

# FIDUCIARIES AND PROFIT DISGORGEMENT FOR BREACH OF CONTRACT

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Introduction.....	1
<i>Attorney General v Blake</i> .....	2
Breach of contract and breach of fiduciary duty.....	4
The undertaking as the genesis of fiduciary duty .....	4
Irrevocable undertakings.....	6
The fiduciary duty in <i>Attorney General v Blake</i> .....	7
Disgorgement of profits for contractual breaches of loyalty by employees and agents	9
Conclusion .....	13

## Introduction

This paper was billed as having a focus upon the ubiquity of disgorgement of profits for breach of contract. Such a title might immediately seem controversial. But the thesis is ultimately conservative. It demands consideration only of the descriptive labels chosen to describe the circumstances in which disgorgement of profits are awarded against contract breakers.

Labels and language are important. They ought to elucidate not obfuscate. One of the most difficult, and obfuscatory, labels is ‘fiduciary’. Fiduciary derives from the Latin *fiducia* meaning trust or confidence. But, as I will explain, it is well recognised that a person can owe fiduciary duties even though no-one reposes any trust or confidence in him or her. It is likewise well recognised that actual trust or confidence is not a necessary condition for the presence of a fiduciary relationship.<sup>1</sup>

Three propositions underlie the thesis I will present. None is remarkable, although the consequence is that an account and disgorgement of profits for breach of contract is an occurrence which is considerably more common than is often realised:

(1) An account and disgorgement of profits is a common, and unremarkable, remedy for breach of fiduciary duty;

(2) it is not unusual for the content of a fiduciary duty to be determined by the nature of express or implied contractual undertakings of loyalty such as undertakings by a

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\* Judge of the Supreme Court of Western Australia. My thanks to Long Pham for research assistance on this paper.

<sup>1</sup> *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 at 69, 141-142; *White v Jones* [1995] 2 AC 207 at 271-273; *Breen v Williams* (1996) 186 CLR 71 at 93; F Maitland *Equity: A Course of Lectures* (1936 revised edition) at 42-43.

defendant not to profit from his or her position or not to put himself or herself in a position of conflict; and

(3) in such cases, attaching the epithet 'fiduciary' to the breach of an express or implied contractual undertaking adds little, perhaps nothing, to the analysis of whether an account and disgorgement of profits should be available.

The conclusion, therefore, is that although profit disgorgement for a breach of contract is thought to be heresy, it may be far more common than is usually realised. The reason for the lack of recognition is that the award is generally made after the label 'fiduciary duty' is attached.

### ***Attorney General v Blake***

The English case which highlights the thesis of this article is *Attorney General v Blake*.<sup>2</sup> In that case, the House of Lords recognised that an account and disgorgement of profits could be awarded for a breach of contract. The case involved exceptional facts. An English spy, George Blake, was a Russian double agent. In 1961, he was caught and imprisoned for 42 years which was then the longest term of imprisonment ever imposed in Britain. Five years later he escaped from his English prison and relocated to Moscow where he has lived ever since in what he has described as 'the happiest days of my life'. In 1989 Blake wrote his autobiography. The information to which he referred was no longer confidential. His publishers started paying him royalties. £60,000 had been paid, and £90,000 more was due when the Crown commenced an action to restrain the payments.

In the Court of Appeal, an injunction had been granted restraining the publisher from sending any royalties to Blake. The difficulty with this order was that in the absence of a private cause of action against Blake there was no right upon which an injunction could be based.<sup>3</sup>

In one respect, Blake is an interesting case as a study in judicial methodology. At the Court of Appeal hearing, Lord Justice Millett asked counsel whether he wished to argue for disgorgement of profits for breach of contract. Counsel declined explaining that his argument was based on breach of fiduciary duty. He was asked again. Again he declined. In the joint judgment, the Court of Appeal said that the Attorney would have been awarded disgorgement of profits for breach of contract if they had been sought. Unsurprisingly, when the matter came before the House of Lords, disgorgement of profits were sought for a breach of contract. But when the House of Lords heard the case, Lord Nicholls then asked whether the account and disgorgement of profits were sought for breach of *fiduciary* duty. And in the leading speech Lord Nicholls explained that the breach of contract, if not a fiduciary obligation, was closely akin to one. But the arguments in the House of Lords were not cast on the basis of fiduciary duties.

When the matter reached the House of Lords the issue concerned whether publication had breached any duty which Blake owed to the Crown. The duty to which the Solicitor General (as his Lordship then was) pointed was Blake's breach of his

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<sup>2</sup> [2001] 1 AC 268 ('*Blake*').

<sup>3</sup> As Lord Nicholls and Lord Hobhouse observed, an injunction could not be awarded in support of a power to confiscate proceeds of crime in the absence of a realistic possibility of invoking statutory confiscation powers: [2001] 1 AC 268, 289 (Lord Nicholls), 298 (Lord Hobhouse).

employment contract with the Secret Intelligence Service.<sup>4</sup> The House of Lords, in a path-breaking decision, held that the profits which Blake made could be disgorged as a remedy for this breach of contract. Their Lordships refused to lay down rules for the circumstances in which an account and disgorgement of profits would be available for a breach of contract.<sup>5</sup> In the leading speech, Lord Nicholls suggested that all the circumstances needed to be considered but that '[a] useful general guide, although not exhaustive, is whether the plaintiff had a legitimate interest in preventing the defendant's profit-making activity and, hence, in depriving him of his profit'.<sup>6</sup>

The decision in *Blake* was met by a frenzy of academic activity. The timing of the delivery of the decision, on 27 July 2000, was also personally unfortunate for me. Several weeks earlier I had just completed, but had not submitted, a doctoral thesis on the subject of gain-based damages. My ultimate response in the revised thesis was a qualified, but positive one. But few other academics had any enthusiasm for the decision. One English commentator argued that the authority of the case as a precedent was confined to the publication of memoirs by spies.<sup>7</sup> Many commentators gave the decision a decidedly cool reception.<sup>8</sup>

The debate surrounding the *Blake* decision, including my contributions, focussed upon the appropriate remedy for a breach of contract. One perspective generally lacking in the debate was the assumption by the lower courts in *Blake* that Blake did not owe fiduciary duties. If Blake's breaches had been characterised as breaches of 'fiduciary' duty then this would have rendered entirely unremarkable the decision to disgorge Blake's profits.

Two decades earlier a majority of the United States Supreme Court had confronted very similar facts and had held that profits could be disgorged by a constructive trust for breach of a fiduciary duty.<sup>9</sup> In that case, Mr Snapp, a former Central Intelligence Agency operative had published a book concerning CIA activities in South Vietnam. The book was published in breach of his contractual obligations to seek pre-publication review from the CIA. Agreeing with the trial judge, the majority of the Supreme Court held that profits could be disgorged because the contract 'was no ordinary contract; it gave life to a fiduciary relationship and invested in Snapp the trust of the CIA'.<sup>10</sup> The dissentients would not have allowed disgorgement of Snapp's profits considering that 'the majority attempts to equate [the] contractual duty with Snapp's duty not to disclose, labelling them both as "fiduciary"'.<sup>11</sup>

The assumption that Blake's duties were not fiduciary was not justified. But the ultimate point to be made in this paper is that the label 'fiduciary' can often distract

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<sup>4</sup> If, indeed, he was ever employed: see A W B Simpson 'A decision per incuriam?' (2009) 125 *Law Quarterly Review* 433.

<sup>5</sup> [2001] 1 AC 268 at 285 (Lord Nicholls) and 291, Lord Steyn explaining that the principles should be hammered out on the anvil of concrete cases.

<sup>6</sup> [2001] 1 AC 268 at 285.

<sup>7</sup> S Hedley 'Very much the wrong people: The House of Lords and the publication of spy memoirs (AG v Blake)' [2000] 4 *Web JCLI*.

<sup>8</sup> See, eg, J Gleeson SC and J Watson, 'Account of profits, contracts and equity' (2005) 79 *Australian Law Journal* 676; A Phang and P Lee, 'Restitutionary and Exemplary Damages Revisited' (2003) 19 *Journal of Contract Law* 1; R Cunnington, 'Equitable Damages: A Model for Restitutionary Damages' (2001) 17 *Journal of Contract Law* 212; D Campbell and D Harris, 'In Defence of Breach: A Critique of Restitution and the Performance Interest' (2002) 22 *Legal Studies* 208.

<sup>9</sup> *Snapp v United States* (1980) 444 US 507.

<sup>10</sup> *Snapp v United States* (1980) 444 US 507, 510.

<sup>11</sup> *Snapp v United States* (1980) 444 US 507, 519 (Stevens, Brennan and Marshall JJ).

attention from the contractual genesis of agreed loyalty undertakings and the fact that the award of an account and disgorgement of profits is made for that particular breach of contract.

## **Breach of contract and breach of fiduciary duty**

### *The undertaking as the genesis of fiduciary duty*

The starting point in this area of law is that 'to describe someone as a fiduciary, without more, is meaningless'.<sup>12</sup> The proper questions to ask are (1) to whom the particular 'fiduciary' duties are owed, (2) the nature of those duties, (3) the manner in which they are said to have been breached, and (4) the consequences which follow from breach.<sup>13</sup>

I have explained elsewhere the difficulties with the view that fiduciary duties arise as an incident of a particular status or relationship. This is demonstrably false. Fiduciary duties have been recognised in relationships *ad hoc* (for the particular relationship in the case). Conversely, fiduciary duties will not always arise even in relationships where their incidence is very common. The 'archetypal' fiduciary,<sup>14</sup> the trustee, can be used as an example. Some trustees do not owe fiduciary duties at all.<sup>15</sup> Other trustees, who might usually owe fiduciary duties, will not do so if the express or implied terms of the trust instrument deny those duties.<sup>16</sup> And even when a fiduciary duty is owed by a trustee, the duty does not arise because of the *fiducia* or 'trust' which is sometimes said to inhere in that relationship. There need be no relationship of trust or confidence between a trustee and a beneficiary; the beneficiary might not know of the trust and the beneficiary might not even be born.<sup>17</sup>

A better approach to understanding fiduciary duties may be to regard the genesis of a fiduciary duty as based upon the undertaking made by the fiduciary. I have explained the reasons for this in more detail elsewhere.<sup>18</sup> Canadian, English and Australian decisions provide some support for this view.

In Canada, Cromwell J writing for the unanimous Supreme Court recently said that 'the law is, in my view, clear that fiduciary duties will only be imposed on those who have expressly or impliedly undertaken them'.<sup>19</sup> A joint judgment of the High Court of Australia, quoting from McLachlin J, has also emphasised that '[t]he essence of a

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<sup>12</sup> *Elovalis v Elovalis* [2008] WASCA 141 [65]. See also *Re Goldcorp Exchange Ltd (In Receivership)* [1995] 1 AC 74, 98 (Privy Council).

<sup>13</sup> *Securities and Exchange Commission v Chenery Corporation* (1943) 318 US 80, 85-86 (Frankfurter J); *Elovalis v Elovalis* [2008] WASCA 141 [65] (Buss JA); *Bristol & West Building Society v Mothew* [1998] Ch 1 at 18 (Millett LJ); P Finn *Fiduciary Obligations* (1977) 2.

<sup>14</sup> *Maguire v Makaronis* [1997] HCA 23; (1997) 188 CLR 449, 473 quoting *Hospital Products Ltd v United States Surgical Corporation* [1984] HCA 64; (1984) 156 CLR 41 at 68 (Gibbs CJ).

<sup>15</sup> *Giumelli v Giumelli* [1999] HCA 10; (1999) 196 CLR 101, 112 [5] (Gleeson CJ, McHugh, Gummow & Callinan JJ).

<sup>16</sup> *Sargeant v National Westminster Bank* (1990) 61 P&CR 518; *Hayim v Citibank NA* [1987] AC 730; *Citibank NA v QVT Financial LP* [2007] EWCA 11, 1 All ER (Comm) 475; *Elovalis v Elovalis* [2008] WASCA 141 [67] (Buss JA); *Re Beatty* [1990] 1 WLR 1503, 1506 (Hoffmann J); *Edge v Pensions Ombudsman* [2000] Ch 602, 621, 627-630 (Chadwick LJ for the Court of Appeal).

<sup>17</sup> *Swain v Law Society* [1982] 1 WLR 17, 48 (Fox LJ); J D Heydon and M J Leeming (eds) *Jacobs' Law of Trusts in Australia* (2006 7th edn) 4 [107].

<sup>18</sup> J Edelman, 'When do fiduciary duties arise?' (2010) 126 Law Quarterly Review 302.

<sup>19</sup> *Galambos v Perez* [2009] SCC 48; [2009] 3 SCR 247, 278 [71].

fiduciary relationship... is that one party pledges itself to act in the best interests of the other.<sup>20</sup>

One common manner in which a fiduciary undertaking, or pledge by a fiduciary, might occur is by contract. English courts have recently observed that it may be that the rules governing the implication or construction of contractual duties of loyalty are the same as those governing the creation of fiduciary duties;<sup>21</sup> for instance, terms preventing conflicts of interest and duty, or conflicts of duty and duty, or the making of profit from a position.<sup>22</sup> There are also statements to this effect in Australia. Although dissenting in the result, one of the most widely quoted statements concerning fiduciary duties in Australia is that of Mason J in *Hospital Products Ltd v United States Surgical Corporation*.<sup>23</sup>

'...the existence of a basic contractual relationship has in many situations provided a foundation for the erection of a fiduciary relationship. In these situations it is the contractual foundation which is all important because it is the contract that regulates the basic rights and liabilities of the parties.'

Or, as Jacobson J said in *ASIC v Citigroup Global Markets Australia Pty Ltd (No 4)*,<sup>24</sup>

'[W]here a fiduciary relationship is said to be founded upon a contract, the ordinary rules of construction of contracts apply. Thus, whether a party is subject to fiduciary obligations, and the scope of any fiduciary duties, is to be determined by construing the contract as a whole in the light of the surrounding circumstances known to the parties and the purpose and object of the transaction.'

The implication of a fiduciary duty into an undertaking may depend on matters including the course of dealing between the parties or the circumstances of the appointment of the fiduciary.<sup>25</sup> But in each case, the undertaking is, as Murphy JA has said, 'the critical feature'.<sup>26</sup>

An example is *Noranda Australia Ltd v Lachlan Resources NL*.<sup>27</sup> In that case, clause 14 of a joint venture agreement provided a joint venturer should not negotiate with a prospective assignee of its interest in the joint venture without first notifying the other joint venturers of its intention and giving the other joint venturers a chance to offer to purchase the interest. One of the joint venturers, Geopeko, negotiated the assignment of its interests to Lachlan without first providing the other joint venturers a chance to purchase its interests. One of the other joint venturers, Noranda, sought to restrain the assignment. One of Noranda's arguments was that Geopeko had breached a fiduciary obligation contained in clause 7.8 of the joint venture agreement. That clause was expressed in broad terms and spoke of the 'fiduciary relationship' between the parties.

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<sup>20</sup> *Youyang Pty Ltd v Minter Ellison Morris Fletcher* [2003] HCA 15; (2003) 212 CLR 484, 500-501 [40] (Gleeson CJ, McHugh, Gummow, Kirby and Hayne JJ) citing *Canson Enterprises Ltd v Boughton & Co* [1991] 3 SCR 534, 543 (McLachlin J).

<sup>21</sup> *Ross River Ltd v Waveley Commercial Ltd* [2012] EWHC 81 (Ch) [241]-[244] (Morgan J); *F & C Alternative Investments (Holdings) Ltd v Barthelemy* [2011] EWHC 1731 (Ch) [225] (Sales J).

<sup>22</sup> See J Edelman, 'When do fiduciary duties arise?' (2010) 126 *Law Quarterly Review* 302 at 316, 323-26 (good faith); 316, 318-19 (conflict of interest and duty); 316, 319-21 (duties not to make a profit from a position).

<sup>23</sup> (1984) 156 CLR 41, 97.

<sup>24</sup> (2007) 160 FCR 35, 77 [281].

<sup>25</sup> *Chan v Zacharia* [1984] HCA 36; (1984) 154 CLR 178, 196 (Deane J); *Streeter v Western Areas Exploration Pty Ltd (No 2)* [2011] WASCA 17, (2011) 278 ALR 291, 349 [70]-[71] (McLure P).

<sup>26</sup> *Streeter v Western Areas Exploration Pty Ltd (No 2)* [2011] WASCA 17; (2011) 278 ALR 291, 304 [364] (Murphy JA).

<sup>27</sup> (1988) 14 NSWLR 1.

Although granting the injunction, Bryson J rejected this argument. His Honour held that the joint venture agreement had defined the limits of the fiduciary duties owed by Geopeko and that the very general 'fiduciary' clause 7.8 did not convert the specific clause 14 into a fiduciary duty: 'it would not be right to impose on the parties fiduciary obligations wider or different to those which in careful terms they imposed on themselves'.<sup>28</sup>

Of course, contract is not the only source of fiduciary duty. Undertakings can also be non-contractual or unilateral. An undertaking by the express trustee to hold assets on trust can import express or implied fiduciary duties. This undertaking can be unilateral. Similarly, a solicitor's fiduciary duties may be the same whether the solicitor acts for remuneration or whether he or she acts by a unilateral undertaking.

### ***Irrevocable undertakings***

It has been argued that there is a fundamental difference between a fiduciary undertaking and other undertakings. It is said that unlike the usual situation with undertakings, fiduciary undertakings are special because they cannot be revoked. This argument does not withstand scrutiny.

It is true that non-contractual undertakings can often be revoked. If I orally promise to pay \$1,000 to a friend in need, then absent any detrimental reliance by my friend, I can revoke my promise at any time. The revocation of my promise may be immoral. But it is not unlawful.

However, not all unilateral undertakings can be revoked. Several examples can be given. First, in some circumstances where a promisee has detrimentally relied upon a promise, the undertaking may not be able to be revoked. The French word *estoppel* is sometimes used to describe these cases. In Australia these cases usually fall within the species of estoppel sometimes described as promissory estoppel. In England they are described as 'proprietary estoppel', although the word 'proprietary' can be used very broadly.<sup>29</sup> It suffices to say here that the word 'estoppel', and its numerous different species, involves language which is at least as obfuscatory as that of 'fiduciary'.

Secondly, if the unilateral undertaking is in the form of a Deed, it will be a breach of covenant to revoke it.

Thirdly, if the unilateral undertaking is contained in a letter of credit, it will be binding.

Therefore, it is not anomalous for an undertaking which is characterised as 'fiduciary', such as a 'no conflict'<sup>30</sup> or 'no profit'<sup>31</sup> duty, to be irrevocable. Nevertheless, deeper questions might be asked concerning why some unilateral promises are irrevocable and binding whilst others are not. On the one hand, unilateral promises in the form of a Deed, or in a letter of credit, or concerning a fiduciary 'conflict' or 'profit' duties are binding. On the other hand, my unilateral promise to pay money, even if intended to

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<sup>28</sup> (1988) 14 NSWLR 1, 17.

<sup>29</sup> *Yeoman's Row Management Ltd v Cobbe* [2008] UKHL 55; [2008] 1 WLR 1752, [14] (Lord Scott) ; 'usually a right to or over land but, in principle, equally available in relation to chattels or choses in action'. See my discussion in *Snell's Equity* (32<sup>nd</sup> edition, 2010) ch 10.

<sup>30</sup> A duty owed to the principal not to put oneself in a position where there is a conflict of duty to the principal and self-interest; or a conflict of duty to the principal and duty to another.

<sup>31</sup> A duty not to make a profit from one's position.

be binding and understood to be so, is not binding. Lord Mansfield thought that any seriously intended promise should be binding.<sup>32</sup> But apart from areas such as letters of credit, his view of consideration did not prevail.

The short point is that some unilateral undertakings can be revoked. Others cannot. A necessary, though not sufficient, condition may be that the unilateral undertaking is objectively intended to be irrevocable. Unilateral undertakings to which courts have attached the label 'fiduciary' (such as no conflict and no profit undertakings) will usually satisfy this condition and will usually be irrevocable.

The same is true of bilateral undertakings. When two parties enter a contract, the contractual obligations cannot be unilaterally revoked. Indeed, even events such as a sufficiently serious breach by the other party will not terminate all contractual obligations. Others will remain, such as a duty of confidence.<sup>33</sup> The same may be true of the termination of a contract which contains an agreement to arbitrate.<sup>34</sup>

The same may also be true of a 'fiduciary' duty which is part of a contractual undertaking. Like all other contractual undertakings it is a binding, irrevocable duty. And like duties of confidence, or arbitration duties, it might survive termination of the rest of the contract. In each case, a necessary condition for the survival of these terms is that the objective intention underlying them is that they survive termination; effect is then given in these categories to that intention.

In relation to fiduciary duties, an example of the duty surviving termination of the rest of the contract is where, after providing legal advice about a commercial opportunity, a solicitor seeks to compete against the former client in relation to that opportunity. Despite the termination of the retainer the solicitor may not be released from the obligation not to profit from this information which came to the solicitor in his or her fiduciary capacity.<sup>35</sup> The implication in all the circumstances is that the duty should continue. On the other hand, a senior employee's contractual duty not to compete with his employer will usually come to an end with the termination of his contract, unless the contract provides that the duty should continue.<sup>36</sup>

### **The fiduciary duty in *Attorney General v Blake***

One difficulty which the lower courts faced in *Blake* arose from a perception that where fiduciary duties arise from a contract the termination of the contract should always terminate the fiduciary duties. As I have said, there was no doubt that if Blake had been labelled a 'fiduciary' then an account and disgorgement of his profits would have been entirely uncontroversial. But the reason that the lower courts rejected the argument that Blake was a fiduciary was because his employment had ceased and, therefore, the fiduciary relationship had come to an end.<sup>37</sup>

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<sup>32</sup> *Pillans & Rose v Van Mierop & Hopkins* (1765) 3 Burr 1663; 97 ER 1035.

<sup>33</sup> See, eg, *Independent Corporate Services Ltd v Stevens* [2002] WASC 280; *NP Generations Pty Ltd (t/as LJ Hooker Blackwood) v Feneley* [2000] SASC 240; (2000) 50 IPR 63; *Forkserve Pty Ltd v Jack* [2000] NSWSC 1064, approving *Faccenda Chicken Ltd v Fowler & Ors* [1987] Ch 117; (1985) 6 IPR 155.

<sup>34</sup> *Fiona Trust and Holding Corporation v Privalov* [2007] UKHL 40; [2007] 4 All ER 951, 959-960 [17]-[19] (Lord Hoffmann), 963-964 [35] (Lord Hope).

<sup>35</sup> *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22; (2007) 230 CLR 89, 137 [103]. (Gleeson CJ, Gummow, Callinan, Heydon and Crennan JJ).

<sup>36</sup> *Attorney-General v Blake* [1998] Ch 439 at 454 (Lord Woolf MR, Millett and Mummery LJ).

<sup>37</sup> *Attorney-General v Blake* [1997] Ch 84 at 96 (Sir Richard Scott VC); *Attorney-General v Blake* [1998] Ch 439 at 454 (Lord Woolf MR, Millett and Mummery LJ).

This argument was not re-agitated in the House of Lords, although Lord Nicholls contemplated that this conclusion might have been wrong. Lord Nicholls said that '[Blake's] undertaking, if not a fiduciary obligation, was closely akin to a fiduciary obligation, where an account of profits is a standard remedy in the event of breach'.<sup>38</sup>

Lord Nicholls was clearly not convinced by the view of the lower courts that Blake owed no fiduciary obligations. It is useful to examine why the trial judge and Court of Appeal thought that there could be no breach of fiduciary duty. The starting point is a decision of the House of Lords in *Prince Jefri Bolkiah v KPMG (a firm)*.<sup>39</sup>

In *Prince Jefri*, Prince Jefri had engaged KPMG to advise him in relation to litigation in which he was involved. He gave KPMG access to confidential information including the location of his assets. The litigation ultimately settled. KPMG were also the auditors of an investment agency engaged by the government of Brunei. Prince Jefri was the chairman of that agency. As auditors, KPMG were appointed to investigate the loss of agency assets alleged to have been removed by Prince Jefri. Prince Jefri objected to the involvement of KPMG. Although KPMG appointed a different team of people to work on the investigation and erected 'Chinese walls' to protect the information provided to them by Prince Jefri, the prince sought an injunction to remove KPMG from the investigation. The House of Lords held that KPMG had not discharged its onus to show that the 'Chinese walls' had removed any real risk of disclosure. The injunction was granted. However, the House of Lords held that KPMG had not breached any fiduciary duty by their involvement in the investigation. Delivering the leading speech in the House of Lords, Lord Millett said:<sup>40</sup>

The fiduciary relationship which subsists between solicitor and client comes to an end with the termination of the retainer. Thereafter the solicitor has no obligation to defend and advance the interests of his former client. The only duty to the former client which survives the termination of the client relationship is a continuing duty to preserve the confidentiality of information imparted during its subsistence.

Dr Conaglen has observed that Australian law is divided on the correctness of this statement that a fiduciary duty does not survive the termination of a contractual retainer.<sup>41</sup> Conaglen rightly doubts the accuracy of the statement as a universal rule, arguing that the bald statement that fiduciary duties terminate with the termination of a contractual retainer goes too far: 'fiduciary doctrines are sometimes applied after the fiduciary relationship has been terminated... [in] instances in which a fiduciary has sought to circumvent fiduciary doctrine's protection'.<sup>42</sup>

The basis for Dr Conaglen's argument is that a fiduciary duty requires the existence of an underlying non-fiduciary duty. I would prefer to express the matter differently. The fiduciary duty requires an assumption of responsibility or, in another word, an 'undertaking'. As I have explained, sometimes the undertaking may be irrevocable by

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<sup>38</sup> [2001] 1 AC 268 at 287.

<sup>39</sup> [1999] 2 AC 222 ('*Prince Jefri*').

<sup>40</sup> *Ibid* 235. See also *Attorney General v Blake* [1998] Ch 439 at 453–55.

<sup>41</sup> See, eg, *Spincode Pty Ltd v Look Software Pty Ltd* [2001] VSCA 248; (2001) 4 VR 501 at 522 [53] (Brooking JA); *Pinnacle Living Pty Ltd v Elusive Image Pty Ltd* [2006] VSC 202 at [13] (Whelan J); *Commonwealth Bank of Australia v Kyriackou* [2008] VSC 146 at [10] (Judd J). Compare *Bureau Interprofessionnel Des Vins De Bourgogne v Red Earth Nominees Pty Ltd* [2002] FCA 588 at [17]-[18] (Ruan J); *Qihua Zhao v Sheng Yu Zhang* [2007] NSWSC 891 at [26]-[28] (Nicholas J). See M Conaglen, *Fiduciary Loyalty* (2010) 188-194.

<sup>42</sup> M Conaglen, *Fiduciary Loyalty* (2010) 188.

the undertaker; the obligation will remain binding, subject to waiver by the right-holder, even when the contract terminates.<sup>43</sup>

There is another way of expressing why, on the reasoning of the House of Lords, Blake's fiduciary duty should have survived the termination of his contract. This is because, by finding that Blake had breached his contract after leaving the security services and publishing his book, the House of Lords implicitly accepted that this contractual duty had survived termination. It would be nonsense to say that the fiduciary duty had terminated when the contract terminated, even though the same contractual duty had *not* terminated when the contract terminated.

Blake's duty, as expressed by the House of Lords, was not to disclose official information gained from his employment.<sup>44</sup> This duty plainly included a duty not to make a profit from the disclosure of official information gained from his employment. So understood, if the House of Lords in *Blake* had simply attached the label 'fiduciary' to Blake's contractual duty then the decision ought to have been entirely uncontroversial. Actually, as the late Professor Simpson pointed out, Blake's undertaking was not, in fact, contractual at all; even the label 'contractual duty' was unnecessary.<sup>45</sup>

## **Disgorgement of profits for contractual breaches of loyalty by employees and agents**

There are a number of instances where a breach of a duty of loyalty in a contract leads courts to disgorge any profits made by the contract breaker. Sometimes these breaches attract the epithet 'fiduciary'. But not always.

One example is the breach of a contractual duty not to profit from the position of agent or for an agent not to put himself or herself in a position of conflict. The concept of a contract of 'agency' is itself used in different ways. On many occasions the High Court of Australia has repeated the remarks of Lord Herschell in *Kennedy v De Trafford*<sup>46</sup> that '[n]o word is more commonly and constantly abused than the word "agent".<sup>47</sup> Sometimes a contractual relationship is characterised as one of 'agency' when what is really sought is to impose vicarious liability upon the principal.<sup>48</sup> On other occasions, the concept of 'agency' is employed in order to attribute the acts of

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<sup>43</sup> In this respect, I went too far when I previously suggested that where a contractual undertaking involves an assumption of 'fiduciary' duties then the fiduciary duties should always terminate with the termination of the contract: J Edelman, 'Four Fiduciary Puzzles' in E Bant and M Harding (eds) *Exploring Private Law* (2010) pp 306-8.

<sup>44</sup> [2001] 1 AC 268, 286 (Lord Nicholls).

<sup>45</sup> In fact, the case might have been even easier because as the late Professor Simpson astutely observed, the undertaking made by George Blake was not actually contractual at all, nor was it terminated: A W B Simpson 'A decision per incuriam?' (2009) 125 Law Quarterly Review 433.

<sup>46</sup> [1897] AC 180 at 188.

<sup>47</sup> See for instance, *Jones v Bouffier* [1911] HCA 7; (1911) 12 CLR 579 at 587 (Griffith CJ); *Colonial Mutual Life Assurance Society Ltd v Producers & Citizens Cooperative Assurance Co of Australia Ltd* [1931] HCA 53; (1931) 46 CLR 41, 50 (Dixon J); *Australian Boot Trade Employees' Federation v Commonwealth* (1954) 90 CLR 24, 42 (Dixon CJ); *International Harvester Co of Australia Pty Ltd v Carrigan's Hazeldene Pastoral Co* (1958) 100 CLR 644, 652 (Dixon CJ, McTiernan, Williams, Fullagar and Taylor JJ); *Scott v Davis* (2000) 204 CLR 333, 408 [227] (Gummow J) 435 [299] (Hayne J); *Pinkstone v The Queen* (2004) 219 CLR 444, 465-466 [60] (McHugh and Gummow JJ).

<sup>48</sup> *Scott v Davis* [2000] HCA 52; 204 CLR 333, 338-339 [4] (Gleeson CJ); 345 [33] (McHugh J); 411 [235] (Gummow J); 435 [299] (Hayne J).

another (rather than the liability of another) to a principal.<sup>49</sup> And, on further occasions where an account and disgorgement of profits is sought in the context of a contractual relationship, the emphasis is generally placed upon the word 'agent' in order to justify the award of an account of profits.

For the purposes of this exposition, the core Anglo-American definition of 'agency' will be adopted, although it must be recognised that the definition is not complete, and that the term agent is used in law with a variety of meanings.<sup>50</sup> The core definition of agency is 'an authority or capacity in one person to create legal relations between a person occupying the position of principal and third parties'.<sup>51</sup>

Where an agent acts in breach of a duty of loyalty owed to his or her principal then it is now well established that the agent will usually be required to account for, and disgorge, any profits made. An illustration of this is the decision of the High Court of Australia in *Thornley v Tilley*.<sup>52</sup> In that case, a client instructed his stockbroker to purchase certain shares for him the price of which would be repaid with interest at 8% until payment. The stockbroker bought the shares but, in breach of his contract with the client, the stockbroker dealt with them on his own behalf. The client sued the stockbroker seeking an account of the profits made from the dealings. The Court held that the client was entitled to account of the profits made from the dealings. Without any consideration of whether the agent was properly to be classified as a 'fiduciary', Knox CJ said:<sup>53</sup>

[The stockbroker] had, in my opinion, no right to use or deal with the scrip so obtained by them for their own benefit; and as they admit having made profit by dealing with such scrip or the shares represented thereby in breach of their duty to the [client], and as such dealings were in fact without his knowledge or authority, they are, in my opinion, liable to account to the [client] for the profits so made.

A more recent example involving disgorgement of profits for breach of a contract of agency is *Pedersen v Larcombe*.<sup>54</sup> Mr Pedersen entered into a contract with Mr Larcombe for Mr Larcombe to sell Mr Pedersen's property. Mr Larcombe undertook to find and communicate to Mr Pedersen offers for the purchase of the property at the best possible price.<sup>55</sup> Mr Larcombe made limited enquiries of potential developers and failed to advertise or market the sale of the property. Mr Larcombe then offered to purchase the house himself which he did through a company called Varinya. Varinya later sold the house for double the price. Mr Pedersen sued Mr Larcombe and Varinya, seeking orders including an account and disgorgement of profits.

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<sup>49</sup> *International Harvester Company of Australia Pty Ltd v Carrigan's Hazeldene Pastoral Company* [1958] HCA 16; (1958) 100 CLR 644, 652 (Dixon CJ, McTiernan, Williams, Fullagar and Taylor JJ).

<sup>50</sup> *Nottingham v Aldridge* [1971] 2 QB 739, 751 (Eveleigh J).

<sup>51</sup> *International Harvester Co of Australia Pty Ltd v Carrigan's Hazeldene Pastoral Co* (1958) 100 CLR 644, 652 (Dixon CJ, McTiernan, Williams, Fullagar and Taylor JJ); *Scott v Davis* (2000) 204 CLR 333, 408 [227] (Gummow J). See also P Watts and F Reynolds *The Law of Agency* (19th edn, 2010) 1 [1-001], borrowing from the American Law Institute *Restatement (Third) of the Law of Agency* (2006); and G Dal Pont *Law of Agency* (2nd edn, 2008) 5 [1.2].

<sup>52</sup> (1925) 36 CLR 1.

<sup>53</sup> (1925) 36 CLR 1, 9.

<sup>54</sup> [2008] NSWSC 1362.

<sup>55</sup> [2008] NSWSC 1362, [46].

The trial judge, Palmer J, held that Mr Larcombe was in a relationship of agency with Mr Pedersen and that Mr Larcombe had accepted (undertaken) a fiduciary duty of loyalty.<sup>56</sup> He said that 'if Mr Larcombe, or his alter ego, Varinya, has received a benefit or gain as a breach of his duty or loyalty then Mr Larcombe or Varinya must account for that benefit or gain to Mr Pedersen'. Palmer J concluded that Larcombe breached his fiduciary duty to Pedersen.<sup>57</sup>

In cases, such as these, where an agent is required to disgorge profits made in breach of the contract of agency, the focus is upon the contractual duty of loyalty which has been breached. The presence of the label 'agent' or 'fiduciary' should not distract from the fact that the breach with which the court is concerned is the particular contractual duty of loyalty (such as a duty not to be in a position of conflict or for the defendant not to profit from his or her position). However, in some cases of agency there is another route by which a principal can obtain the profits made by the agent in breach of the agency agreement. This is through the fiction of ratification. Ratification is a fiction because it treats a transaction as having been authorised at the time it occurred, even though it is known that the transaction was not authorised. The fiction of ratification is sometimes relied upon instrumentally to aware an account and disgorgement to a principal of the profits made by an agent. This is Fuller's classic definition of a fiction.<sup>58</sup>

An early example of this reasoning is in *De Bussche v Alt*.<sup>59</sup> In that case, the plaintiff engaged Gilman & Co as his agent to sell a ship for \$90,000. Gilman engaged the defendant as a sub-agent to sell the ship with the same instructions. This occurred with the plaintiff's knowledge and consent. The Court of Appeal held that the relationship of sub-agency constituted 'in the interests and for the protection of the [plaintiff] a direct privity of contract between him and [the sub-agent]'.<sup>60</sup> In breach of the contract of agency, the defendant bought the ship for himself for \$90,000 and then resold the ship to a Japanese prince for \$160,000. The plaintiff sought an account and disgorgement of the defendant's profits. The reasoning of the Court of Appeal did not focus upon the breach of contract by the sub-agent as the reason requiring the agent to disgorge profits, but instead treated the transaction as ratified by the principal so that, by a fiction, the \$160,000 was paid from the prince to the sub-agent to be held for the plaintiff.<sup>61</sup>

Another fictitious approach is to find that there is an implied contractual promise to repay any profits improperly received by an agent. This was the approach taken in the decision of the House of Lords in *Reading v Attorney General*.<sup>62</sup> In that case, an army sergeant sat on a truck in uniform to allow alcohol to be smuggled through British checkpoints. The sergeant was paid more than £20 000 in bribes. His profits from these bribes were sought by the Crown. The trial judge, Denning J focused only on the breach. He said that the profits could be disgorged simply because his acts were

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<sup>56</sup> [2008] NSWSC 1362, [48], [50].

<sup>57</sup> Palmer J made orders including that Varinya account for and disgorge its profits from the sale as a knowing assistant in the breach.

<sup>58</sup> L Fuller *Legal Fictions* (1967), 73.

<sup>59</sup> (1878) 8 Ch D 286.

<sup>60</sup> (1878) 8 Ch D 286, 310.

<sup>61</sup> (1878) 8 Ch D 286, 312-313.

<sup>62</sup> [1951] AC 507.

'in violation of his duty of honesty and good faith, [taking] advantage of his service to make a profit for himself'.<sup>63</sup> On appeal to the Court of Appeal, the court held that the profits should be disgorged. In a statement which was endorsed in the House of Lords,<sup>64</sup> Asquith LJ (delivering the judgment of the court) said:<sup>65</sup>

[t]here is a well-established class of cases in which [a master or principal] can ... recover, whether or not he has suffered any detriment in fact. These are cases in which a servant or agent has realized a secret profit, commission or bribe in the course of his employment; and the amount recoverable is a sum equal to such profit.

The court held that the profits should be disgorged because of an 'imputed promise' by Reading that he would pay over any bribes received.<sup>66</sup> The court suggested that Reading was a fiduciary in 'a very loose... sense'<sup>67</sup> but said that this fiduciary relationship was not necessary for recovery of the profits.<sup>68</sup>

The House of Lords upheld the decision of the Court of Appeal that the profits made by Reading were recoverable by the Crown.<sup>69</sup> In a speech with which Viscount Jowitt LC agreed, Lord Porter said that 'the existence of [a fiduciary relationship] is, in my opinion, not an additional necessity in order to substantiate the claim.'<sup>70</sup> In 'complete agreement' with the views of the Court of Appeal, Lord Porter said that the reason was because disgorgement of profits was available to the Crown for Reading's implied contractual promise to repay the bribe money to his employer.<sup>71</sup>

Courts today may not always be prepared to employ the fiction of ratification of an unauthorised act or the implication of a promise to pay unauthorised profits. For instance, in *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd*,<sup>72</sup> the English Court of Appeal rejected the reasoning that a bribe taken by an agent could be considered to be the property of the principal because 'a bribe paid to a fiduciary could not possibly be said to be an asset which the fiduciary was under a duty to take for the beneficiary'.<sup>73</sup> And in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council*<sup>74</sup> the House of Lords overruled the implied contract reasoning which had been relied upon by the Court of Appeal in *Reading v the King*.<sup>75</sup>

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<sup>63</sup> *Reading v The King* [1948] 2 KB 268 at 275.

<sup>64</sup> *Reading v Attorney General* [1951] AC 507, 515 (Lord Porter).

<sup>65</sup> *Reading v The King* [1949] 2 KB 232 at 236.

<sup>66</sup> *Reading v The King* [1949] 2 KB 232 at 237.

<sup>67</sup> *Reading v The King* [1949] 2 KB 232 at 236.

<sup>68</sup> *Reading v The King* [1949] 2 KB 232 at 238.

<sup>69</sup> *Reading v Attorney General* [1951] AC 507 at 516 (Lord Porter), 517 (Lord Normand).

<sup>70</sup> *Reading v Attorney General* [1951] AC 507 at 516 (Lord Porter).

<sup>71</sup> *Reading v Attorney General* [1951] AC 507 at 517 (Lord Porter).

<sup>72</sup> [2011] EWCA Civ 347.

<sup>73</sup> *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* [2011] EWCA Civ 347 at [80]. Compare *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6 at [574]-[576] (Finn, Stone and Perram JJ) where their Honours reject the *Sinclair* conclusion but avoid any fiction in their reasoning which is powerfully focused upon the deterrent basis for the remedy for the defendant's breach.

<sup>74</sup> [1996] AC 669. See also *Haugesund Kommune v Depfa ACS Bank* [2010] EWCA Civ 579, [65]-[80] (Aikens LJ).

<sup>75</sup> *Reading v The King* [1949] 2 KB 232 at 237 relying upon *Sinclair v Brougham* [1914] AC 398 which was overturned in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669.

At least in situations where an agent has received a bribe, the award of an account and disgorgement of the agent's profits is more transparently awarded on the basis of breach of the agent's contractual duty of loyalty. On the existing authority it is not necessary, nor desirable, for a court to find that the agent impliedly promised to pay bribes to his principal, or that the principal has ratified the agent's usually criminal bribe-taking activity. But, in any event, even as an alternative route for recovery, the focus upon the breach of the agent's contractual duty of loyalty illustrates the availability of the account and disgorgement of the profits of breach of contract.

## Conclusion

Once the contractual foundation of many fiduciary relationships is acknowledged, *Blake* becomes an entirely unexceptional case. *Blake* is no more than a case where Blake's undertaking of loyalty, not to profit from his position, survived the termination of his employment. The survival of this duty was the foundation for his claim for breach of contract and there is no reason that the label 'fiduciary' could not also have been attached to Blake's undertaking not to use his official position .

There may be instances where breaches of other contractual duties can lead to an account and disgorgement of profits. But the breach of a contractual duty not to make a profit from one's position, or the breach of a contractual duty not to put oneself in a position of conflict, are archetypical instances where a breach of contract gives rise to a liability to account for and disgorge profits. Attaching labels such as 'agent' or 'fiduciary' to these breaches may assist in highlighting the nature of the duty as one of loyalty. But it does not alter the fundamental character of the duty as contractual.

If the label 'fiduciary' had been attached to Blake's duty, then the only controversy might have been whether the fiduciary duty could survive the termination of the contract to which it owed its existence. On this point, there was little controversy with the implicit finding of the House of Lords that Blake's contractual duty survived termination of the contract of employment. In this respect it was no different from situations such as duties of confidence or arbitration clauses which also survive termination, as intended by the parties.

It is true that Lord Nicholls came very close to characterising Blake's duty as fiduciary. Lord Nicholls said of the contractual duty that 'if not a fiduciary obligation, was closely akin to a fiduciary obligation'.<sup>76</sup> And the description of the effect of the contractual duty by Lord Nicholls was in classic terms by which 'no profit' duties, usually labelled as fiduciary, are usually described: 'the [Crown] had a legitimate interest in preventing the [Blake's] profit making activity and, hence, in depriving him of his profit'.<sup>77</sup>

One by-product of the failure by Lord Nicholls explicitly to characterise Blake's breach as a breach of a fiduciary duty has been that his Lordship's decision focussed attention upon the breach of contract as the underlying reason for orders that profits be disgorged in cases involving breaches of duties of loyalty. This invites, at least for English courts, interest in the boundaries of those contractual duties where a plaintiff has a legitimate interest in preventing profit making activity. The unexceptional cases will involve contractual breaches of duties of loyalty duties, commonly characterised

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<sup>76</sup> [2001] 1 AC 268 at 287.

<sup>77</sup> [2001] 1 AC 268 at 285.

as 'fiduciary', such as such as 'no conflict'<sup>78</sup> or 'no profit' duties. And once the genesis of these duties in contract cases is recognised as the contract itself, then further questions might be asked:

- (1) why should disgorgement of profits be permitted for these loyalty duties and not others?
- (2) Why should these loyalty duties, even if breached innocently, give rise to a duty to disgorge profits when a deliberate and cynical breach of another contractual duty does not?

These questions may have been in Lord Nicholls' mind, but he did not need to answer them in *Blake*. There may be good answers to them which might lie in the nature and scope of the duty undertaken. But the message of this paper is that it is not necessarily a satisfactory answer to a claim for disgorgement of profits for breach of contract simply to say that an account and disgorgement of profits is not an available remedy for breach of contract.

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<sup>78</sup> A duty not to put oneself in a position where there is a conflict, or real and substantial possibility of conflict, of duty to a principal and self-interest; or duty to a principal and duty to another.