the family had insisted that no further property investments be made. That was taken by the court as going merely to the issue of the principal's choice, in the way just noted. But on another reading, the assertion goes instead to the issue of scope. If, as a result of the bar on future investment, the company is no longer a company interested in property investment (notwithstanding that its corporate capacity was not so limited), then the defendant fiduciaries' acquisition would not involve a conflict; indeed, it would not be disloyal in any way. The court, however, refused to accept that scope could be limiting in this way. True, the facts surrounding the agreed bar on future investments in this case can be interpreted in different ways, especially in the context of family breakdown, but one of those interpretations does go to scope, and the question is crucial doctrinally in assessing the existence and nature of the remedies for fiduciary disloyalty.

[108] *O'Donnell v Shanahan* [2009] EWCA Civ 751 at [69] (Rimer L.J.), suggesting, in the context of directors as fiduciaries, that a director was always a director; he did not have "off-duty" time. Similarly, see *Bhullar v Bhullar*, [2003] EWCA Civ 424 at [41]: a fiduciary has "one capacity and one capacity only".

[109] Hence the suggestion here of a strict and limiting "scope" or "line of business" test. By contrast, however, notice that there is no "line of business" limitation in category (1) use of property cases, nor in category (3) misuse of position cases, nor is one warranted: see immediately below.

[110] [2003] EWCA Civ 424.

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But, for present purposes, what is important is that there *is* a dividing line. Here that line is applied rigorously, and the "conflict of duty and interest" category embraces *only* those cases where the opportunity taken personally by the defaulting fiduciary is one which, given the specific ambit or scope of the fiduciary's duty to act for the benefit of the principal, might legitimately have been pursued for the principal.

C. Category (3) gains from opportunities which arise solely because of the fiduciary's role (i.e. misuse of position cases)

The fourth important point concerns category (3). Taken at face value, this may seem the most difficult category to define, but this is simply because we are not used to applying rigorously the prescription adopted here that the gain must be one made "by reason of *and in the course of*" the fiduciary's role: the opportunity must have been offered to the fiduciary *as fiduciary*. This category does not capture gains simply because the fiduciary's role has equipped him to access or evaluate them more effectively; nor does it capture gains just because they could not have been made "but for" the fiduciary role. All this was discussed earlier. As a result of this restrictive approach, very few cases will be classed exclusively in this category. And this is the only category where the disgorgement remedy is personal. Empirically, therefore, *most* cases of fiduciary disgorgement will be proprietary – perhaps as the proponents of that view have said all along.

D. Assigning different scenarios to appropriate categories

The fifth and final point to be made is about category overlaps. Notice that the facts of a particular fiduciary breach may admit of classification quite uncontroversially under more than one of the categories described above.[111] For example, it is often possible to characterise disloyal gains as category (1) uses of property or alternatively as a category (2) conflicts of duty and interest, and so on.[112] In these circumstances, the fiduciary can simply pursue the claim which delivers the most advantageous remedy. But on any given set of facts it will be clear whether the gain falls within each of the nominated categories *or not*. And each category contains cases which do not fit within any of the other categories. This, then, is the fewest possible doctrinally distinct categories which can be mooted. On the analysis proposed here, all this is dealt with in one step by treating the categories as creating an

[111] This is not the same type of classification problem identified in *Mankarious* [2013] EWCA Civ 17 at [83]–[84] (Etherton C.), where the problem was that a given set of facts could *not* be clearly classified as within or outside each of the categories in *Sinclair*.

[112] Consider the way commentators write about *Keech v Sanford, Regal Hastings* and *Boardman v Phipps*, to take three well-known examples.

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analytical hierarchy and testing, first, whether the given facts fall within category (1), and, failing that, within category (2), and, finally, failing that, within category (3). This simplifies the factual analysis and deals in one step with the most appropriate remedies.

By way of closing this section, it is pertinent to notice that, if accepted, this proposed analysis would support the ultimate findings of most of the cases cited in *Sinclair*, *Lister* and *Reid*. However, it would not, as it turns out, support the ultimate findings in those three cases themselves. As indicated at various points in the preceding discussion, those cases would be assigned to categories (1), (2) and (3) respectively: the remedies in the first two cases would therefore be proprietary, not personal; and in the last would be personal, not proprietary. That reversal, in each case, seems amply justified as a matter of doctrine; it is also supported by a substantial weight of precedent in each case.[113] But this difference in identified and preferred outcomes also reinforces the point that these three cases each illustrate different and particularly unusual contexts for the remedying of fiduciary disloyalty, and therefore require especially careful analysis. These three cases have each ignited wide debate. They certainly cannot all be right. Indeed, it is, at the very least, difficult to see how the outcome in *Lister v Stubbs* can now be defended, even on the analysis proposed by Lord Neuberger in *Sinclair*.[114]

VI. Insolvency and Third Party Creditors – Normative Concerns

Finally we should say something about insolvency. The clear and explicit policy line running through all the cases which have rejected the notion that the principal's remedy is proprietary is the idea that otherwise the fiduciary's creditors would be unduly and unfairly penalised.[115]

In truth, the disloyal fiduciary has by definition acquired the assets in question by doing wrong. He should not have them, and – unless an alternative argument can be run, as to which see below – then none of his creditors nor his principal should have them either. They are gains which should not be *in* the insolvency pot. But the fact of the matter is that they are there. It then becomes a matter of policy to decide who, as between all the innocent claimants on the pot, is most entitled to the unexpected advantage of the fiduciary's wrongdoing. Since the ordinary creditors at least have a positive claim, while the disloyal fiduciary's principal only has a negative claim (i.e. that the fiduciary

[113] Although that is hardly persuasive, given the diversity of views in such cases.

[114] See *Mankarious* [2013] EWCA Civ 17 at [116] (Etherton C.), noting the urgent need for the Supreme Court to resolve the issue.

[115] See the cases and commentary cited in notes 6 and 24 above, noting especially the writings of R. Goode.

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should *not* have the gains), then it seems tolerably clear that the principal should not rank ahead of the general creditors. Indeed, it might seem obvious, when the problem is put this way, that the principal should rank *behind* the general creditors.[116] But that would require a change to the statutory insolvency regime. Until then, we might at least be thankful that the analysis proposed here gives doctrinal support to an outcome which does not automatically compound the problem by awarding the principal priority in the recovery of fiduciary disgorgement gains.

But, and this is a big "but", this argument about relative ranking applies only to gains made by the fiduciary which the fiduciary *must not* have; it does not apply to gains which the principal *must* have. Then, by contrast, *those* gains can and *should* go in priority to the principal.[117] And as it turns out, on the analysis proposed here, *most* disloyal gains fall into that category, being category (1) and (2) gains.

All this is not unfair to the insolvent fiduciary's creditors: such creditors take their fiduciary as they find him, with all pre-insolvency proprietary interests respected on insolvency, and for good practical reasons. Here those proprietary interests arise specifically to give appropriate support and recognition to the valuable and rather complicated institution constituted by the fiduciary relationship.

VII. Conclusion

The arguments presented here can be summarised very simply.

First, we can draw no conclusions about proprietary consequences from the assertion that a fiduciary must "account in equity".

Secondly, the maxim that "equity treats as done that which ought to be done" does not convert every obligation relating to identifiable property into a proprietary remedy by way of constructive trust, not even when the obligation to transfer is owed by a fiduciary. The fiduciary's proscriptive obligation to disgorge is not enough; it simply explains why the fiduciary *must not* have the property. To explain why the principal *must* have the property, and have it by way of constructive trust, requires something more. That emerges not from the proscriptive fiduciary rules, but from the positive underpinnings of the fiduciary relationship which oblige the fiduciary to act in the best interests of the principal in dealing with the principal's property or in pursuing investment opportunities within the defined scope of the fiduciary's appointment. The scope question is thus crucial, and has not so far been given the careful attention it deserves. Within this limited realm of

[116] See the argument in V. Finch and S. Worthington, "The Pari Passu Principle and Ranking Restitutionary Rights" in F. Rose (ed.), *Insolvency and Restitution* (London 2000), ch. 1.

[117] Ibid.

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fiduciary activity, the principal can *adopt* the fiduciary's choices, including his disloyal choices, and insist that their benefits are specifically delivered to the principal and not held personally by the fiduciary.

Thirdly, the disgorgement of secondary profits deserves careful attention. The prophylactic goal in fiduciary law is directed at stripping the fiduciary of any profits he would not hold *but for* his disloyalty. This does not depend on tracing at all. It depends upon proof of causal links. By contrast, if the fiduciary uses the principal's property to make further investments, then the traceable proceeds of those investments will, ipso facto, be held on constructive trust for the principal. Whatever the explanation for these tracing consequences (and the leading authority is doubted here), it is at least clear that the notions of traceable and "but for" secondary profits must be kept quite separate.

These three propositions are advanced in order to correct certain assumptions that have infected consideration of the equitable duty to account, the maxim that "equity treats as done that which ought to be done", and the use of tracing to access investment gains, and have, in different ways, contributed to the difficulties in analysing proprietary remedies for disgorgement.

By contrast, used rigorously, in combination with a careful analysis of the foundational rules on fiduciary loyalty, it is clear that there are only three doctrinally distinguishable categories of disloyal gain which a fiduciary might be required to disgorge:

(1) gains derived from use of the principal's property (regardless of the nature of the use);
(2) gains derived from opportunities which are within the scope of the fiduciary's endeavour (i.e. gains involving "conflicts of duty and interest", judged with very careful regard to issues of scope, but with it then being irrelevant that none of the principal's property was used in acquiring the gain);
(3) gains derived from opportunities which arise solely because of the fiduciary's role (often termed gains from "misuse of position", but restricted here to gains from opportunities presented to the fiduciary *as fiduciary*, acquired "by reason of and in the course of" the fiduciary role, but with it then being irrelevant that the gain was not within the scope of the fiduciary endeavour and did not involve use of the principal's property).

These categories provide a simple analytical hierarchy. If a gain falls within category (1) or, failing that, within category (2), then the resulting disgorgement remedy is proprietary. If the gain falls into neither of those categories, but falls into category (3), then the disgorgement remedy is personal. As indicated above, this simple remedial hierarchy

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is derived from a detailed consideration of the positive elements of the rules on fiduciary loyalty.

This proposed analysis is eminently simple. It provides both a ready classificatory scheme and a doctrinal justification for proprietary or personal outcomes within the different categories. If it is accepted, and if it really is so simple, then the question might be asked, how have we managed to tie ourselves in knots for so long over the issue of disgorgement of fiduciary gains? One answer is suggested. Much of our private law is built on ideas of property and obligation, including our explanations of remedies. But these concepts can sometimes trip us up. In the area of fiduciary disgorgement remedies, we have perhaps hung too much on the obligation to disgorge, giving it a positive impetus its doctrinal roots do not support. Equally we have hung too much on notions of property, presuming too much where analogies are seductive but not secure. But a return to the fundamental principles of fiduciary loyalty, as proposed here, appears to provide a simple route out of these troubles and will, it is hoped, assist in resolving these important questions concerning fiduciary disgorgement remedies.

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